

Life & Disability Insurance 101

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BANYAN
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A Division of First Niagara Risk Management, Inc.

Goals





Life and AD&D Insurance

Group Term Life

- Most basic and least expensive life insurance product.
- Participant does not accumulate any equity by paying the premium for the policy.
- Generally employer paid.

Group Accidental Death and Dismemberment

- Sounds depressing, but it helps!
- Provides an additional benefit if death is the result of an accident, or in the event of a severe injury.
- AD&D usually mirrors the basic life insurance benefit.



Sample AD&D Coverage Provisions

- Equal to 100% of the Basic Life amount
- Benefits terminate when the Basic Life terminates

Covered Loss	Benefit Amount
Life	100% of Full Amount
Any combination of a hand, a foot, and/or sight of an eye	100% of Full Amount
Speech AND hearing in both ears	100% of Full Amount
Paralysis of both arms and legs (Quadriplegia)	100% of Full Amount
An arm or leg	75% of Full Amount
A hand, a foot, OR, sight of an eye	50% of Full Amount
Paralysis of both legs (Paraplegia)	50% of Full Amount
Paralysis of one arm AND one leg on the same side of the body (Hemiplegia)	50% of Full Amount
Speech OR hearing in both ears	50% of Full Amount





Common Life and AD&D Plan Designs

Flat Amount

- \$50,000 coverage for all employees.

Salary Related

- 2X the employee's Base Annual Earnings (BAE).
- Usually a dollar maximum will also be set on benefit provided.
 - Example: 4x BAE to \$500,000





Quiz Time!



QUIZ TIME

Microsoft provides life insurance coverage at 2x salary to a maximum of \$500,000 and AD&D in matching coverage.



Steve is a super-smart software designer who is making \$350,000 a year.



What is his basic life insurance benefit and why?

What would his beneficiary receive if Steve dies in an accident?



QUIZ TIME



Susie also works for Microsoft. She makes \$200,000 a year, but received a \$50,000 bonus.

(Benefit is 2x to \$500,000)



What is her basic life insurance benefit and why?





Base Annual Earnings

Knowing what your definition of Base Annual Earnings includes is VERY important!

- ✓ Salary / Hourly Wages
 - ✓ Bonuses
 - ✓ Commissions
 - ✓ Shift Differential
- ✓ Check your policy for details



Be careful when switching carriers that the definition of Base Annual Earnings matches!



QUIZ TIME

*Microsoft also lets their employees buy additional coverage. Employees can buy 1X, 2X, 3X or 4X their salary to \$1M **PLUS** they can buy coverage for their spouse up to 1x salary, provided they buy at least the same amount for themselves.*



Steve has dangerous hobbies and needs more coverage.



What is the most he can buy for himself and his lovely wife Susie (wearing the blue backpack)?



Tax Implications

“In this world nothing is certain but death and taxes.”



Benjamin Franklin



Tax Implications



Ins and Outs of taxes
associated with life
insurance



Tax Implications

Imputed Income

- IRC Section 79 allows the first \$50,000 of employer paid group term life insurance as non-taxable to the employees.
- Any group term life insurance amounts over \$50,000 is considered imputed income to the employees and, therefore, subject to tax.

A key concept to remember is that the US tax code premise is the employee is not being taxed on the amount over \$50,000, but, is being taxed on the perceived benefit of that group term life insurance amount over \$50,000.





Tax Implications

The employee's imputed income is NOT calculated on the rates you pay the insurance carrier.

- The Life Insurance Imputed Income Rates are commonly referred to as either:
 - “Table I Rates”, or
 - “Table One Rates”
- The Rates are updated by the IRS, periodically.
- When determining age, you should use the employee's age on the last day of the tax year (December 31st).
- Generally, your payroll system can be programmed to calculate the imputed income based on your benefits.





Key Provisions in Life Insurance and AD&D



Key Provision #1

Conversion VS. Portability

- An Employer-sponsored group life/AD&D program is not subject to COBRA.
- Your life insurance contract may offer two clauses to allow employees to keep their coverage.
- **Conversion** allows employees to convert their term coverage to permanent life insurance (often Whole Life) at rates based on their age. \$\$\$
- **Portability** allows employees the ability to “port” their term coverage with them. Rates are generally based on their age when they port the coverage and often increase in 5 year intervals.



YOU may be responsible to send the employee conversion or portability notices. Check your policy.





Key Provision #2

Disability in a Life Insurance Plan?

General Restriction

- A new life/AD&D carrier will not assume liability for an employee who is out on a disability that took effect during the prior carrier's policy, UNLESS, the disabled employee was disclosed on the list of those Not Actively-At-Work.

Waiver of Premium

- An employee goes out on a disability after the carrier's policy has become effective. While out on disability, the employee still has life coverage, but, the employer does not have to pay life insurance premium for the coverage.
- HOWEVER, an employer must disclose to the carrier any employee who is out on disability and subject to Waiver of Premium.
- Typically, there is no Waiver of Premium/Continued Protection provisions for AD&D policies.





Key Provision #3

Age Reduction Formula

- For employer-sponsored life/AD&D plans, coverage typically terminates at retirement.
- For active employees over age 65, however, there typically is a Reduction Formula built into the amount of life/AD&D coverage available.
- The Reduction Formula is on a graded scale such as:

Age	% of Original Benefit
65	65%
70	45%
75	30%
80	20%





Key Provision #4

Guaranteed Issue

- Amount of life insurance that may be received without the employee needing to show evidence of good health.

Evidence of Insurability

- For employees with amounts in excess of the guarantee issue, late entrants and/or significant increases in the amount of coverage, the carrier may require proof of good health.



When comparing policies, make sure the Guaranteed Issue limits are as good or better than your current coverage.



Key Provisions

Accelerated Benefits Option (ABO)

- Early payment of a portion of the life benefit when a terminal illness with a pre-set estimated time to live.



The major question here is not IF the carrier contract has the provision, but comparing the current carrier's ABO description to the new carrier's description.



Rate/Premium Development

Assumptions

- ✓ 2x Annual Basic Earnings rounded to next highest \$1,000 with \$250,000 maximum
- ✓ Rate = \$.524 per \$1,000 of coverage
- ✓ Insureds are under ADEA limiting age and under G.I.

Worksheet to Calculate Life Insurance Premium Due

	Annual Salary	Multiples Applied to Earnings	Rounding Applied to Coverage Amount
Claribel	\$23,500	2 x \$23,500 = \$47,000	\$47,000
Bozo	\$36,444	2 x \$36,444 = \$72,888	\$73,000
Yackey	\$72,500	2 x \$72,500 = \$145,000	\$145,000
Booboo	\$127,632	2 x \$127,632 = \$255,264 capped at \$250,000 max	\$250,000
Carrottop	\$175,000	2 x \$175,000 = \$350,000 capped at \$250,000 max	\$250,000
Total	\$435,076		\$765,000 monthly volume

Example of a Monthly Premium Calculation

Monthly Volume x Monthly Rate / \$1,000 = Monthly Premium

\$765,000 x .524 / 1,000 = \$400.86 Monthly Premium





Questions?





Disability Outline

Topics Include:

Definition of Disability

Short-Term Disability

Long-Term Disability

Key Provisions

Tax Implications

Rate/Premium Development

Questions



Definition of Disability



What is Disability Insurance?

- Income replacement for *off-the-job* illness or accidents that prevent someone from working.
- How is **Disability Insurance** different from **Workers' Compensation**?
 - Workers' Compensation is for *on-the-job* injuries.
- Typically, a disabled employee cannot receive benefits from both Disability Insurance and Workers' Compensation.





Common Disability Coverage

What are the types of disability protection programs?

- **Short-Term Disability (STD)**
 - Usually lasting 13, 26 or 52 weeks, at the most.
- **Long-Term Disability (LTD)**
 - Generally several years or to retirement age.
- **Salary Continuation**
- **Family Medical Leave Act (FMLA) –**
 - Although not an insurance product, FMLA may be a component of an employer's disability program.





2 Key Factors in Disability

1. Definition of Disability

2. Earnings Test

*Based on your specific contract language

*Typical provisions vary from carrier to carrier



Definition of Disability

How is “Disability” defined?

- Depends upon the insurance contract, however, it usually involves employees’ ability to perform the duties of:
 - **Own Occupation (“Own Occ”), and/or**
 - **Any Occupation (“Any Occ”), and/or**
 - **Specialty Occupation**



Definition of Disability

Common Definitions of Disability:

- “**Own Occ**” – In this contract type, the employee is unable to perform the job duties of his own occupation.
- “**Any Occ**” – Employee is unable to perform the job functions for any job they are reasonably qualified for.
- Many contracts, especially LTD contracts, may have a combination of the two. Example: “Own Occ” period of 2 years, followed by “Any Occ” coverage to age 65.
- “**Specialty Occupation**” a.k.a “**Extended Own Occ**” – A more expensive contract for specialties like a brain surgeon, attorney, etc.



When comparing policies, make sure definition of disability matches or is more generous than your current program.





Definition of Disability

Another factor in determining Disability is the **Earnings Test**:

- As a result of the illness/accident, has the employee lost a significant portion of his income because he is unable to work?
- Typically, >20% loss of income is considered “significant” in most contracts.

In order for an employee to be considered “disabled” he must meet both the Occupation definition AND the “Earnings Test” detailed in the contract.





Short-Term Disability

Short-Term Disability (STD)

- Benefit Duration – Typically, lasts for 13, 26 or 52 weeks
- Benefits Payable – Generally, a percentage of income from 60% to 100% with a weekly earnings maximum. Some examples:
 - 60% of weekly earnings to a maximum of \$500
 - 66 2/3% of weekly earnings to a maximum of \$700
- No pre-existing condition limitations.
- Not all STD cases are necessarily due to accident or illness as maternity leave usually is included in STD policies.





Short-Term Disability

Statutory STD

- 5 states plus Puerto Rico have minimum STD requirements for employees residing in those states. Currently, these states are:
 - New York
 - New Jersey
 - Rhode Island
 - Hawaii
 - California
 - Plus Puerto Rico
- Employers must provide, at a minimum, the Statutory STD as defined by each state to the employees residing in those states.





Short-Term Disability

Salary Continuation

- Instead of purchasing a STD policy from an insurance carrier, many employers decide to self-fund their STD coverage through a Salary Continuation program.
- A typical Salary Continuation program will have a graded scale to provide an increasing level of benefit based on length of employment.
- Technically, Salary Continuation is a “payroll practice” and is not covered by ERISA.
- The employer does not purchase an insurance carrier’s product for Salary Continuation, however, may hire an insurance carrier on an *“Advice to Pay”* basis to review Salary Continuation claims.
- An example of a Salary Continuation graded scale follows:





Short-Term Disability

If you have worked for the employer for:	You will receive 100% of your pay for:	And you will receive 60% of your pay for:
30 days but less than 1 year	1 week	25 weeks
1 year but less than 2	3 weeks	23 weeks
2 years but less than 3	6 weeks	20 weeks
3 years but less than 4	9 weeks	17 weeks
4 years but less than 5	12 weeks	14 weeks
5 years but less than 6	15 weeks	11 weeks
6 years but less than 7	18 weeks	8 weeks
7 years but less than 8	20 weeks	6 weeks
8 years but less than 9	22 weeks	4 weeks
9 years but less than 10	24 weeks	2 weeks
10 years or more	26 weeks	0 weeks





Short-Term Disability

FMLA / STD Comparison	
FMLA	STD
Guarantees job protection	Income protection under an employer's benefit plan
Laws vary state to state or follows federal guidelines	Not regulated by law (except in statutory STD)
FMLA is not necessarily paid leave	May run concurrently with FMLA
FMLA laws carry fines and penalties for non-compliance	

FMLA concurrent with STD example:

Federal FMLA allows for one unpaid leave up to 12 weeks during a 12-month period. The employer's STD plan allows a 6-week benefit for normal maternity leave. At the end of the 6-week normal maternity leave, the employee applies for an FMLA leave. The employer would only have to grant a 6-week leave instead of a 12-week FMLA.



Rate/Premium Development

Assumptions

- ✓ 66 2/3 % benefit with \$1,150 Weekly Maximum
- ✓ Rate = \$.597 per \$10 of Weekly Covered Benefit
- ✓ Maximum Covered Weekly Payroll is $(\$1,150 / .667) = \$1,724.14$

Worksheet to Calculate STD Insurance Premium Due

Annual Salary	Weekly Covered Benefit (CB) (Annual Salary / 52 x benefit %)	Monthly Covered Payroll (CP) (Annual Salary / 52)
Claribel \$23,500	$\$23,500 / 52 = \$451.92 \times .667 = \$301.43$	$\$23,500 / 52 = \451.92
Bozo \$36,000	$\$36,000 / 52 = \$692.31 \times .667 = \$461.77$	$\$36,000 / 52 = \692.31
Yackey \$72,500	$\$72,500 / 52 = \$1,394.23 \times .667 = \$836.54$	$\$72,500 / 52 = \$1,394.23$
Booboo \$127,000	$\$127,000 / 52 = \$2,442.31 \times .667 = \$1,629.02$ capped at \$1,150.00	$\$127,000 / 52 = \$2,442.31$ capped at \$1,724.14
Carrotop \$175,000	$\$175,000 / 52 = \$3,365.38 \times .667 = \$2,244.71$ capped at \$1,150.00	$\$175,000 / 52 = \$3,365.38$ capped at \$1,724.14
Total \$434,000	\$3,899.74 CB volume	\$5,986.74 CP volume

Example of per \$10 of Weekly Covered Benefit Monthly Premium Calculation

Monthly Covered Volume of Covered Benefit x Per \$10 Weekly covered Benefit rate / 10 = Monthly Premium

$$\$3,899.74 \times \$0.597 / 10 = \$232.81$$





Long-Term Disability

Begins at the end of the STD or Salary Continuation benefit duration.

Benefit Payable - Generally, between 40% to 60% of pre-disability covered earnings up to a maximum monthly dollar figure.

Example: 60% of monthly base salary, up to a maximum of \$10,000 per month

Disability Limitations - Most contracts will place some form of limitations on behavioral health disorders and/or subjective conditions.

Example: Mental /Nervous Conditions are limited to 2 years on LTD

Benefit Offsets - LTD benefit will be REDUCED by any other type of disability benefit the most common of which is Social Security disability.





Tax Implications

As expected, an employee with an employer-sponsored group disability policy must pay taxes, at some point.

- On the dollars paying the premium.
- On the benefit received.

An employer may provide the employee the option of when to be taxed.

Dollars paying the premium:

- Even though it may be the employer paying the premium, the employee can be taxed on the amount paid by the employer.
- The benefit to the employee is that any disability benefit received would be tax-free.

On the benefit received:

- The employee is taxed on the benefit. Since the benefit is limited to, for example, 60% of monthly income, then after taxes are taken the disabled employee would receive less than 60% in replacement income.





Rate/Premium Development

Premium Billing

- Two Formats:
 - Self-Bill
 - List-Bill
- Self-Bill
 - Preferred format. Just like with life insurance, the carrier sends the employer a blank form to determine the amount of STD/LTD insurance coverage and premium due for the month.
 - No eligibility interfacing between carrier and employer.
 - At time of claim, employer documents that claimant was eligible for coverage.
- List-Bill
 - More labor intensive requiring an eligibility interface between carrier/employer for carrier to provide a bill listing all employees eligible for STD/LTD coverage and the amount of premium due.



Rate/Premium Development

Assumptions

- ✓60% benefit with \$5,000 monthly maximum
- ✓Rate = \$.480 per \$100 of Covered Payroll (CP)
- ✓Maximum monthly Covered Payroll is $(\$5,000 / .60) = \$8,333.33$

Worksheet to Calculate LTD Insurance Premium Due

Annual Salary	Monthly Covered Payroll (CP) (Annual Salary / 12)	Monthly Covered Benefit (CB) (Annual Salary / 12 x benefit %) (Monthly covered Payroll x benefit %)
Claribel \$23,500	$\$23,500 / 12 = \$1,958.33$	$\$1,958.33 \times .60 = \$1,175$
Bozo \$36,000	$\$36,000 / 12 = \$3,000.00$	$\$3,000 \times .60 = \$1,800$
Yackey \$72,500	$\$72,500 / 12 = \$6,041.67$	$\$6,041.67 \times .60 = \$3,625$
Booboo \$127,000	$\$127,000 / 12 = \$10,583.33$ capped at \$8,333.33	$\$8,333.33 \times .60 = \$5,000$
Carrottop \$175,000	$\$175,000 / 12 = \$14,583.33$ capped at \$8,333.33	$\$8,333.33 \times .60 = \$5,000$
Total \$434,000	\$27,666.66 CP volume	\$16,600 CB volume

Example of a CP Monthly Premium Calculation

Monthly Covered Payroll Volume x Monthly Covered Payroll Rate / 100 = Monthly Premium

$$\$27,666.66 \times \$.480 / 100 = \$132.80$$





Key Provisions

Elimination Period

- Number of days after the onset of the Accident/Illness before the disability insurance coverage is effective.
- STD example:
 - 1/8 – First number is accident, second number is illness.
 - **Accident** – Typically, it is the date of the accident in most contracts.
 - **Illness** – The 8th day after the diagnosis
- LTD example:
 - 90 days
 - 180 days





Key Provisions

Pre-Existing Conditions

- Usually, a rider to a carrier's standard disability contract.
- Fairly common one is “3/12” meaning no disability benefit will be available for the first 12 months after becoming eligible for disability benefits if care/treatment was received during the 3 month period prior to becoming eligible for disability benefits.

Mandatory Rehab

- No benefits if the disabled employee ceases or refuses to participate in an approved rehab program.
- Usually standard in most contracts, but, can be removed with a load to the rates.





Key Provisions

Return-To-Work (RTW) Incentive

- Changes in the RTW Incentive is a very common error an Employer can make when changing disability carriers.
- Every carrier touts their RTW Incentive in their disability marketing materials and the RTW Incentives can vary greatly.
- Example of an RTW Incentive:
 - **Work Incentive**
 - Allow up to 100% of pre-disability earnings replacement. No offset of RTW earnings during the first 24 months of benefits provided disability benefit plus RTW earnings does not exceed 100% of pre-disability earnings.
 - **Rehabilitation Incentive**
 - Monthly benefit increased by 10% while participating in an approved rehabilitation program.





Key Provisions

Cost-of-Living Adjustment (COLA)

- Another rider that can be added to a contract at an increased rate.
- Fairly common COLA provision provides an annual 3% COLA following the 12th month of disability benefit payment, for a period of no more than 5 years.

Lump Sum Survivor Benefit

- Typically, provides a 3-times net benefit paid in a lump sum.
- If there is a terminal illness, the benefit can be accelerated just like with life insurance.





Questions?



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