

# Article – Group vs. Individual Plans



## Disability Income Insurance

### What Type of Coverage is Best for Employees?

### Individual vs. Group LTD /Association Plans – Differences at a Glance

Is your employer *really* doing you (or themselves for that matter), a favor by providing you with employer paid group Long Term Disability (LTD) insurance coverage? You betcha, maybe! Most employees wouldn't have coverage at all if it weren't for the fact that it was a company paid benefit, because most employees either can't afford it, haven't recognized it as a real need, or they don't believe they will ever become disabled (consider: foreclosures are three to four times higher due to disability than due to death!). But, are the employees *really* being done a favor? Read on, perhaps not, and if more employers really knew of the many deficiencies of these group plans, which can even affect themselves, they might think twice and look at some other options.

Note: This article makes more mention of group plans vs. association plans, simply due to the fact that most group plans are more consistent with each other in terms of deficiencies, than with those plans offered by associations which could have more variations.

#### **UNDERWRITING (information which can affect the issuance of coverage)**

Typically, underwriting a Disability Insurance application, either for Group LTD or Association coverage is less involved (and sometimes coverage can even be issued on guaranteed basis) when compared to underwriting individual plans. Individual plans require much more underwriting (health, financials, duties etc.), due to all of all the guarantees and liberal wording in the contract, all of which allow a claim to be paid under more circumstances and conditions.

On the other hand, some of the reasons why group/association plans are more “forgiving” and have less underwriting, is because if the claims experience of the carrier becomes too high (thus reducing their profitability), one of two actions can result: a) the group or the association plan can get canceled by the carrier or, b) the carrier raises the rates (which are not guaranteed like individual plans). Neither of these two scenarios are a pretty picture. On the other side of the coin, coverage might be issued on a guaranteed basis by group/association LTD plans and this then can be a very desirable element, especially if an association member or an employee of a company that is applying for group coverage, is either uninsurable, or has a pre-existing condition that would normally be excluded from coverage as it would from under an individual plan.

However, a word to the wise in connection with pre-existing conditions, when applying for any type of coverage; since a claim begins with the application, the applicant must fully disclose all pertinent information on the application. Omissions, misstatements, or fraudulent statements can cause a claim to be denied or a policy to be rescinded.

## **POLICY WORDING (Governs the conditions under which a claim will be paid)**

### ***Definition of total disability –***

Generally speaking, all definitions, terms, and conditions in an individual policy, are more liberal and can provide a true own-occupation definition of total disability (e.g. even if you are working, so long as it is in another occupation, benefits will still be paid for the full benefit period) vs. the restrictive and split definitions found in most group and association plans. For example; depending on the various occupation classifications of the group, the following definitions for total disability might be offered; own-occupation for 2 years or 5 years (initial period), thereafter the definition changes to; not working in any occupation, or unable to work in any reasonable occupation (given; education training or experience. What that means is; that after the initial period of time has expired, in order to continue collecting benefits for the remainder of the benefit period (which might be to age 65), the claimant must be unable to e.g. “flip hamburgers”, or not be working at all! These split definitions give the carrier some form of control of the claim and helps to keep premium low.

*Mental and Nervous* – These subjective conditions, are only covered for two years with all Group plans. For now, some individual plans are treating this condition like any other sickness and will pay benefits for the full benefit period; however, there are more carriers who also limit this type of disability, to; two -five years, and some even offer a shorter benefit period as an *option*, in order to lower the premium.

## **PORTABILITY (Can the employee take the coverage elsewhere)**

This is a serious deficiency of both Group LTD and Association plans. There is no portability at all! If a member leaves the group, or is longer in good standing with the Association, coverage terminates. Individual plans have no such limitations.

## **GUARANTEES (Refers to rates and renewability)**

*Renewability* – There are a couple of different contract types – obviously, guaranteed renewable, or conditionally found in individual plans are the best, and without exception are noticeably *lacking* in all group or association plans which means; coverage can be canceled by the carrier (otherwise, they would be aggressively underwritten and thus would be higher in cost)

*Premium* – Only (non-cancellable) individual plans offer guaranteed rates and once again, if Group\Association rates were guaranteed, the cost would be much higher than their initially published rates. I say initially published rates, because these rates can be increased by the carrier any time and group rates certainly will be increased as the average age of the group rises, while rates for association are usually age banded.

## **PARTICIPATION (how much of a salary will be covered)**

*Salary* – Usually Group LTD limits coverage is to a maximum of 60% -70%) of wages, sometimes including commissions, excluding bonus, along with a typical maximum (cap) benefit amount of \$5,000 (could be higher). Word of caution here – be aware that a \$5K cap can cause a “reverse discrimination” situation for most highly compensated employees, e.g. incomes beyond \$100K. The reason I refer to this situation as “reverse discrimination” is because when executives earn \$200K, for example, they will still only get \$5,000 (not \$10K and as a result, they are then only being covered for 30% of wages! Not too good, since it’s hard enough living on 100% of income (see offsets below)!

*Bonus* – This form of income, as previously mentioned, is not (usually) covered by LTD, and as a result, the insured (even those making less than \$100K) will not receive their full 60% of coverage.

## **OFFSETS (Reductions to the benefit amount)**

Standard offsets, or reductions to the benefit amount payable from group plans are:

- 1) Workman's compensation,
- 2) Social security disability,
- 3) benefits received under a retirement plan which has been triggered prior to the retirement date,
- 4) other disability income policies. However, there are some carriers who can delete the aforementioned offset and those who do, charge a higher premium for this option.

Note: Employer paid group coverage plans will be taxable. However, there are ways to circumvent this taxable event, i.e. to have the premium paid by the employer and *still* have the benefits tax free! I will be pleased to let you in on this little secret just for the asking!

**CONCLUSION** – what can be done to fix some of the aforementioned Group coverage deficiencies? The easiest and doable fix is to correct the “reverse discrimination” problem and the way to do that, is to either have certain classes of employees to “opt out” and then have the employer provide a tax free individual plan for the full amount that the employee is eligible for or, provide a tax free individual plan to *supplement* the taxable group coverage, or raise the cap, if that is economically feasible.

That takes care of the “reverse discrimination” and the “taxable” issues. What about the remainder of the deficiencies, e.g. portability, rate guarantees, etc.? Unfortunately, there's no cure for these inherent deficiencies and make up the reasons for the initial low cost. However, in view of the low cost advantage of Group plans, a small group that has a minimum of turn-over, may be ultimately better off by going with an individual plan, even in view of the fact that these never increasing premiums are initially much higher!

## **SUMMARY OF GROUP LTD DEFICIENCIES AND SHORTCOMINGS**

1. Taxation of benefits...Benefits are TAXABLE when premium is employer paid, creating a situation whereby only a maximum of 40% of income is kept AFTER taxes (see # 2-3-8 below for other possible reductions). Remember, one might only get 60% coverage and that is reduced by approximately 33%!
2. Benefit amount...usually 50-60% of income will be covered and that is NOT guaranteed, since it can fluctuate based on income at time of claim, and usually capping at \$5-15K/month depending on the policy's specifications.
3. Offsets...benefit amount can be REDUCED by other income sources e.g., social security, workman's compensation etc., thus further reducing the 50-60% coverage (see 1-2 above).
4. Portability...employee doesn't get a policy, only a certificate which usually is NOT portable.
5. Plan administration...time consuming.
6. Option choices...may be limited (no cola/residual, FIO etc.).
7. Definition of total disability (own occupation) ... may NOT allow benefits to be paid to 65, rather only for 2 years, then another definition takes over, which is more restrictive.

8. Bonus...normally NOT covered, again creating a coverage amount shortfall (see 1-2-3 above)
9. Contractual wording.... protects the carrier more than the insured (definitions, rate increases etc.).
10. Rates...NOT guaranteed, can be increased unilaterally.
11. Renewability...NOT guaranteed, coverage can be cancelled anytime by carrier, also coverage normally terminates at 65, just when it is needed the most.
12. **Claims...due to ERISA.... acts of bad faith NOT discouraged, claimant can NOT sue for punitive damages, therefore, claim can drag on for years.**
13. Claims...can only be submitted while working and while coverage is in force.
14. Pre-X conditions...may create an unanticipated problem at claim time.
15. Contract wording...can be changed by the carrier ANYTIME, to be less favorable to the insured (see 9 above)
16. Mental nervous claims will be paid ONLY for two years (see 9 above)
17. Recovery Benefit - none
18. COLA conversion...none
19. Presumptive disability...none
20. Caps...may create a “reverse discrimination” issue (see 1,2,3,8 above), for highly compensated employees who make more than \$100K/yr. with a \$5K cap!
21. Others