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HOW TO AVOID THESE PITFALLS IN OFFERING EMPLOYEES DISABILITY INSURANCE

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Employers that provide long-term disability insurance for their employees are helping set a good foundation for protecting income and assets in the event of an accident or illness. Unfortunately, employers and consultants often check the box that the coverage is provided without taking a critical look at determining if key employees are well served by the protection offered.

When audits are performed, results often show surprising gaps between employee needs and the available group benefits. Employers can unknowingly have plans that provide insufficient coverage for most employees and result in reverse discrimination for highly compensated employees.

Several contractual provisions can prevent long-term disability benefits from providing the desired replacement of income, including the following:

Taxability of benefits: Many employers like to offer free benefits, but disability insurance is a benefit that can be more advantageous if the employee pays the premium with after-tax dollars, because it results in a tax-free benefit. If premiums are paid by the employer, benefits received by the employee are generally taxable income.

For example, a benefit cap of $5,000 per month could amount to a $60,000 annual long-term disability benefit before taxes. This falls short of the income requirements of many highly compensated employees, resulting in inadequate protection from the group plan.

For example, John Doe earns $100,000 per year plus a potential annual bonus of $15,000. Assuming a 28 percent tax bracket, his net income per year is $82,800. If he experiences a disability, he will receive a maximum benefit of $5,000 per month ($60,000 per year). However, his after-tax benefits from the group plan would be $43,200 per year – just 52 percent of his usual after-tax compensation. This means Doe will experience a significant shortfall of $39,600 in his annual after-tax income.

Consultants can work with employers to design a plan that results in a higher replacement of income. Areas to be reviewed can include increasing plan maximums,

modifying contribution methods, and supplementing group coverage with individual disability insurance.

Definition of covered earnings: Basic long-term disability policies generally cover base salary only. For many high earners, a large portion of their total compensation comes in the form of bonuses, commissions, or other incentive pay. These employees would face a substantial income gap if they became disabled and couldn't work.

Plan designs can be modified to cover total compensation and supplemented with individual disability insurance. The goal should always be to get employees closer to their regular take-home pay. Disability can negatively impact other important benefits, such as retirement plans.

Provisions that should be considered include **retirement contributions.** Retirement plans are one of the most valued benefits an employer can provide. Few people realize that if an employee becomes too sick or injured to work, neither the employer nor employee can make contributions to their retirement plan because the employee is not actively at work. When contributions stop, retirement security ends.

Plans can be designed to replace contributions made to a defined contribution plan during a disability. While eligible for benefits, a monthly benefit insuring up to 100 percent of retirement contributions, including any employer matching contributions, can be paid into a trust established by the employee, thus helping mitigate the risk of lost retirement earnings.

Brokers, consultants, and employers tend to spend most of their time and energy on strategies to reduce an employer's medical costs because the expense is such a big part of a company's budget. Working with an experienced benefits consultant to identify creative solutions, an employer can provide a benefit that makes a real difference to employees if disability strikes.

By considering strategies similar to the items outlined above, employees can focus on how to get back to work instead of how to provide for their family. Peace of mind is a win-win for everyone.

As always, should you have any questions, please contact your Parker, Smith & Feek Benefits Team.