Disability Coverage Done Right:

Foundation of Financial Planning

By Jim Mooradian

When most of us embark on our financial planning mission, our list of priorities can be long and varied, including retirement, college tuition, money for a second home and usually life insurance in the event of death. What most people overlook, however, is the very thing that makes all of this planning possible: their income. The cornerstone of any sound financial plan is the protection of your income. What if your ability to earn an income was compromised due to a disability? What happens to your financial plan then?

Many companies' disability plans have gaping holes that result in a weakened financial condition for an employee who gets sick or hurt and cannot work. Two thirds of American households are living paycheck-to-paycheck, and the average American family cannot make it more than four weeks without income, according to "Is the American Dream Still Possible?" (*Parade Magazine*, April 23, 2006). Given this stark reality, analyzing your company's group disability plan is extremely important if you want to give your employees the opportunity to build a solid financial plan. The following three criteria are extremely important because they do have a substantial impact on your employees' financial situation if they needed the benefit.

- Is the benefit taxable?
- What kind of earnings are covered in the underlying definition?
- Are bonuses covered or not?

Evaluating these three criteria is the first step in customizing your group long-term disability (LTD) plan, rather than settling for an off-the-shelf LTD plan.

Most employees have not done the actual math to determine what their disability benefit would be if they were on claim and how that relates to their personal obligations. As the benefits planner, you must fully understand this gap to help employees assess their "exposure" and then decide what can be done about it. Many companies are starting to take this topic more seriously and looking to find ways to help educate their employee population on this gap or "exposure." Most HR directors do not realize the impact of the type of compensation the formula covers, so many times the education needs to start there.

Once a company gets its underlying group disability plan in line with its own compensation structure, it can turn to supplemental programs that can dramatically help an employee's situation. Supplemental disability programs typically aim to allow employee populations the ability to purchase additional disability insurance above and beyond the group plan. This is the second step in further customizing your company's disability program. Adding such supplemental programs gives employees the ability to have a higher replacement ratio percentage of their *total*

Jim Mooradian, founder of Jim Mooradian and Associates, Inc., has been a New England Financial service representative for the last 25 years.

He formed his firm in 1998, continuing and expanding his work in the supplemental disability arena. Jim Mooradian and Associates, Inc. is a Boston, MA-based full service insurance brokerage firm that specializes in supplemental insurance programs, including voluntary benefits and supplemental disability programs. Contact Jim at 617 423 0062 or via www.jmooradian.com.

compensation, not just the standard 60% replacement ratio of salary, which is typical in the group disability arena. Many times the supplemental disability program will allow a replacement ratio of 75% of someone's total compensation including bonus. If a program is well-designed and the employee population is well-educated, a program such as this can give an employee the ability to close the gap mentioned above.

Here's a quick example. Suppose you have an employee with an annual base salary of $60,000 and a bonus of $40,000. If your company provides an LTD plan that covers 60% of base salary to a maximum of $3,000 per month, this employee would receive $3,000 monthly. With the bonus, this employee's actual monthly earnings are $8,333 ($100,000 / 12). Since this employee's bonus is not covered under the LTD plan, this employee's actual disability benefit is only 36% of total pre-disability income — not 60 percent. If the program was designed to allow a replacement ratio of 75% of this employee's total compensation (which is $100,000), then this employee could purchase a supplemental policy in the amount of an additional $3,250 per month of benefit on top of their group benefit, which maxed out at $3,000 per month. ($100,000 x .75 = $75,000 / 12 = $6,250 - $3,000 [group coverage] = $3,250 of supplemental disability benefit) If this same employee had household expenses above $3,000 per month, he might be interested in purchasing some additional disability insurance to help offset the shortfall between his monthly obligations and his group disability benefit. Many times a supplemental program can be very beneficial just by virtue of offering some additional protection to offset the tax impact of the group LTD benefit alone. In the example above, if the $3,000/month is a taxable benefit, then the employee would receive less than $3,000 based on his tax bracket.

Another area where "exposure" can be created by the group LTD plan's design is with the monthly maximum or cap. The maximum benefit can cause the income ratio to be an amount lower than 60 percent. Here's another example of how the monthly maximum in a group plan could cause "exposure" for an employee. Your company might have an LTD plan designed to offer 60% of monthly base salary to a maximum of $3,000 per month. An employee earning a salary of $100,000 would receive the maximum benefit, which is $3,000 per month. The employee's monthly base salary is $8,333 ($100,000 / 12). Sixty percent of this would be $5,000 per month, but because the company's LTD plan has a monthly maximum of $3,000 the employee would receive an amount closer to one-third of his pre-disability income in reality.

Please note, these supplemental programs can be offered on a voluntary or employer-paid basis. These supplemental programs can bring other advantages to employee populations, such as simplified underwriting and premium discounts that employees would find difficult to duplicate in the marketplace on their own.

Understanding how your group disability plan works for your employee population is crucial as it relates to your own ability to communicate the significance of this benefit for their own personal financial planning. Carefully consider customizing your group LTD plan with the elements described above, and also consider whether a supplemental disability program would be a suitable enhancement. At the very least, educating your employee population about the financial impact of getting sick or hurt is extremely valuable.