Employee Benefit Adviser

Benefit equalization for the Highly Compensated

By: Laura Muka & Sean McNiff

On October 25th, 2011, the Wall Street Journal published an article titled The Wild Ride of the 1%. In 2007, before the Great Recession, there were nearly 400,000 individuals in the U.S. earning $1,000,000 or more. After the recession, the number dropped to roughly 286,000 (2009) and further to 235,400 by 2011. By 2014 (the most recent data available), those pulling in $1,000,000 paychecks rebounded to 409,300. With so many at the top entering or returning to a $1,000,000 income, it's no surprise we have seen a significant increase in employers seeking to help these individuals protect their considerable earning power.

Either by way of a highly competitive benefits package, or simply a voluntary benefit program, employers often provide disability insurance to their employees to protect their earnings in the event of an injury or illness. The problem is, domestic disability carriers have limitations on the amount of insurance they are willing to provide, and more often than not, even highly experienced benefit advisors don't recognize a higher level of protection exists, but it does, and it's important that advisors assist Corporations in protecting their best drivers. Unfortunately, the way benefits are structured now, they do a better job of protecting the rank and file.

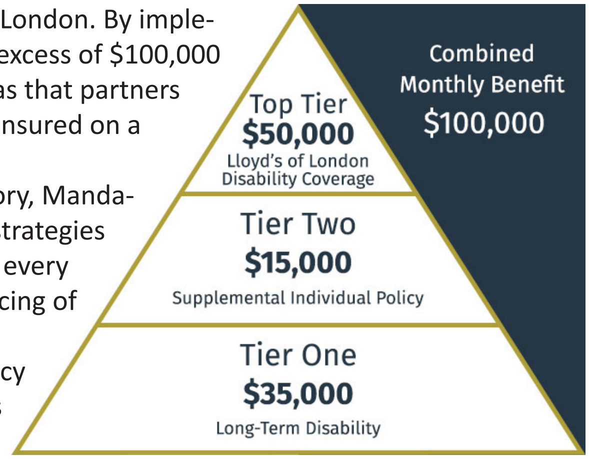
In today's world, group long-term disability insurance has become an expected benefit offering for professionals. It has been around for decades, it has become highly commoditized and there are many carriers that offer it. The problem for those earning seven figures isn't a lack of group insurance, the problem is underinsurance. Unfortunately for the highly compensated, disability insurance is like realizing your fuel gauge is broken when you run out of gas on the way to your biggest client meeting of the year. You thought you were prepared, but that's when you realize what you really need isn't there.

In a nutshell, group long-term disability income insurance typically offers the insured party 60% of their base pay to a maximum of $15,000 per month. For instance, if the highly paid CEO at a public company is earning somewhere in the $1,000,000-plus range, and suddenly becomes disabled, most often group long-term disability insurers cap monthly disability income benefits at $15,000 per month. With these programs most often paid by the employer, that CEO suddenly recognizes a drop in his monthly income by more than 80% once the post-tax benefit is received.

But a second domestic solution exists. Traditional group long-term disability insurance can also be supplemented by a second layer of protection in the form of domestic individual disability insurance offered on a Multi-Life Guarantee Standard Issue (GSI) basis. This second layer can provide significant discounts, medical underwriting concessions, and can increase disability income protection to a combined $30,000 per month. It softens the compensation blow for salaries up to around $600,000, but it's still light years away from where that CEO needs to be, considering he is pulling down $1,000,000, before bonuses kick in.

For a company's highest-earning individuals there is an excess disability income product offered by the likes of Lloyd's of London, and other specialty carriers. This product is designed to deliver up to an additional $100,000 per month of disability income insurance and is used to cover the canyon-wide chasm between a high-powered executive's two primary layers of disability insurance and his income, protecting his family's lifestyle and his future earning potential so it wouldn't be affected in the event a disability occurs.

These new plans came about when a high-powered New York law firm adopted a third layer of income protection on a guaranteed issue basis to equalize benefits for their highly compensated partners; those earning in excess of $600,000 suffered from inadequate coverage. Suddenly large law firms across the country, perhaps realizing they were losing some of their highest earners to other firms, sweetened the benefits pot by taking on a three-tiered approach; utilizing a base of Group LTD, then guaranteed issue individual disability insurance through a major domestic carrier, and topping it with supplemental excess disability protection with Lloyd's of London. By implementing this third layer of protection, large law firms could purchase in excess of $100,000 per month through the combination of all three programs. The result was that partners earning $1,000,000 were now fully protected with 60% of their income insured on a tax-favorable basis.



High limit disability plans today fit into four categories; Mandatory, Mandatory with a Voluntary Buy-Up, Opt-Out, and Voluntary. Each of the four strategies has pros and cons, but every client is different and no one plan works in every situation. The primary drivers for the amount of GSI offered, and the pricing of the coverage, is based on such variables as plan design, number of lives, average age, loss experience for the group, smoking status and core policy provisions. One of the major pluses is that the buyers of these programs can use their leveraged buying power to negotiate discounted rates, more attractive policy provisions and even eliminate the need for medical underwriting. Over the last four years consulting and investment firms followed suit, and now we are seeing top corporate clients implementing these "Tier 3" plans for their most highly compensated talent.

Today, high-income coverage is becoming more and more common. What's important to recognize when approaching large organizations with high income earners is that the successful installment of these programs is highly process driven. If you want to look sophisticated, and participation in the plan in important to you, you'll need to find a partner specialized in the space who understands how to build and enroll a plan utilizing best practices.

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