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The Evolution of High-Limit Disability Plans

By: Edward A. Tafaro

"Group long-term disability income insurance isn't something new and exciting. It doesn't have the sexy buzz of that hot new app or the latest iPhone revelation. It's been around for decades and it's pretty boring. But it's like realizing you don't have a shovel the morning you wake up to three feet of snow. That's when you realize how important something is; when you really, really need it and it's not there."

Edward A. Tafaro, Chief Executive Officer

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The Evolution of High-Limit Disability Plans

Your high-net-worth clients can live the lifestyles of the rich and famous and possess all the supplementary prizes that goes with it; million-dollar homes, yachts, expensive toys in the garage, bank accounts bursting at the seams. But what happens when that pixie dust blows away because he returned from his last ski trip in Vail with a severe back injury preventing him doing his job, while at the same time seriously impacting his income?

Is this when he wants to find out that while he was so diligent in insuring and protecting all his expensive bling that he didn't take the necessary steps to protect his most valuable asset?

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In a nutshell, group long-term disability income insurance typically offers the injured party 60% of their base pay to a maximum of $20,000 per month. For instance, if a highly paid CEO at a bio-tech company is earning somewhere in the $1,000,000-plus range suddenly becomes disabled, most group long-term disability income insurers will cap the monthly disability income at $20,000 per month.

To the average Joe on the street this sounds like something you'd hope to attain only by scratching a Lottery ticket you bought at the local 7-Eleven. But to the high-net-worth businessman, who maybe owns a dozen 7-Elevens and is used to bringing in more than $60,000 per month — and who has built a lifestyle for his family that revolves around that figure — to suddenly drop his monthly income by 75% is a tough pill to swallow.

Traditional group long-term disability insurance can also be supplemented by a second tier in the form of a supplemental plan using individual disability income insurance (IDI), which can increase disability replacement income to a combined $35,000 per month or so, which makes things more palpable for salaries in the $700,000 and above range. But it's still light years away from where that CEO needs to be, considering he was pulling down $1.5 million, before considering bonuses.

The primary problem here is underinsurance, something akin to insuring a million-dollar home for a couple of thousand dollars. The secondary problem is most traditional insurance brokers don't realize a viable option exists to protect these high-performing individuals above and beyond what traditional disability income carriers will underwrite.

Here's an example. Let's take a high-powered attorney who earns $1,200,000 annually. The attorney's existing disability portfolio consisted of five traditional disability income policies with a combined value of $15,250 per month in disability income protection and group long-term disability of $15,000 per month. Unfortunately, this represents only 30% of the individual's income. Again, all the numbers seem impressive; put it into the context of the average person who takes home $6,250 monthly on his $75,000 salary, who suddenly realizes that $6,250 has now shrunk to $1,875 per month. Everything is relative.

For that high-earning individual there is an excess disability income product underwritten by the likes of Lloyd's of London, and other specialty carriers designed to deliver an additional $35,000 per month of disability income insurance, meeting a target 60% tax efficient replacement ratio for this high-powered attorney. This type of specialized disability insurance covers that canyon-wide chasm between the attorney's primary disability insurance program and his income, protecting his family's lifestyle so it wouldn't be affected in the event a disability occurs.

Evolution, even in the insurance business, is inevitable and several years ago a seismic shift occurred that changed the way many of the plans got adopted.

The genesis of 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 protect their highly compensated partners from suffering the reverse discrimination fate.

Suddenly large law firms, 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 income insurance protection through one of the major IDI carriers and topping it with supplemental excess or high-limit disability protection with Lloyd's. By implementing this third layer of protection, large law firms could typically purchase as much as $100,000 per month of disability income benefits through the combination of all three programs. The result was that the partner earning $2,000,000 annually is now fully protected with 60% of his income insured on a tax-favorable basis, whereas before this third layer of coverage was installed he only had $35,000 per month protected through his Group LTD and IDI plan.

While $35,000 per month may sound like plenty of insurance, in reality it only protects 21% of his income, leaving a massive hole in his financial plan, prompting different plan types to form to accommodate the diverse needs of these highly compensated groups.

High limit disability plans today fit into three categories; Mandatory, Mandatory with a voluntary buy-up, and Voluntary. Each of the three strategies has pros and cons, but every client is different and no one plan works in every situation.

Their primary uses are based on such variables as plan design, number of lives, average age, and loss experience for the group, smoking status and core policy provisions.

Each plan is unique and shaped to meet client needs and objectives. 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.

These "Tier 3" plans started separately in the law firm space, where a more paternalistic benefits environment exists. Over the last four years consulting and investment firms followed suit, and now we are seeing top corporate clients implementing these plans for their most highly compensated executive talent.

The bottom line is that there now exists an exciting new opportunity for advisors, particularly that have within their portfolio highly compensated individuals, to present to their clients unique insurance solutions to assisting them in retaining the storybook lifestyles they worked so hard to attain.

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Exceptional Risk Advisors is one of the country's foremost experts on high-limit specialty life, accident and disability products. They are located in Mahwah, NJ and can be reached at info@exceptionalriskadvisors.com