

**The Financial Shortfalls of Group Long Term Disability Programs  
By Allan Checkoway, RHU**

Company sponsored Long Term Disability (LTD) Programs typically insure from 50% to 70% of income. Industry experts note that 60% plans were the “norm” for more than 90% of the corporations in the US in 1992. The average benefit nationally last year was approximately \$5,600/month. Let’s review the impact of a 60% monthly LTD benefit in common situations . . .

**60% Group LTD Plans, Are They Adequate?**

When premiums are company paid, benefits received when disabled are subject to federal and state income taxes. Prior to a long term disability, an executive gets to keep about 65¢ after taxes of each \$1 of salary (e.g. assuming a 35% tax bracket, combining federal and state income taxes). Let’s review how a \$100,000 per year salaried executive fares when disabled, insured to 60% income, compared with a more desirable target benefit of 70% . . .

	\$100,000	annual salary when healthy, insured to 60%=
	\$ 60,000	annually when disabled
Target Benefit of		
70% (of salary)	\$ 70,000	annually when disabled
17% Shortfall	\$ 20,000	annually when disabled

**By not insuring to 70%, there’s a disability shortfall of at least 17%, not counting the long term diminishing financial impact of inflation and taxation.**

**There Is At Least A  
17% Shortfall In  
Most Corporate  
LTD Programs**

**Insuring Compensation, Not Salary**

In addition to the financial shortfall of 60% LTD plans, senior level executives have a more serious financial exposure that is almost never protected against the risk of long term disability. Most company sponsored LTD programs insure salary, not compensation. “Compensation” can include pension, deferred compensation, profit sharing, 401K contributions, etc. . . . additional sources of tax sheltered revenue over and above basic salary.

Consider a \$100,000 per year salaried executive with 15% of income deposited in a pension plan in his behalf (\$15,000 annually). What happens to pension contributions when disabled? As pension contributions are based on a percentage of earned income; when regular earnings stop, pension contributions stop as well. Let’s look at the financial implications of not insuring the compensation package . . .

	\$115,000	compensation package (includes \$15,000 pension contribution) insured to 60%=
	\$ 60,000	annually when disabled
Target Benefit of		
70% (of compensation)	\$ 80,500	annually when disabled
34% Shortfall	\$ 20,500	annually when disabled

By not insuring to 70% of compensation, the disability shortfall in this illustration is 34%, not including the diminishing effects of inflation and taxation, if premiums are company paid. Unlike basic salary where \$1.00 is worth only 65¢ after tax, pension dollars can be worth \$5 or \$10 or \$20 and more; dependent upon the tax sheltered accumulation period. Therefore, since pension contributions are tax sheltered, the most valuable dollars in the corporate compensation package are usually not insured against the risk of total disability.

**The Most Valuable  
Compensation Dollars Are  
Usually Not Insured Against  
The Risk Of Long Term  
Disability**

**EMPLOYER PAID PREMIUMS = TAXABLE BENEFITS**

Many corporations have long since recognized the significant expense of employee benefit programs impacting their corporate bottom line. Costs have been passed along to employees by splitting/sharing premiums, the introduction of "flex benefit" (cafeteria) plans, etc. For the business that is paying group LTD premiums for its employees, let's evaluate the financial impact on those that are unfortunate enough to face a long term disability.

**A 60% Group LTD Plan,  
With Employer Paid Premiums,  
Provides only a 39%  
After Tax Benefit**

The \$100,000 per year salaried executive, insured to 60%, only gets to keep 39% (assuming 35% combined federal and state income tax bracket) after taxes when disabled! If insured to only \$5,000/month, how many six figure executives can get by on only \$3,250/month net benefit?

**RECOMMENDATIONS**

LTD programs offer an efficient solution for corporations to provide disability protection for an entire company. But, insuring an entire company with "boiler plate" coverage will not take into consideration the personal needs of individual employees. This is particularly true for senior level executives with much to lose as they are usually in an "older age" group, when they are particularly vulnerable to the risk of disability and least likely to recover from an extended disability. Insurance advisors should consider the following:

- Insure total compensation, not just salary; to deal with the loss of valuable hard earned perks when disabled.
- Make sure you understand the potential impact of taxation when disabled. Each executive can elect to have their Disability premiums bonused to them and considered taxable W2 compensation, so that their LTD benefits will be tax free when disabled.
- Consider a Supplemental Individual Disability Program, bringing benefit levels up to 70% or 80%; either company paid or offered voluntarily to each executive, with premiums paid by convenient payroll deductions.

The corporation should first explore the financial impact of a long term disability to their higher paid senior level executives. They can then elect to either initiate a supplemental company sponsored disability program to fund the shortfalls, or they can simply agree to do a payroll deduction for their executive group. Then each executive can elect voluntarily to solve the shortfall problem on their own.

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