

Sample

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OBJECTIVE 1 – Plan and Product Provisions

GROUP CH. 12: GROUP DISABILITY INCOME BENEFITS

Key Points

- STD benefits and provisions
- LTD benefits and provisions
- Offsets
- Disability market trends

Introduction

- Disability insurance (DI) designed to replace lost income resulting from a serious accident or sickness
- Determining whether someone is disabled can be challenging
- Setting the proportion of lost income to < 100% of the earnings prior to disability encourages disabled EEs to return to work and discourages filing unsubstantiated claims
- Good example of insurable risk low likelihood but extended period of disability could be financially and psychologically devastating

Long Term Disability (LTD)

- Definition of disability
 - Disability depends not on medical symptoms, but on the insured's inability to perform occupational duties
 - Own occupation definition
 - Unable to perform some or all duties of employee's own occupation
 - Usually applicable for first 24 months of disability
 - More generous
 - Makes it easier to qualify for DI benefits
 - Any occupation definition
 - Once an EE has been disabled for some period of time (usually 24 months), it is common to use the stricter "any gainful occupation" definition
 - Unable to perform duties for any occupation
 - Partial, residual, or loss of earnings definition allow someone working part-time to qualify for DI benefits, reduced by their work earnings while disabled
 - Some LTD contracts require that the insured receive Social Security DI benefits after 2-3 years of disability in order to continue receiving LTD benefits
- Elimination period (EP)
 - Period of time that covered EEs must be disabled before they are eligible to collect DI benefits
 - o They avoid overlaps in coverage with sick leave or STD programs
 - Usually EP is 3-6 months (i.e. the length of the STD coverage, in order to avoid overlap)
- Benefit period (BP)
 - \circ Number of years most common. (E.g. 2 or 5 years) or "to age 65"
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- "To age 65" BP is evolving into "social security normal retirement age" (SSNRA)
- Age discrimination in employment act (ADEA)
 - ADEA states that cost of benefits must not decline with advancing age of the EEs
 - Most companies provide benefits paid until age 65 for disability prior to age 60, and then grading down between ages 60 and 70
 - The shorter BP at older ages is offset by higher claim rates, so the total expected cost for a particular age is not lower than that for a younger age
- Benefit amounts
 - Typically a defined percentage of pre-disability earnings (such as 60%), not to exceed a maximum benefit amount
 - When EEs pay the premiums, results in a higher percentage of after-tax income being replaced
 - Employer-paid premiums result in taxable benefits
 - EE-paid premiums result in tax-free DI benefits
- Benefit offsets
 - LTD benefit offset by income from other sources to ensure the sum of benefits plus income from other sources does not exceed pre-disability earnings
 - Maintain incentive for employee to go back to work
 - Integration with Social Security treated in a variety of ways
 - 1. Only the primary Soc. Security benefit may be deducted
 - 2. Any family Soc. Security benefits may be deducted
 - 3. All sources integration the primary and family Soc. Security benefits deducted only if DI benefit and the Soc. Security exceed some income percentage (e.g. 70%)
 - o Advantages of disabled individual receiving Soc. Security benefits
 - Reduces cost of the insurance program for the ER
 - EE receives higher replacement of income since Soc. Security benefits aren't fully taxed
 - Allows continued Soc. Security credits for the disabled individual
 - Qualifies the disabled person for Medicare benefits
 - Methods to reduce LTD benefits by a disabled EEs earnings from working while disabled
 - 1. Proportionate loss formula percentage of lost work earnings is applied to the benefit otherwise payable
 - 2. 50% offset method benefit reduces by \$1 for every \$2 of work earnings
 - 3. Work incentive benefit ignores earnings during an initial period unless work earnings plus benefits would exceed 100% of pre-disability earnings. At that point, benefit is reduced dollar for dollar by the excess amount. After work incentive period, either proportion or 50% offset is used
 - EXAMPLE: pre-disability earnings of \$10K per month, LTD provides benefit of \$6K per month, individual works part-time earning \$2,500 per month
 - Proportionate loss: (10K 2.5K) / 10K = 75%. 75% * 6K = \$4,500 monthly benefit
 - 50% offset: LTD benefit is \$6K 50% * 2,500 = \$4,750
 - Work incentive: Since \$2,500 + \$6,000 < \$10K, the net LTD benefit is the full \$6K
- Limitations and exclusions
 - Used to manage the risk of antiselection and avoid costly administration of subjective claims
 - Special conditions limitation clause example is limiting benefits for mental and nervous and/or drug and alcohol conditions to 2 years

- Preexisting condition exclusions for disabilities occurring during the first 12 months of policy, which manifested 3-12 months prior to issuance of the policy
- Other act of war, intentionally self-inflicted injury, and commission of a felony
- o Certain states laws that restrict of prohibit certain benefit limitations/exclusions on LTD policies
 - E.g. Vermont prohibits limitations related to mental illness or substance abuse
 - New York pre-existing condition exclusion limited to a max period of 12 months
- Optional benefits
 - COLA (cost of living adjustment) inflation protection for benefits received during disability
 - Survivor benefit lump sum benefit payable to the insured's survivors
 - Child Care reimbursement (for day care expenses)
 - Retirement benefit benefit payment in lieu of contributions to retirement plans that would otherwise be lost due to lost earnings
 - Portability ability for insured to leave the group and continue group coverage by paying premiums directly to insurer
 - Conversion option ability to convert to either group or individual DI coverage
 - Spousal benefits
 - Catastrophic benefits additional amount for a more serious type of disability
- Self-insured LTD plans
 - Many large employers choose to self-insure all or part of LTD
 - May choose to insure claims after an extremely long period (during which benefits are selfinsured)
 - May purchase stop-loss coverage for claims that exceed a specified cost
 - Tax legislation made self-insurance less attractive
- Voluntary LTD plans
 - Trends that contributed to a rise in voluntary coverage, in which some of the premium is paid by EEs:
 - Rising medical costs
 - Expansion into new markets
 - Greater recognition of the need for DI coverage
 - If EE-paid, after-tax money used for premiums, then benefit is non-taxable

Short-Term Disability (STD)

- Primary differences between STD and LTD
 - o STD benefits are paid weekly vs. LTD paid monthly
 - Benefit period for STD is shorter (usually 13 or 26 weeks)
 - Much of claim cost for STD comes from normal maternity claims and accidents, while much of LTD comes from illness
- Definition of disability
 - Unable to perform own occupation
 - May be focused only on accidents or sicknesses occurring outside of the workplace (i.e. nonoccupational coverage)
 - Avoids overlap with workers' compensation coverage
 - Partial disability benefits can be found on STD to better coordinate the STD and LTD programs

- Elimination periods (EP)
 - Very short 7 or 14 days is common
 - o Common to have shorter EP for accidents than for sickness
 - STD has higher frequency of claim than LTD and much shorter claim durations
 - Experience becomes credible more quickly, and greater proportion of STD self-insured than with LTD programs
 - Common to design sum of STD Elimination Period and maximum benefit period = LTD Elimination Period [*i.e.* LTD starts when STD ends, and there is no overlap]
- Benefits
 - STD maximum benefit amounts typically smaller than LTD
 - EEs have other sources of funds to meet their needs for the short term
 - ER sick leave program supplements the STD plan
 - STD usually not integrated with Social Security benefits of part-time earnings
 - Occasionally integrated with ER sick leave
 - Few exclusions for STD
 - Pre-existing condition exclusions less common than for LTD
- Optional benefits
 - 1. 24-hour coverage payable for on-job as well as off-job injury and sickness
 - 2. First day hospital coverage EP is waived, and benefits begin immediately in the insured is confined in hospital due to the disabling condition
 - o 3. Survivor benefit similar to LTD (lump sum paid to survivors upon insured's death)
 - o Less common include portability and work incentive benefits
- Mandated state disability insurance (SDI)
 - California, New Jersey, New York, Rhode Island, Hawaii and Puerto Rico have STD programs for workers in their state
 - Insurers either offer longer EP for LTD or reduce STD benefit so that the sum of STD + SDI match the benefit desired by the ER
 - For all states except Rhode Island, the ER can elect to cover the mandated benefits under a private program
 - Paid Family and Medical Leave (PFML) legislation
 - Mandates PFML benefits for all eligible employees in the state
 - States have adopted programs Washington, Massachusetts, Oregon, Connecticut, and DC
 - Benefits similar to STD benefits; paid to employees who take time off work to treat serious health conditions or maternity leaves of absence, time to bond with newborn children or to care for relatives with serious issues
 - Plan Features
 - Benefit Amounts Tiered benefits that replace higher percentage of income for employees with low wages
 - E.g. in MA PFML benefit = (1) 80% of EE wages up to 50% of State Avg Weekly Wage (SAWW) plus (2) 50% of any wages over 50% of SAWW; up to max benefit of 64% of SAWW

- E.g. in WA PFML benefit = (1) 90% of EE wages up to 50% of State Avg Weekly Wage (SAWW) plus (2) 50% of any wages over 50% of SAWW; up to max benefit of 90% of SAWW
- Max Benefit Period Differs by state and leave type
 - E.g. in MA EEs can take up to 12 weeks of paid family leave, up to 20 weeks of paid medical leave and up to 26 weeks combined
 - E.g. in WA EEs can take up to 12 weeks of paid family leave, up to 12 weeks of paid medical leave and up to 24 weeks combined
- Waiting Period most have a 7 day unpaid waiting period before benefits begin (in WA no waiting period for bonding claims)
- Family and Medical Leave Act (FMLA)
 - Permits eligible EEs to take extended leaves of unpaid absence for personal or family medical reasons, with continued group coverage from employer
 - May be absent up to 12 weeks over a 12 month period
 - If caring for family member injured in military, time period is up to 26 weeks
 - Difficult and expensive for employers to administer
 - Due to complexity, STD insurers may offer full leave administration services to customers (provides STD insurance along with administrative support)

Trends

- 1980s disability carriers had solid growth and high profits
 - New entrants to market
 - Less strict definitions of disability
 - Small rate increases
- Early 1990s increased stress on professional occupations
 - This was the primary market for disability insurers at the time
 - Claims costs increased and profits decreased
 - Insurers responded with rate increases, product changes, underwriting guideline changes, and more sophisticated claim adjudication systems
- 1996/1997 rates rebounded from low point in 1995
 - After-tax profits have generally remained from 6-9% since then
 - 2017 Tax Cuts and Jobs Act increased profits by reducing corporate tax rate from 35% to 21%
- 2019 statistics
 - Group disability market totals around \$18.3 billion in premium
 - \$12.5 billion in LTD and \$5.8 billion in STD
 - STD premiums up 7-8% per year in past three years, LTD premiums up 4-5% per year
- Packaging STD and LTD
 - Insurers believed packaging STD and LTD together would lower LTD claims costs
 - Companies could manage big claims at an earlier date, so discounts were offered
 - Has not materialized as expected to justify the discounts being offered
 - Maybe due to STD benefits that allow employee to remain out of work during LTD elimination period, thus leading to more LTD claims

- Some insurers now increase premium rates when STD and LTD are packaged (to cover higher incidence of LTD claims)
- o Emergence of PFML Programs in Different States
 - Most significant recent challenge to disability insurers
 - Some employers may not see the need to provide STD insurance in addition to state mandated PFML insurance
 - Many insurers speculate the impact of the PFML plans will be large and are exploring the risks and opportunities in the changing marketplace