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Challenges with Regard to Disability in a World of Individual Responsibility

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Important Note

- The ERISA Advisory Council had a project on “Managing Disability Risks in an Environment of Individual Responsibility” in 2012. (The ERISA Advisory Council is connected to the U.S. Department of Labor. ERISA is major legislation governing employee benefits in the U.S.)
- Anna Rappaport served on the Council in 2012 and participated in the disability topic drafting group.
- The views represented here are their personal views, and not those of the ERISA Advisory Council or any organization. The presentation considers the research conducted in connection with the Council project.



Agenda

- Understanding the issues: learning experiences
- Public knowledge of disability
- Disability benefit issues
- Forms of long-term disability coverage
- Regulation of coverage
- Disability and retirement
- International perspective
- Anna's policy recommendations
- Appendix
 - ERISA Advisory Council findings
 - U.S. Legal Issues
 - More data



“Understanding the issues: it is more complicated than I thought”

- Over my career as an actuary, assumed that disability risk management should be integrated into total picture, BUT....
- About 5 years ago, became concerned that common coverage of disability embedded in DB retirement plans lost when plans switched to DC
- Discovered – low awareness of issues even among pension experts
- 2011 – gave presentation at EBRI Policy Forum and wrote for Benefits Magazine about disability and DC
- 2011 – learned that employers who wanted to continue savings in DC for disabled employees had regulatory problem (Proposed regulation counter to private letter rulings)
- 2012 – ERISA Advisory Council put topic on their agenda
 - Learned that there were more problems
 - Confusion about multiple definitions and offsets
 - Lack of awareness and appreciation
 - Problems with return to work vs. LTD benefits
- 2012 – Worked on Society of Actuaries/NAPFA Presentation



The Importance of Disability

Status of Americans Age 50-61 Not in Labor Force

	Retired	Disabled	Other Reasons
Men (14% of Population)			
% of Not in Labor Force	32%	64%	4%
% Poor	15%	24%	NA
Women (24%)			
% of Not in Labor Force	26%	40%	34%
% Poor	14%	34%	10%

Source: CBO, Disability and Retirement: The Early Exit of the Baby Boomers from the Labor Force, November 2004



The Importance of Disability

Economic Status of Americans Age 50-61

	Retired	Disabled	In Labor Force
Men			
Median Annual Family Income	\$30,000	\$20,000	\$62,000
Median Net Worth	\$231,000	\$19,000	\$148,000
Women			
Median Annual Family Income	\$34,000	\$19,000	\$54,000
Median Net Worth	\$218,000	\$14,000	\$132,000

Source: CBO, Disability and Retirement: The Early Exit of the Baby Boomers from the Labor Force, November 2004 (CBO analysis based on 2001 SIPP)



% Disabled Increases with Age

Social Security Disability Incidence Rates per 1000 by Age 1998

Age	25-29	35-39	45-49	55-59	60-64
Rate	1.3	2.8	5.3	14.0	15.5

Source: Social Security Office of the Actuary, Actuarial Study Number 114 Table 4

- Three in 10 workers entering the workforce today will be disabled before they retire
- One in seven workers can expect to be disabled for five years or more before retirement
- 90% of Americans underestimate their chances of being disabled
- 85% express little concern that they will suffer a disability lasting three months or more

Source: Worker Disability: A Growing Risk to Retirement Security, Council for Disability Awareness, June 2008



Public Knowledge About Disability

- Disability is underestimated, not top of mind for most people
- Underestimate the severity of disability – surveyed employees expected 25% of those who are disabled for three months to be unable to work for 2 years – BUT IN FACT – it is 50%
- Employees think injuries accidents are most common cause of disability that keeps people out of work for at least three months – BUT IN FACT – 90% of claims are paid for illnesses

ERISA Advisory Council was told that employees do not appreciate Disability coverage

Source: Employee Knowledge and Attitudes about Employer Provided Disability Insurance, Research conducted by Opinion Research Corporation, 2012, and sponsored by Consumer Federation of America and UNUM

For more Facts: Council for Disability Awareness Web Site



What LTD Claimants Say

- 85% of LTD claimants cut back on saving for retirement
- 67% used retirement savings, but 17% did not have to use these savings because they had LTD
- 23% missed mortgage payments, but 49% said that they did not miss mortgage payments because they had LTD benefits
- 31% applied for food assistance, but 33% did not have to apply for assistance because they had LTD
- 58% delayed medical or dental care, but 20% did not have delay care because they had LTD

Source: Employer Sponsored Disability Insurance: The Beneficiary's Perspective, research conduct by Mathew Greenwald & Associates, 2013, and sponsored by Consumer Federation of America and UNUM



Disability issues: Gaps in Disability Coverage Today

- Disability in 40s and 50s means
 - Loss of income
 - Loss of new retirement savings
 - Possibility of added expenses—medical and care-giving
 - Stress on family members
- Only 31% of civilian labor force have employer-sponsored LTD
- DC plans and disability – the usual situation
 - No continued accrual of benefits
 - Pay out lump sum on disability
 - Funds may be spent too early
 - Regulations are a barrier to fixing this challenge



More Disability Issues

- Auto-enrollment – used frequently for 401(k), but not much for disability (Confusion about regulations)
- Offsets – LTD benefits normally offset for Social Security benefits, but other offsets also used
 - Don't know how often
 - Some seem counter to the purpose of the plan
- Definitions of disability – create confusion
- Helping people work vs. paying benefits – benefits vs. ADA
 - Not well coordinated
- Fragmented regulations
- Homemakers and unpaid caregivers have NO disability coverage



Sources of longer-term disability coverage

	Social Security	Employer LTD	DB Pension	Individual Plan
Employer role	Pay tax	Sponsor plan	Sponsor plan	Mostly none
Prevalence	All in Soc. Sec.; not for homemakers	Common in large cos., 31% of civilian labor force	Minority of employees today and dropping	Small minority; highest amount higher-paid professionals, self-employed
Definition of disability*	Very strict – total and permanent, but variable administration	Depends: your occupation, any occupation, blend and variations	Depends on plan; may mirror LTD	Depends: your occupation, any occupation, blend and variations
*Americans with Disabilities Act has entirely different definition.				



Integrating Disability with Other Benefits

Benefit	Disability coverage
Life Insurance	Waiver of Premium
Health Benefits	Some employers provide for continued medical coverage, Medicare after 2 years if on SSDI
DB Pensions Traditional	Many plans continue crediting service (like waiver of premium); some plans pay disability pension
DB Cash Balance Plans	Could continue crediting service or pay out benefit
DC Plans	Logical approach would be to continue making contribution (like a waiver of premium), but regulatory barriers Can offer special LTD benefit as an investment option Can offer stand-alone disability make-up benefit



Regulation of longer-term disability coverage

	Social Security	Employer LTD	DB Pension	Individual Plan
Who's in charge	Congress	Employer, subject to law	Employer, subject to law	Ins. Co's offer plans
Regulation of benefits	Soc. Sec. Adm.	Benefits – Federal (ERISA) Insurance – State ins. laws	Federal law (ERISA) DOL, IRS, PBGC	State insurance laws
Taxation	Depends on household income level	Depends on whether pre-tax of post-tax plan	Benefits are taxable	Benefits generally not taxable

In addition Americans with Disabilities Act – regulates employment



Disability and Retirement: DB vs. DC

- Defined Benefit
 - Continued benefits during disability
 - Disability retirement pension benefits
 - Supplemental payment during disability
- Defined contribution
 - Recent survey indicated that 75% of current LTD claimants stopped saving for retirement during disability (situation worse for those without coverage)
 - Can we accomplish in a DC plan (or in a DC world) what we often accomplished in a DB plan (or in a DB world)?



Ideas for DC solutions

- Logical solution
 - Add “Waiver of premium” type provision to DC plan
 - Make sure there is LTD in place so retirement won’t be tapped in case of disability
- But in the U.S. legal issues create barriers
- Conceptual alternatives
 - Include a benefit in the plan
 - Include an added benefit in the LTD plan
 - Save in a separate vehicle (in the US, an IRA perhaps)
 - Added benefit in a personal disability policy



Increasing LTD coverage

- Improve awareness to increase demand
- Gain acceptance for auto-enrollment



International Issues

- Social Security systems cover disability
- Need your help: Don't know about provisions linked to pension plans
 - What is DC practice?
 - What is DB practice?



Advice to policymakers

- Adopt measures to increase LTD participation
 - Encourage auto-enrollment in LTD
- Provide centralized information resources
- Improve public education about importance of disability
- Remove barriers to continued savings in 401(k) and other DC during disability
- Revisit coordination of disability and retirement benefits in light of increasing retirement ages, phased retirement
- Unify terminology used for definition of disability so that differences are clear and understandable
- Strengthen returned to work support/deal with conflicting rules and administration
- Analyze standards re offsets, and maybe revise



Tips to Individuals and Advisors

- Think holistically
- Examples of riders are available with individual policies
 - Inflation protection
 - More liberal definition of disability
 - Protect retirement savings
- Watch out for
 - Different definitions of disability
 - Offset provisions



Conclusions: What We Need

- Greater awareness
- National conversation about gaps in coverage
- Employer focus on disability
- Policymaker action
- Changes
 - Remove barriers to continued DC saving
 - Clarify auto-enrollment
 - More employer support of this benefit
 - Clarity around areas of misunderstanding/maybe standard definitions



References

- David Kaleda and Anna Rappaport co-authored an article on this subject published in May, 2013 for the SOA Pension Section News. <http://www.soa.org/News-and-Publications/Newsletters/Pension-Section-News/2013/may/Don-t-Let-Disability-Derail-Retirement-Security.aspx>
- 2012 ERISA Advisory Council report: Managing Disability Risks in an Environment of Individual Responsibility
<http://www.dol.gov/ebsa/publications/2012ACreport2.html>
- Anna Rappaport authored an article in the Summer 2013 Journal of Retirement: Disability: *A Threat to Long-Term Financial Security Is Growing More Serious in a World of Increasing Individual Responsibility*
<http://www.ijournals.com/doi/full/10.3905/jor.2013.1.1.055>
- For Statistics: Council for Disability Awareness



Appendix: 2012 ERISA Advisory Council

Topic:

Managing Disability Risks in an Environment of Individual Responsibility

Note that Anna Rappaport served on the Council in 2012 and participated in this project. The views presented today are her own and not those of the Council or the Department of Labor.



Managing Disability Risks

Questions studied: ERISA Advisory Council

- What long-term disability benefits are offered to employees?
- What retirement income gaps are created during periods of disability?
- How can DOL assist participants in managing disability risks?
- How can DOL assist employers in establishing effective disability benefit designs?



Managing Disability Risks

Findings of ERISA Advisory Council

Testimony confirmed:

- Major gaps in employer and employee knowledge about disability coverage
- Many individuals do not fully understand the risk of becoming disabled or appreciate the value of disability coverage
- Disability coverage is often lost in the shift from DB plans to DC plans
- Disability can derail retirement income planning for DC participants – contributions cease and retirement savings are spent prematurely



Managing Disability Risks

Findings of ERISA Advisory Council

Testimony confirmed:

- Tax regulations are a barrier to plan designs promoting continued savings in DC plans during periods of disability
- Complexity, misunderstandings, and lack of disclosure of offsets have led to unexpected outcomes for participants
- Differing definitions of disability can create barriers to retraining or returning to work



Managing Disability Risks

Recommendations of ERISA Advisory Council

The Advisory Council recommends that DOL:

1. Develop educational materials for employers, employees, participants, and beneficiaries addressing:
 - The likelihood of becoming disabled
 - The impact of disability on retirement benefits
 - Types of disability coverage
 - Options for securing replacement income during periods of disability



Managing Disability Risks

Recommendations (Continued)

2. Review and modify current claims regulations regarding disability benefits, drawing upon recent health care regulations where appropriate, including:
 - The content for denial of disability claims
 - The rule regarding full and fair review, addressing what is an adequate opportunity to develop the record and address retroactive rescission of an approved benefit
 - Resolution of conflicts between the administrative claims and appeals process and the participants' ability to timely bring suit
 - Applicability of the ERISA claim procedures to offsets and eligibility determinations



Managing Disability Risks

Recommendations Continued

3. Issue guidance for plan sponsors and plan administrators on the following:
 - Permissibility of auto-enrollment for employee contributory long-term disability plans
 - Characterization of long-term disability benefits as welfare benefits without regard to retirement age
 - Payment of insurance premiums for continuing retirement contributions during periods of long-term disability in DC plans, including whether a default feature is appropriate



Appendix: Pension Legal Issues in the U.S.



DB vs. DC: Treatment of Disability

- Defined Benefit
 - Continued benefits during disability
 - Disability retirement pension benefits
 - Supplemental payment during disability
- Defined contribution
 - Can we accomplish in a DC plan (or in a DC world) what we often accomplished in a DB plan (or in a DB world)?



Disability Benefits: Legal Issues

- “Qualified disability benefit” – ERISA I.R.C. § 411(a)(9) & ERISA § 3(22)
 - A benefit at NRA that equals the benefit the plan participant would have earned had he or she not become disabled
 - Same definition for DB & DC
- But, nature of DC plans – employer and participant contributions (often based upon compensation); Participant bears investment risk; Lump sums



“Side-by-Side” Arrangement Legal Issues

- Pair a traditional LTD policy with an IRA
- Use LTD payments to fund IRA contributions during disability period
- Administrative issues
- Poses complicated tax and prohibited transaction issues
- Tax inefficient



“In-Plan” Options Legal Issues

- Contributions during disability period
 - 415(c)(3)(C) – “compensation”
 - “Permanently and totally disabled”
 - Not available to HCEs
- LTD 401(k) Insurance
 - Participant purchases insurance through 401(k) plan
 - Provides for the allocation of contributions during disability period
 - PLRs vs. Proposed Regulation



Legal Issues: Other Options?

- Stand-alone Post-Retirement LTD Plans
 - Designed to pay benefits until some date after retirement
 - Question whether welfare plan or pension plan – significant differences in treatment for ERISA purposes
- Auto enrollment in traditional LTD plans
 - Permissible?



Appendix – more data



Primary Causes of Disability

Impairment	% of Claims
Back	18.2
Emotional/psychiatric	12.7
Neurological	11.3
Extremities	9.0
Cardiovascular	4.1
Diabetes	3.6
TOTAL	58.9

Source: HIAA Source Book of Insurance Data, 1999-2000



Odds One Person Will Become Disabled

Age	Total Number of Employees		
	2 Employees	5 Employees	10 Employees
27	66.3%	93.4%	99.6%
37	62.4%	91.3%	99.2%
47	54.4%	85.9%	98.0%
57	35.4%	66.4%	88.7%

Based on 1985 Commissioner's Individual Disability Table B - Equally Weighted 90 Day Elimination Period



Speaker: Anna Rappaport

Anna Rappaport, FSA, MAAA is an internationally known researcher speaker and author. She chairs the Society of Actuaries Committee on Post Retirement Needs and Risks and is a Past President of the SOA. She founded Anna Rappaport Consulting in 2005 after retiring from Mercer. She will complete 50 years as a Fellow in 2013.

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