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Disability – the Underappreciated Risk

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4,291,000. That's the number of working-age Americans who experienced a disabling injury or illness in 2016.[1]

That's a lot of disabilities, so let's put this in numbers that may be easier to comprehend:

- One out of every four of today's 20-year-olds will become disabled between now and their retirement
- One in eight workers will be disabled for five or more years during their working careers
- The average group disability claim lasts approximately three years[2]

Knowing this, I wonder why more than six out of every ten workers believe they have only about a two percent chance of being disabled for three or more months.

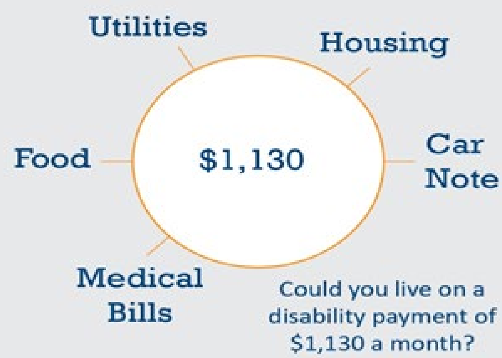
Protecting workers against disability

How long could you survive financially if your income stream dried up today? Two weeks? Three months? Several years? In the case of injury or illness, disability insurance can mean the difference between financial security or poverty, especially if the disability lasts for months or years.

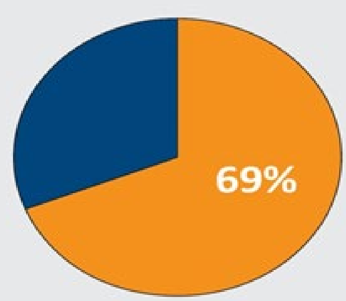
The "Employee Benefits Survey 2016," conducted by the International Foundation of Employee Benefit Plans (IFEBP), found that 78 percent of employers provide employees with short-term disability protection, which typically lasts for six months. Once short-term disability has run its course; however, an extended injury can quickly become a serious financial issue for employees who don't have adequate personal savings or long-term disability.

To protect employees from the financial ruin that can result from long-term disability, 63 percent of employers that participated in the IFEBP survey reported offering long-term disability benefits to their employees. Among employers that offer long-term disability to employees, rather than making it an automatic benefit, the trend is to offer coverage as a voluntary benefit that is typically paid for in whole or in part by employees. The downside of this arrangement is that many employees don't

The average group long-term disability claim lasts **34.6** months.



The average monthly benefit paid by SSDI in December 2012 was **$1,130**.



69% of workers in the private sector have no private long-term disability insurance.

recognize the cost benefit of long-term disability plans and fail to take advantage of this undervalued benefit.

For the disabled, the future can be grim

With generally higher unemployment rates and increased health care needs and costs, disability takes a financial and emotional toll on the disabled as well as their family members. Many family members become primary care givers, further reducing household income. In the private sector, only about one in three employees are covered by an employer-sponsored long-term disability plan, and while Social Security may provide a small benefit, being approved is a difficult and lengthy process. The result is a high percentage of working-age disabled are poor. This not only affects their current standard of living, it also affects their future.

> *...long-term disability may present a financial risk that goes beyond the months or years of working age disability and extend into retirement.*

Depending on the type of retirement plan available to a disabled person, long-term disability may present a financial risk that goes beyond the months or years of working age disability and extend into retirement. If a disabled person is fortunate enough to participate in a defined benefit (DB) plan, the plan may make supplemental income payments during disability, and the individual may continue to accrue benefits or credit for service.

This typically isn't the case when an individual is covered by a defined contribution (DC) plan. Too often, when these individuals become disabled they:

- Stop making contributions to a DC plan during the disability period
- Take distributions from the plan to cover everyday living expenses

That could change

Up until now, few DC plans have adopted a mechanism to continue contributions, but a 2014 final regulation issued by the IRS may change that. The IRS regulation addresses the tax treatment when a plan sponsor offers disability insurance from within the plan to insure future contributions under certain conditions. The insurance would be treated like a plan investment, with premium payments treated like any other investment option. In the event of a disability, benefit payments would be made to the trust to replace contributions that would have been made if the employee had not become disabled.3 The IRS regulation provides an example illustrating how "Amounts to be paid to the trustee from the insurance contract with respect to a participant are equal to the sum of the elective, matching, and non-elective employer profit-sharing contributions that would have been made on the participant's behalf during the participant's disability. . . ."

The premium payments by the plan are not treated as taxable distributions and the benefits paid to the participant's account in the plan are treated as investment earnings rather than contributions as long as the participant elects to be covered by the disability insurance contract and:

- Premium payments under the contract are paid directly by the plan out of the participant's account
- Benefit payments (i.e., replaced contributions) are paid because the employee is disabled and unable to work
- Benefit payments to the participant's account cannot exceed the reasonable expectation of the annual contributions that would have been made if the participant was not disabled, reduced by any other contributions made on the participant's behalf

Prior to the final regulations, plan sponsors could continue contributions in one of two ways: they could self-insure contributions or purchase coverage outside of the plan; however, neither approach offers the level of financial protection available under the final regulations.

In perspective

Disability is one of the most serious financial risks that working-age people face, but it is often ignored. Employers can help their employees by educating them about the risk disability poses to their long-term financial security and by offering and encouraging participation in group long-term disability insurance. Wellness programs that detect health risks before they become chronic conditions can reduce the risk of disability. And, thanks to regulations issued in 2014, it now may be easier for employers that sponsors DC plans to protect their workers from the short- and long-term financial ruin that often accompanies a disability.

[1] America's Disability Counter, Council for Disability Awareness, http://www.disabilitycanhappen.org/. Accessed December 13, 2016.

[2] Chances of Disability, Disability statistics, Council for Disability Awareness, July 3, 2013, http://www.disabilitycanhappen.org/chances_disability/disability_stats.asp. Accessed December 13, 2016.

[3] Internal Revenue Service final regulations (T.D. 9665), Tax Treatment of Qualified Retirement Plan Payment of Accident or Health Insurance Premiums, Federal Register, May 12, 2014, https://www.federalregister.gov/documents/2014/05/12/2014-10849/tax-treatment-of-qualified-retirement-plan-payment-of-accident-or-health-insurance-premiums. Accessed December 14, 2016.

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