By Ted Tafaro

The Next Generation of High-Limit DI Plans

Advisors' business clients can now offer richer DI plans to their most valuable employees.

Law office partners, CEOs, orthopedic surgeons and the pricey nip-and-tuck specialists from Beverly Hills to Park Avenue are all highly trained and highly compensated professionals. It's not unusual for these individuals to earn million-dollar paychecks while living the lifestyles of the rich and the famous.

However, the magic of their fairy tale vanishes when an injury or illness impacts their ability to do their job while taking a serious bite out of their income. This is when we often discover that these high-net-worth individuals have not protected their lifestyles.

The genesis of these new plans came about when a law firm adopted a third layer of protection to protect its highly compensated partners.

Group long-term disability income (DI) insurance has been around for decades, typically offering the injured party 60 percent of his base pay to a maximum of $20,000 per month. For instance, if a distinguished physician earning in the $700,000 to $1 million-plus range per year becomes disabled, most group long-term DI income insurers will cap the monthly disability income at $20,000 per month, even for doctor groups with good experience and an employer willing to pay the cost for a substantial benefit plan.

Traditional, group, long-term DI can be supplemented by a second tier in the form of a supplemental plan using individual DI insurance, which increases the disability replacement income to a combined $35,000 per month or so, which is deemed adequate for salaries in the $700,000 per year range. But it's a proverbial drop in the ocean when you have someone earning $1.2 million before bonuses.

The primary problem here is underinsurance. Think of it as owning a house that has a replacement cost of $2 million but is only insured for $500,000. Compounding this problem is a flaw in our insurance distribution system whereas most traditional insurance brokers don't realize a viable option exists to protect these high-performing individuals above and beyond what traditional DI carriers will underwrite.

A case in point

We recently worked with a New York law firm partner who earned $1.3 million annually. The attorney's existing DI portfolio consisted of five traditional DI policies with a combined value of $15,250 per month in DI protection and group long-term disability of $15,000 per month. Although considered a solid DI program, it was less than 30 percent of the individual's income.

This would be like having a $10 million home and insuring it for $2.8 million. Utilizing an excess DI product underwritten by Lloyd's of London, we designed a plan delivering an additional $35,000 per month of DI insurance, fully protecting the partner's income and meeting a target 60 percent tax-efficient replacement ratio. This type of specialized DI insurance covered the gap between the partner's primary DI program and his income, protecting his family's lifestyle in the event of a disability.

For years we helped advisors procure adequate DI protection for their clients through a similar process. A few years ago an interesting shift occurred that changed the way many of the plans got adopted. The genesis of these new plans came about when a best-of-breed law firm adopted a third layer of income protection on a group guaranteed- issue basis to protect its highly compensated partners from suffering the reverse discrimination fate.

Plan designs for highly compensated employees

Plan designs for some of the most highly compensated law firms now took on a three-tiered approach: with a base of Group LTD, then guaranteed-issue, individual DI insurance through one of the major IDI carriers, and topping with supplemental excess or high-limit disability protection with Lloyd's.

By installing this third layer of protection, large law firms could typically purchase as much as $100,000 per month of DI income benefits through the combination of all three programs. The result is that the partner earning $2,000,000 annually is now fully protected with 60 percent 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 IOI plan.

While $35,000 per month may sound like plenty of insurance, in reality it protects only 21 percent of his income, leaving a massive hole in his financial plan. As partners jumped from firm to firm, suddenly the top 25 law firms in the country started playing catch-up, as everyone saw the need to "keep up with the Joneses." The result was a seismic shift in how highly compensated lawyers procured the protection they needed. Consequently, deviations in plan types emerged to accommodate the diverse needs and philosophies of these highly compensated groups.

While excess or high-limit disability plans in this marketplace were largely mandatory programs at first, today, they fall into three categories: (1) mandatory; (2) mandatory with a voluntary buy-up; and (3) voluntary. Each of these strategies has pros and cons, but every client is different and no one plan works in every situation. Premium drivers include plan design, number of lives, average age, loss experience for the group, smoking status and core policy provisions.

Each plan is unique and nuanced to meet the client needs and objectives. What is great about these plans is that the buyers can use their leveraged buying power to negotiate discounted rates and more attractive policy provisions and, perhaps most importantly, eliminate cumbersome medical underwriting.

One thing to recognize is that this shift to a richer disability benefit plan has most prevalently taken place in the partnership space where two key factors converge: (1) you have large groups of highly compensated professionals; and (2) you have a partnership structure that tends to be far more paternalistic than the typical corporate publicly held company marketplace.

Any way you look at it, it is an exciting new opportunity for advisors who work with employers interested in a unique insurance solution for their most valuable employees.

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