PHYSICIANS WITH LONG-TERM DISABILITY

COMMON ISSUES THAT CAN JEOPARDIZE YOUR FINANCIAL SECURITY

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As an attorney dedicated to representing disabled professionals with Individual Disability Insurance (IDI) and Long-Term Disability (LTD) insurance matters, I am often in the unenviable position of informing clients of the deficiencies in their coverage. Such was the case during a recent consultation with a physician, who was forced to cease practicing due to a rheumatological disorder affecting her physical and cognitive function.

Prior to becoming disabled, she was employed by a prominent teaching hospital and had both clinical and academic responsibilities. Her compensation structure reflected this and was itemized as Clinical Compensation, Academic Compensation, and Bonus Compensation.

Like many physicians, the client purchased an IDI policy with "True Own Occupation" coverage and a "Future Increase Option" rider from a financial advisor during residence. She paid for the same with post-tax dollars. When she left her prior employer and began working at the teaching hospital, she was provided with an employee benefits package that included an employer-sponsored LTD plan.

Without consulting a qualified financial consultant, she allowed her IDI coverage to lapse. She explained that she did so because her employer paid 100 percent of the LTD premium, so she did not see a need in having two disability insurance products, and she preferred to save the $3,600 ($300 a month) IDI premium payment.

This decision significantly compromised her financial security when she became disabled and ceased working.

Why Is Disability Insurance Important?

Statistics show that 25 percent of physicians will cease practicing prematurely due to a disabling medical condition.[1] The financial consequences of becoming disabled can be devastating if physicians lack proper financial planning. Specifically, studies indicate that 38 percent of disabled physicians will struggle to pay their normal living expenses within three months of losing their regular income.[2] These studies also indicate that approximately 65 percent of disabled physicians will be unable to pay their normal living expenses within one year of becoming disabled[3].

[1] U.S. Social Security Administration, *The Facts about Social Security's Disability Program*. SSA Publication No. 05-10570, January 2015

[2] Id.

[3] Council for Disability Awareness, Disability Divide Consumer Disability Awareness Study, 2010

To avoid significant financial hardship, it is recommended that physicians obtain disability insurance that provides a net benefit equal to 60 to 70 percent of their gross earnings. This general rule accounts for the applicability of tax consequences. However, as will be outlined below, there are a number of factors that can affect a physician's perceived disability coverage.

Three issues that affect perceived LTD benefits:

1. How the monthly LTD benefit is calculated

Unlike IDI products, which contain a set numerical monthly benefit, LTD plans traditionally utilize a formula to determine a physician's monthly benefit. The LTD benefit is typically based on a percentage of the physician's "*Covered Monthly Earnings*." Generally, the LTD plan will state the physician's monthly benefit is the lesser of 60 percent of their "*Covered Monthly Earnings*" or the Maximum Disability Benefit (the number agreed upon when the employer negotiated the coverage and specified in the LTD plan).

For this client, her original IDI policy, which lapsed, contained a set "*Maximum Monthly benefit of $10,000*, whereas her LTD plan defined her monthly benefit as "*60% of monthly earnings to a maximum benefit of $15,000 per month*." As outlined below, failing to understand the definition of "*Monthly Earnings*"/"*Covered Monthly Earnings*" can significantly impact a physician's perceived coverage.

To properly understand one's coverage, physicians should review the definition of their *"Monthly Earnings"/"Covered Monthly Earnings."* Most LTD plans seek to limit the company's financial exposure by excluding other forms of compensation such as bonus and only cover the physician's base monthly salary from clinical practice.

2. The effect of "*Other Income Benefits*"

Camouflaged within most LTD plans is a provision regarding "*Other Income Benefits*." This provision entitles the LTD plan administrator to reduce a physician's monthly benefit dollar for dollar, if they are receiving income from any of the listed sources.

While the LTD plan will provide a detailed list, the most common "*Other Income Benefits*" that could affect a physician's LTD benefit are: State Disability Benefits, Social Security Benefits, Workmen's Compensation, Salary Continuation, Voluntary Retirement Payments Attributed to an Employer Funded Plan, and Benefits Received from Other Group Disability Plans. In practice, the most common "*Other Income Benefit*" that affects clients' LTD benefits is Social Security Disability.

To assess your exposure to reductions based on "*Other Income Benefits*," you should thoroughly review the definition section of your LTD plan. If your LTD plan contains a list of "*Other Income Benefits*," understand that your LTD plan administrator will seek to apply a dollar-for-dollar reduction to your monthly benefit.

3. Tax consequences

Similarly, unlike most IDI products which are paid for with after-tax-dollars and provide a tax-free benefit, most LTD plans are paid for with pre-tax-dollars. This results in the disability benefit being subject to both federal and state income tax liability. As such, if a physician is relying on an LTD plan that was paid for with pre-tax-dollars, and depending on where they live, the LTD benefit could be subject to federal, state, and city/local income tax obligations. These tax consequences can significantly reduce a physician's perceived coverage, jeopardizing their financial security.

To assess your tax liability, simply review how your premiums are paid with your employer and/or a certified public accountant.

The Consultation

When meeting my client for the first time, she explained that she let her IDI policy lapse because it was capped at $10,000 a month/$120,000 a year, and her LTD plan provided her with a $15,000 a month/$180,000 a year benefit. She advised that her gross income was $300,000 a year, and she believed she was over insured and did not see the need for both policies.

We discussed her earnings, and she advised that while her annual gross income was $300,000, her clinical salary was set at $150,000 and her academic salary and bonus compensation were both $75,000 a year.

My client believed she was entitled to the maximum monthly benefit of $15,000. The LTD plan defined her monthly benefit as "*60% of monthly earnings to a maximum benefit of $15,000 per month*." By applying simple math, her calculation might appear reasonable:

- $300,000 divided by 12 months provides an average monthly income of $25,000.
- 60 percent of $25,000 provides a monthly benefit of $15,000.
- As such, she believed she was entitled to the maximum monthly benefit of $15,000.

However, by not accounting for 1) the definition of "*Monthly Earnings*," 2) the applicability of "*Other Income Benefits*," and 3) tax consequences, she significantly miscalculated her monthly benefit and surrendered an IDI policy that provided significantly better protection.

1) Covered Monthly Earnings

The definition of "*Monthly Earnings*" was not located on the specification page in the front of the LTD plan. Rather, it was buried on page 20 of the LTD plan. The definition of "*Monthly Earnings*" **excluded** all compensation other than her "current monthly rate of pay from **Clinical Practice**."

This definition specifically excluded her $75,000 academic salary and $75,000 bonus compensation. By excluding 50 percent of her gross income ($150,000), her monthly LTD benefit was reduced from the anticipated $15,000 a month maximum benefit to $7,500 a month. By not fully understanding the definition of her "*Monthly Earnings*," the client overestimated her monthly LTD benefit by 50 percent and surrendered an IDI policy that would have provided her with a $10,000 a month benefit. This miscalculation resulted in her overestimating her LTD coverage by $7,500 a month/$90,000 a year.

This issue is not unique to this client's LTD plan. Similar issues have occurred in private practices where the shareholders set a monthly draw and rely on distributions. Depending on the wording of the LTD plan, and how the income is identified on pay statements, LTD providers will seek to exclude the same from a physician's "*Monthly Earnings*."

To confirm your monthly benefit, review the definitions contained within your LTD plan. If you still have questions, discuss these with human resources and/or someone with knowledge and experience dealing with these products.

2) Other Income Benefit Offsets

Based on this client's medical condition, she was eligible for Social Security Disability. This provides her with a monthly benefit of $2,500/$30,000 a year. Under her LTD plan, her $7,500 a month/$90,000 a year benefit is reduced to $5,000 a month/$60,000 a year. By not fully understanding the definition of her "*Other Income Benefits*" and "*Monthly Earnings*," the client overestimated her monthly LTD benefit by 66 percent or $10,000 a month/$120,000 a year.

To understand the effect of *Other Income Benefits* on your LTD plan, review the itemized list and assess your potential eligibility for each noted benefit. Add these numbers together and reduce them from your noted monthly benefit. This will provide you with a general estimate of potential reductions in your LTD benefit.

3) Tax Liability

This client also did not account for the tax liability on her LTD benefit. Since 100 percent of the premiums for her LTD plan were paid for by her employer with pre-tax-dollars, 100 percent of the benefit was classified as taxable income. Based on where this client lives, her benefit is subject to federal, state, and city income tax liability.

Accordingly, her $5,000 a month/$60,000 a year benefit was subject to a combined tax liability of approximately 35 percent. Her tax liability reduced her benefit from $5,000 a month/$60,000 a year to $3,250 a month/$39,000 a year.

To assess your tax liability, simply review how your premiums are paid with your employer and certified public accountant. If the premiums are paid for with pre-tax dollars, then the benefit is most likely subject to tax liability.

The Financial Fallout

Had the client consulted with a financial planner and/or another qualified consultant prior to letting her IDI policy lapse, she could have kept both policies in place. She would have received her tax-free, $10,000 a month IDI benefit, the benefits provided under her LTD plan, and Social Security Disability.

Unfortunately, this client misunderstood her LTD coverage and significantly compromised her financial security. When this client entered my office, she believed her LTD plan covered 60 percent of her gross earnings and provided a $15,000 a month/$180,000 a year benefit. After going through our analysis, she was devastated to learn that she overestimated her coverage by 78 percent, leaving her with an LTD benefit of $3,250 a month/$39,000 a year to support her family.

My client's story is becoming all too common and can be easily avoided by consulting with a qualified professional to review and assess your coverage. Your financial security, and your family's well-being, may one day depend on it.

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