Advisory Council on Employee Welfare and Pension Benefit Plans

Report to the Honorable Hilda L. Solis,
United States Secretary of Labor

Managing Disability Risks in an Environment of Individual Responsibility

December 2012

2012 ERISA Advisory Council Report:

Managing Disability Risks in an Environment of Individual Responsibility

NOTICE

This report was produced by the Advisory Council on Employee Welfare and Pension Benefit Plans, usually referred to as the ERISA Advisory Council (the "Council"). The Council was established under Section 512 of ERISA to advise the Secretary of Labor. This report examines Managing Disability Risks in an Environment of Individual Responsibility. The contents of this report do not represent the position of the Department of Labor (DOL).

ABSTRACT

This report focuses on income replacement during periods of long-term disability, and how disability coverage (or lack thereof) impacts an individual's retirement security. Specifically, the report examines disability benefits offered through ERISA-covered plans, plan design options to employers, and administration of such benefits under the Department of Labor's claims and appeals regulations for ERISA-covered plans. The Council notes that public benefits such as Social Security and Medicare, and short-term disability coverage provided by an employer, are beyond the scope of this report, except to the extent these benefits are integrated and produce an effect on an employer-sponsored plan that is covered by ERISA. In addition, individually secured disability coverage is beyond the scope of this report, although the Council's observations concerning claims and appeals of disability benefits may be applicable if an individual's plan is subject to ERISA. Notwithstanding its limited scope, the report provides a brief overview of disability benefits with the intended goal of enhancing the individual's understanding and appreciation of their value within the context of the employment relationship.

A lengthy period of disability can lead to prolonged loss of income, resulting in serious financial consequences for any individual and his/her family. The absence from work and loss of continued compensation usually will result in the disabled individual discontinuing contributions to his/her defined contribution plan (DC plan) during the period of disability. Not only does the individual cease saving for his/her retirement, but often will tap into retirement savings to ease the financial hardship. At the time of this need, it does not matter to the individual that the savings were intended to fund retirement and that access to these funds for non-retirement purpose will weaken his/her retirement financial security. Moreover, with the proliferation of DC plans as the primary vehicle for retirement savings, the risk of depletion of these funds becomes more likely as penalty-free withdrawals are statutorily permitted during periods of disability.

While existing programs, such as SSDI, are helpful to any individual who is facing a long-term disability during working years, long term disability insurance is increasingly important to ensure that the individual maintain a certain level of financial security during the disability period without having to use their retirement savings to finance non-retirement expenditures. The Council received repeated testimony on the fact that far too many employees significantly underestimate and underappreciate the risk of becoming disabled. This is reflected in the low

take-up rate for employees who have access to this coverage through their employment. In addition, witnesses noted that because employers have limited resources to provide employee benefits, many employers offer other competing benefits that are in greater demand by the employees.

In addition, the Council received testimony on design aspects of certain plans regarding the application of offsets and the process of reviewing claims and appeals that are governed by ERISA and corresponding regulations.

List of Members who worked on the Report:

Mildeen Worrell, Council Chair
Karen Kay Barnes, Council Vice Chair
Denise Clark, Issue Chair
Anna Rappaport, Issue Vice Chair
James D. English, Drafting Team Member
David C. Kaleda, Drafting Team Member
J.M. Towarnicky, Drafting Team Member
Ralph C. Derbyshire
Cindy Hounsell
Marilee Pierotti Lau
Michael A. Sasso
Neal S. Schelberg
Mary Ellen Signorille
Gary A. Thayer
Richard A. Turner

ACKNOWLEDGEMENTS

The Council recognizes the following individuals and organizations who contributed greatly to the Council's deliberations and final report.

Larry Good	Employee Benefits Security Administration (EBSA)
DiWeena Streater	EBSA

June 12, 2012

David Stapleton	Mathematica Policy Research, Inc.
Lou Mazawey	Groom Law Group, Chartered
Richard Shea	Covington & Burling, LLP
Steve Mitchell	Unum
Carey Burnell	United Steelworkers
Donald Fuerst	American Academy of Actuaries

<u>August 28, 2012</u>

Joe Canary	EBSA
Steve Clayburn	American Council of Life Insurers (ACLI)
Diann Howland	American Benefits Council (ABC)
Leslie Greer	National Telecommunications Cooperative Association
Tony Cost	Silgan Containers
Warren von Schleicher	Smith von Schleicher and Associates
Mark DeBofsky	Daley, DeBofsky & Bryant
Mala Rafik	Rosenfeld Rafik & Sullivan

TABLE OF CONTENTS

I. EXECUTIVE SUMMARY

II. RECOMMENDATIONS

III. BACKGROUND

A. Increased Frequency of Disability and Lack of Preparedness
B. Sources of Income for the Disabled
C. Employer-provided LTD Coverage
D. General Structure of Disability Coverage Plans
E. Sources and Characteristics of Disability Coverage
F. The Legal Framework of ERISA Disability Claims

IV. SUMMARY OF TESTIMONY AND COUNCIL DISCUSSION

A. Educational Materials for Employers and Employees
B. Regulatory Guidance on Claims Determination, Appeal, and Estimated Offsets
C. Guidance/Clarification Regarding Auto-enrollment, Disability Premiums for DC Plans, and Payment of LTD benefits for Indefinite Periods
D. Other Important Issues

V. CONCLUSION

APPENDIX A: WITNESS SUMMARIES

I. EXECUTIVE SUMMARY

Disability is a major risk that faces adult Americans during the primary period of their work life, and a risk that is significantly underestimated by many workers. It has been demonstrated that the length of time an individual is absent from work due to a disability decreases his/her financial security in current years as well as during retirement.

Disability coverage is designed to protect the insured, and often their families, against severe economic loss during a period of disability. However, in cases where a worker has access to such benefits this alone does not guarantee that the worker and his/her family will not suffer some measure of economic loss. Testimony the Council received highlighted the fact that there are many different disability plan designs currently in the market. The type of disability plan, if any, that is available to the worker is crucial in determining how much financial security the worker will have during periods of disability. In addition, the testimony illustrated that even when a worker has disability coverage, there could be legal issues that need to be resolved. As testimony and research demonstrated, the area of greatest need for the coverage is where the worker does not have access to disability benefits and then experiences a period of disability.

Defined benefit pension plans (DB plans) have traditionally included the occurrence of disability as a basis for awarding benefits. In fact, many DB multiemployer plans provide this optional form of retirement benefit. However, with the shift in retirement coverage to primarily defined contribution plans (DC plans), integrating disability coverage within, or as a component of, DC plans is almost non-existent. Unlike DB plans where the participant continues to accrue benefits when on disability, in DC plans the participant's contributions end when the participant becomes disabled and no longer receives compensation. In addition, participants often have to tap into retirement funds for non-retirement expenditures rather than being able to secure the savings to fund their retirement years.

For employers who would like to provide disability benefits as a component of employer-sponsored DC plans there remain substantial regulatory hurdles.

The Council identified several major concerns with regard to disability coverage and underlying benefits as set forth below:

- Far too many individuals do not fully understand the risk of becoming disabled during their working years. Consequently, they often undervalue and/or do not fully appreciate the benefit of disability coverage.

- The existing gaps in coverage are significant with only 31 percent of the labor force covered by employer-sponsored long term disability benefits. Also, individuals are less likely to purchase disability coverage on their own, outside the employment relationship.

- Not all results have been positive for the participant under ERISA-covered plans and the implementing claim procedures regulations, even though these rules were intended to protect participants. The Council was made aware of reoccurring issues and administrative practices that participants and beneficiaries face when appealing a claim that may be inconsistent with the existing regulations.

- The complex nature of many disability coverage contracts and the administration of these contracts have often resulted in the insured, and sometimes the sponsoring employer, misunderstanding the details of the coverage and the true nature of the benefits that are due when a disability occurs. The Council was made aware that in some cases individuals will receive lower benefits than expected because of the application of offsets the individual is not made aware of, very often, until the benefits are payable .

- The Council learned that while the primary offset under a disability plan is Social Security disability benefits, in many cases the benefits are offset by other sources of income some members of the Council believe to be unanticipated by most participants and inconsistent with the underlying policy of disability coverage.

- While economic security initiatives for the disabled should include both income protection and back-to-work support, current conflicting definitions of disability and back-to-work policies do not always work well together or complement the desired overall goal.

- The Council heard testimony to support a recommendation for the development of educational materials and outreach, as well as clarification of existing guidance all designed to help improve disability security.

The Council heard from the policy community, insurers, employers, labor organizations, professional representatives of various groups, and attorneys representing plans and participants. The Council's examination of disability coverage and benefits focused on the following questions:

- What disability benefits are currently offered to employees?
- What retirement income gaps are created during periods of disability?
- How can the Department of Labor assist participants to better manage disability risks?
- How can Department of Labor assist employers establish effective disability coverage for their employees?

II. RECOMMENDATIONS

The Council has examined current issues surrounding access to, and provision of, long-term disability benefits ("LTD"), and how periods of disability impact retirement savings in light of the shift to defined contribution plans. The Council recommends that the Department of Labor (DOL):

1. Develop educational materials for employers, employees, participants and beneficiaries addressing the likelihood of becoming disabled, its impact on retirement benefits, types of disability coverage, and options for securing replacement income during periods of disability.

2. Review current claims regulations to determine updates and modifications, drawing upon analogous processes described in health care regulations where appropriate, for disability benefit claims including: (a) content for denials of such claims; (b) rule regarding full and fair review, addressing what is an adequate opportunity to develop the record and address retroactive rescission of an approved benefit; (c) alternatives that would resolve any conflict between the administrative claims and appeals process and the participants' ability to timely bring suit; (d) the applicability of the ERISA claim procedures to offsets and eligibility determinations.
3. Issue guidance for plan sponsors and plan administrators on the following subjects: (a) permissibility of auto-enrollment for employee contributory LTD plans; (b) characterization of long term disability benefits as welfare benefits without regard to retirement age; (c) payment of insurance premiums for continuing retirement contributions during periods of long-term disability in DC plans, including whether a default feature is appropriate.

In addition to the above recommendations, the Council received testimony and discussed at length other issues. The Council acknowledges the importance of the issues set forth below:

a. There is need to clarify the tax treatment of disability benefits permitting continued accumulation of DC plan retirement savings during periods of disability.
b. There are differing statutory and plan definitions of disability which are, in some cases, inconsistent. The Council acknowledges that these inconsistencies can create confusion and barriers to the ability of an individual to return to work.
c. Offsets to long term disability benefits are many and varied. The Council acknowledges that employers voluntarily offer these benefits and can adopt plans with different designs. Employers sometimes do not fully understand how offsets work, or how they impact their employees. The Council heard testimony which raised concerns that certain offsets appear to be inconsistent with the purpose of offering disability coverage.

III. BACKGROUND

A. <u>Increased Frequency of Disability and Lack of Preparedness</u>

In the United States workers face a major risk of becoming disabled during their work life.[1] In fact, the risk of becoming disabled for 90 days or longer is greater than the risk of premature death.[2] According to the Social Security Administration, 1 in 4 of today's 20-year old individuals will become disabled before reaching age 67.[3] Similarly, the Council for Disability Awareness indicated that one in seven workers can expect to be disabled for five years or longer;[4] and, 50 percent of those disabled employees that are out of the workforce for three months or more are likely to remain out for at least two years.[5] In addition, and of equal significance, based on claims being made, the risk of becoming disabled is increasing.[6] Research has shown that 90 percent of all disability claims paid are for illness and chronic conditions, not because of work-related trauma or injury.[7]

The consequences of becoming disabled are devastating for any worker. According to testimony presented to the Council, the mean household income for families that are headed by a disabled individual is only 52 percent of the income of other working-age households.[8] In addition, unemployment for disabled employees is higher than that of their non-disabled counterparts. With the declining economy, by 2010 only 20 percent of disabled workers were likely to be employed. [9] A study by Milliman[10] highlights that, even where an individual has LTD coverage at 60 percent of his salary, the adverse financial impact of a lengthy period of disability is severe. Not surprisingly, the working-age disabled are more likely to live in poverty with the annual poverty rate for households of disabled working-age individuals at 2.5 times as high as working-age individuals without disabilities. According to testimony, 65 percent of individuals living in poverty for at least three years had a disability.[11]

B. Sources of Income for the Disabled

Income to replace a worker's earnings during periods of disability is partially provided by Social Security, state worker's compensation, state disability programs, employer offered benefits, and individually purchased disability insurance. Each type of coverage is subject to specific conditions and timeframes for payment of benefits.

Social Security Disability Insurance (SSDI) covers over 150 million workers, with 8.6 million individuals collecting disability benefits. This benefit applies only to persons whose disabilities make them unable to engage in "any substantial gainful activity," a standard that is strictly interpreted and applied by the Social Security Administration. SSDI benefits are based on the past earnings of the disabled worker with an average disability benefit of approximately $1,110 per month, or $13,320 per year.[12] On average, LTD plans provides a total benefit equal to 60% of earnings before disability.

Workers' compensation benefits are implemented by the states and designed to replace income only for workers who are injured on the job. Such benefits normally will not extend to disabled employees, as more than 95 percent of disability claims reported are **not** related to a work-related injury or trauma.[13]

Disabled individuals may have limited access to a state-sponsored disability program, or employer-sponsored benefits such as continued compensation for a period of time during a major illness. However, these programs are beyond the scope of the report and were not the focus of testimony or additional research.

C. Employer-provided LTD Coverage

Common employer philosophy and practice in the area of employee benefits has evolved over time. For many employers, offering valuable employee benefits was an important aspect of recruiting and retaining workers. Today, there is greater emphasis on risk-management and much of the risk of retirement has been shifted to employees.

Aside from SSDI, disability coverage through employer sponsored insurance plans remains the primary source of disability benefits for workers, and is a benefit that is more likely to be offered by large employers. Small employers are less likely to make this benefit available to their employees. Witnesses noted that this results from a combination of factors, including the fact that the employer must make choices concerning the benefits to offer its employees. They further noted that disability benefits compete for limited dollars, against benefits such as health care insurance, life insurance, or even dependent care assistance, which, witnesses noted, are very often given greater importance and demand by workers. [14] Despite the risk of a worker becoming disabled during his/her working life, and the resulting severe financial consequences, both testimony and research show that less than one-third (31 percent) of the American workforce is covered by LTD insurance policies (or plans) that is accessed through their employment.[15] The lack of coverage is significantly greater for employees within certain groups or industries. For example, only 11 percent of workers in the service industry are covered; 6 percent of part-time workers have coverage; and 17 percent of establishments with 49 or less workers offer disability coverage to their employees.

Employer -provided long term disability support may include programs to help employees return to work or secure other employment, as well as income replacement insurance and continued medical coverage.

The possible options for employer-provided disability coverage are examined below:

1. <u>LTD coverage through DB pension plans</u>: the decline of the DB plan system has produced a corresponding reduction of available disability coverage through employer-provided plans. The limited number of DB plans that continue to offer this benefit are sponsored either by the large employers or Unions.
2. <u>LTD coverage offered by employer as stand-alone plan</u>: A significant number of large employers offer employer- paid LTD plans. Many of these companies offer employer-paid coverage that will replace 40-50% of salary while the covered employee is disabled, and generally offer employees the opportunity to purchase additional coverage at a group rate (often up to 80% of salary).
3. <u>LTD coverage options for employee purchase</u>: Some large employers offer their employees the opportunity to "buy-up" coverage to increase the level of disability income to between 80 and 100 percent of salary. Some of these companies are eliminating employer-paid disability plans and replacing them with employee-paid options that are purchase with pre-tax dollars.

In considering whether to offer this benefit, the employer may evaluate a number of features and designs such as:

1. *Who will pay the costs*: approximately 53 percent of large employers who offer this benefit provide it as employer-paid. However, many employers are restructuring to include some level of employee cost.
2. *What is the income replacement target as a percentage of base pay*: it is not uncommon to find coverage at a base amount of 40-50 percent of salary, with an employee option to purchase additional amounts, often up to 60 percent of salary. (See table below for important features of this type of coverage.) Voluntary or employee-paid LTD coverage usually has an option to include bonuses in the benefit formula and provide coverage to social security normal retirement age.
3. *Whether the benefit is offered to employees and purchased through the employer*: currently approximately 15 percent of large employers offer this option and is a growing trend. For example, Silgan Company provides a voluntary employee-paid LTD plan that pays 60 percent of

an employee's base pay up to Social Security age. Under this option employees pay the cost of coverage with pre-tax dollars.
4. *Whether to provide LTD coverage or other employee assistance*: this is more an option for small employers. A study conducted by Mercer found that 84 percent of manufacturing companies offer some form of disability benefit to their employees.
5. *Whether to provide a vehicle for LTD within the framework of a 401(k) plan*: Some employers have experimented with a combination product that includes an annuity-like product (triggered for retirement payments at age 55) under a 401(k) plan and an option to purchase LTD coverage to cover the gap between working life and the triggering of retirement payments under the annuity.

It is important to note that employers should be prepared to reconcile any disability coverage approach with disability benefits paid under Social Security and state disability requirements or insurance standards.

D. General Structure of Disability Coverage Plans

While industry definitions of disability differ to some degree, most define disability as occurring when an employee is unable to perform the major tasks of the occupation he/she is engaged in at the time of becoming disabled.[16] After an initial finding that the individual has sustained a disability covered by the plan, the insurer will continue to evaluate the claim upon the receipt of new information. In the case where an individual remains disabled for an extended period (typically two years or longer), the insurer will conduct a more formal review to determine if the individual continues to be eligible for benefits because he/she still meets the definition of disability applicable to the plan. [17] There may be other conditions that, if not met, could result in the loss of coverage, for example, failure to be under the regular care of a physician. [18]

Typical important aspects of the plan language are set forth below: [19]

1. Two-year Own Occupation with Residual**:** under this plan, the insured is determined to be disabled when the insurer determines that: (1) the insured is limited from performing the material and substantial duties of his/her regular occupation due to the sickness or injury; and (2) the insured will suffer a loss of 20 percent of his/her indexed monthly earnings due to the same sickness or injury. [20]

2. Five-Year Own Occupation with Residual: this plan typically has the same provisions as a 2-year own occupation plan with disability payments under this plan extending for a period of 60 months.

3. Long Term Income Protection (LTIP): this plan operates similar to a 2- and 5-year own occupation with residual, except that the regular occupation period lasts for the duration of the claim, rather than requiring the individual to transition to a gainful occupation. Under this type of benefit , the disability must continue to exist.

E. Sources and Characteristics of Disability Coverage

Generally, disability benefits can come from a variety of sources. The table summarizes the most common sources of disability benefits as follows:

Sources of LTD Coverage[21] and Method of Calculating Benefit

	Social Security Disability	Employer LTD program	Defined Benefit Pension	Individual Disability Policies
Employer role in program	Pays Social Security tax	Program could be self-insured (employer's discretion in program design) employer-paid coverage; employee-paid coverage; cost split	Employer- sponsored program; usually self-insured	Generally none; can offer supplemental coverage at the worksite
Prevalence of coverage	Social Security requirements re work history for effective coverage; Non- working spouse - no coverage	Generally offered by large employers - preference salaried workers	Declining existence. More likely to be offered at large employers.	Most prevalent among high-paid professionals; white collar workers; business owners etc.
Disability benefits based on:	History of lifetime earnings and benefit formula	Current earnings & benefit formula; commonly offset by SSDI or other sources of income	Benefit formula provided by the plan's disability provision	Amount of the coverage purchased
Definition of type of disability	Total and permanent - expected to last at least one year or results in death (more details below)	Own occupation; any occupation; a combination with own occupation first; can be linked to earnings, or a variation depending on coverage	Plan provision determines, may be similar to a regular LTD program	Own occupation; any occupation; combination with own occupation first; can be linked to earnings, or a variation pending on coverage
Link - disability to resources at retirement	History of earnings; may be reduced	No direct connection; possible continued retirement savings	Continued service accrual allowed under some plans for pension benefit	No direct connection; may cover continued retirement savings
Regulation of coverage and claim process	Extensive appeals process	State insurance law; ERISA & regulations	ERISA	State insurance laws
Length of Time for claims settlement	Can be extensive	Usually promptly after qualifying period ends; no later than ERISA regulatory deadline of 45 days	Variable depending on the definition of disability	Usually promptly

Note: This table does not include Worker's Compensation, which provides a specialized form of disability coverage, and is beyond the scope of this report. The table does not cover disability coverage connected to DC plans under which disability coverage is rarely offered and which is the major focus of the report. The report does not focus on medical benefit continuation to disabled employees or on Medicare, which is provided after two years of disability and to individuals who receive SSDI benefits.

F. The Legal Framework of ERISA Disability Claims

Employers are subject to a number of different sets of legal requirements as they consider issues related to disability and employee benefits that provide financial security linked to disability. ERISA governs employer-sponsored benefits and is the primary regulation over both insured and self-insured LTD benefits. The Internal Revenue Code (IRC) governs the taxation of these benefits at both the employer and employee level. The IRC also has a major impact on feasible plan designs, and can be a barrier to desirable plan designs. Where benefits are insured, state insurance law governs the insurance contracts. This is an added layer in addition to the application of ERISA and the IRC for the tax treatment of the benefits. The Americans with Disabilities Act (ADA) protects disabled persons with regard to employment issues and public accommodation. Because employment is an important part of economic security for disabled persons, and because employee benefits include provisions to support return-to-work, there is some interconnection between the ERISA employee benefit issues and the ADA.

The Department of Labor has jurisdiction over a limited part of the total legal picture. The Council focused its attention primarily on the areas of DOL jurisdiction, and, more specifically, on areas where they can make a difference. However, the Council's focus was done in the context of the total picture and recognizes the importance of the other areas of applicable laws.

Legal requirements can interact with benefit plans in several different ways: (1) the requirements can mandate and regulate certain practices, such as in the claims appeal areas; and (2) they can serve as a barrier to including certain provisions in plans, such as in the area of continued contributions to DC plans during disability. Barriers can arise from clear requirements and from uncertainty. The Council considered, in its recommendations for guidance, areas where DOL can enable enhanced LTD coverage or can clarify practices to help plan beneficiaries. Also, the Council includes in the report observations regarding areas where DOL cannot act directly, but note that the resolution of issues in these areas is an important aspect of developing better outcomes for plan participants.

Under ERISA, the plan is required to:

(1) Provide adequate notice in writing to any participant or beneficiary whose claim for benefits under the plan has been denied, and must set forth the specific reasons for the denial. This must be written in a manner calculated to be understood by the participant; and,

(2) Afford a reasonable opportunity to any participant, whose claim for benefits has been denied, to have a full and fair review by the appropriate named fiduciary of the decision denying the claim. (29 U.S.C. §1133).

To implement these requirements, DOL issued final claims regulation on November 21, 2000. (Final Rule on Claims Procedure, 29 C.F.R. § 2560.503-1 (65 Fed. Reg.70,246)). These regulations will be referred to in the report as the current regulations. The current regulations became effective January 20, 2001, with application to all claims filed on or after January 1, 2002.

Under the current regulations, a claim is considered to be filed when the claimant, or the claimant's representative, makes a request for a plan benefit or benefits to be paid in accordance with the plan's reasonable claims procedure. (29 C.F.R. §2560.503-1(e)). The period of time for making a determination with respect to the claim begins when the claim is filed in accordance with the claims procedures, without regard to whether all of the necessary information is included. (29 C.F.R. §2560.503-1(f)(4)). However, the period of time for making a determination will be tolled from when the claimant is notified that additional evidence is needed to the date the claimant responds to the request.

In compliance with the current regulations, disability claims require a 45-day turnaround period, and an appeal of the determination of the claim must be decided within 45 days from the date of receipt of notice of appeal. (29 C.F.R. §2560.503-1(f)(3), (i)(3)). With respect to disability claims, an appeal must be decided by a named fiduciary *other than* the party or a subordinate of the party who made the original benefit determination. (29 C.F.R. § 2530.503- 1(h)(3)(ii),(h)(4)). Additionally, the decision maker on appeal cannot give deference to the initial adverse determination. (29 C.F.R. §2530.503-1(h)(3)(ii),(h)(4)).

IV. SUMMARY OF TESTIMONY AND COUNCIL DISCUSSION

A. Educational Materials for Employers and Employees

Develop educational materials for employers, employees, participants and beneficiaries addressing the likelihood of becoming disabled, its impact on retirement benefits, types of disability coverage, and options for securing replacement income during periods of disability.

In developing the recommendation, the Council encourages DOL to focus on certain aspect of the education materials that would address the following areas:

Participants/Employees: (1) increased awareness of the risks of an individual becoming disabled during their working years; (2) the value of disability coverage; (3) basic types of disability coverage and how each works; (4) the importance of continued savings for retirement during the years the participant is disabled.

Employers/Plan Sponsors: (1) increased awareness of the availability of disability insurance to be offered by employers to employees for protection of their income; (2) basic options employers can make available to employees; (3) crucial features and design of basic options (employee-paid vs. employer-paid; income offsets); (4) how employees can access disability coverage; (5) the importance of continued savings for retirement during the years the individual is disabled, and reduction of leakage.

The Council recommends education and outreach because, as mentioned above, there is a real likelihood of an employee experiencing either short or long periods of disability; and, many employees do not have adequate disability coverage. The knowledge gaps for employers exist both in securing and designing disability coverage, while in contrast, the knowledge gaps for employees exist mainly in securing disability coverage. Additionally, coverage provided by employers to which employees have accesses is often insufficient in terms of covering periods of disability and providing little or no protection for individuals' retirement savings during periods of disability.

Several of the witnesses discussed the need for education and identified some of the information that should be included. Don Fuerst, from the American Academy of Actuaries, pointed out some of the gaps and misperceptions in public knowledge about disability and the problems that are linked to disability without proper coverage. He pointed out that the risk of becoming disabled is greater than most people think. Mr. Fuerst noted that many Americans associate disability with serious accidents, but in reality, the overwhelming percentage of disabilities are caused by illness—more than 85 percent of short- term disabilities and almost 90 percent of long-term disabilities are related to illness. He indicated that the probability of becoming disabled during an individual's working career ranges from 15 percent to 30 percent, varying with age and gender. Additionally, according to testimony, the risk of disability lasting 90 days or longer is greater than the risk of premature death. While most people routinely insure against the risk of premature death, they insure against disability much less frequently. Don Fuerst's testimony strongly reinforces the need for education.

The testimony showed how disability coverage adds value to a range of stakeholders. Stephen Mitchell, from Unum, suggested a government partnership to focus on the importance of disability coverage, and pointed out that those with income protection insurance reduce spending by government programs in amounts up to $4.5 billion per year. He testified that Americans greatly underestimate the impact of losing the ability to earn an income due to disability, and overestimate the public and private safety net available to them should they become disabled, in spite of the fact that only about one-third on workers have access to employer- provided LTD . He pointed out that the most effective and affordable way to protect workers financially in the event of disability is through group disability insurance which is delivered at the workplace. According to Mr. Mitchell, this type of income protection is very affordable, and those that are covered by it are better able to provide for themselves and more likely to return to work than those without such coverage. Mr. Mitchell noted that because many employers do not offer such coverage, it is important to educate them about the increased likelihood of an employee becoming disabled during his/her work life, and how offering such coverage can protect their employees during such periods. Mr. Mitchell pointed out that employers who offer such coverage enjoy reduced absenteeism, increased efficiency, and higher morale. The Council notes that it is important to offer education to employers to enable them to appreciate making the benefits available to their employees.

Tony Cost from Silgan Corporation testified that employers today face severe business pressures and have limited dollars to allocate to employee benefits. As employees focus more on total compensation, it is important to increase their appreciation and demand for disability coverage in order to elevate the employer's interest in providing this benefit. Such an approach will not necessarily result in increased access to disability benefits without improved employees' knowledge about disability. This makes outreach to employees very important.

Mr. Cost also addressed the link of disability to retirement, explaining why it is important to include the importance of continued saving for retirement during disability in education material for employers and employees. . Mr. Cost explained that as employers shifted from DB to DC approaches to retirement benefit, they often did not address the issue of how disability can derail retirement plans. While DB coverage often includes provisions to prevent disability plans from derailing retirement security, DC coverage usually does not. He pointed out that the shift from DB to DC plans has resulted in the need to re-examine LTD benefits. DB plans often included built-in LTD benefits but when companies shift to DC plans they may not replace the LTD benefits. Thus, employees participating in a DB pension plan often receive greater LTD benefits than employees not participating in a DB plan. With respect to continued retirement security, in many cases DB plans provided continued benefit accruals to disabled workers similar to when they were actively employed. Thus, retirement benefits continued to grow through periods of disability, and workers would receive benefits similar to those they would have received absent the disability.

DC plans, on the other hand, lack similar LTD benefits. In the case of DC plans, often no additional contributions are made to the individual accounts of disabled employees. As a result, disabled participants' retirement security can be compromised if they are not enrolled in a pay continuation plan like STD, or LTD, if the pay continuation program does not provide adequate benefits, or if the design of the plan does not permit such contributions. Additionally, to further erode retirement security disabled workers can withdraw money from their DC plans early, penalty free, thus having fewer assets in their DC retirement plan when they reach retirement age. Mr. Cost's testimony makes clear how the lack of disability coverage can create both an immediate problem and a longer term problem that can derail a worker's retirement security. This is another reason why increased education and DOL outreach is important.

Mr. Cost also discussed benefit structures that require employees to pay for their own disability coverage. Lack of employee motivation to spend money preparing for what they view as an unlikely event can be a major barrier to coverage. Mr. Cost testified that at Silgan, when employees go on disability, the company offers salaried employees pay continuation at 100% of salary for up to 6 months. Silgan also offers employees voluntary long term disability which can be purchased by way of payroll deductions and is offered at group rate discounts. Mr. Cost stated that 70 percent of eligible employees have enrolled in the plan. He noted that this is the result of a concentrated effort on the part of the company to educate employees, and to promote and encourage enrollment. In his testimony, Mr. Cost outlined several types of options for employers who may consider making LTD available to their employees, and some of the considerations for the employers. He focused on the following; (1) disability coverage within a DB plan, (2) freestanding disability coverage, (3) possibility embedding provisions in a DC plan, and (4) employee- paid coverage. He noted the need for employers to coordinate any coverage selected so that it logically fits with Social Security.

The Council heard testimony suggesting that employees generally are unaware of how to obtain disability coverage, but that there are options available for securing such coverage. Individuals who want to secure replacement income through LTD coverage can participate in an employer plan if one is available or they can purchase individual disability insurance. It is noted that individually purchased coverage is likely to be more costly than if purchased under an employer-offered plan that can benefit from group rates. In addition, members of professional organizations may be able to obtain LTD coverage through a professional association. The individual who purchases coverage can make decisions regarding to how much income replacement coverage, the length of the waiting period, the maximum benefit period, and the types of riders to include. The available LTD policies may differ with regard to certain features such as inflation protection, definition of disability and the offsets that will apply against the benefit payable under the contract. It is clear from the testimony that individuals need more information and education to help them sort out these issues, understand the trade-offs between more and less coverage, price, offsets etc.. This information will be helpful to individuals in better understanding any LTD benefit offered by their employer.[22] The testimony from Stephen Mitchell, Don Fuerst and Tony Cost provide a consistent picture of gaps in knowledge, sense of lack of priority for disability benefits, and collectively demonstrate the value of education needed for greater support of disability coverage.

B. Regulatory Guidance on Claims Determination, Appeal, and Estimated Offsets

Review current claims regulations to determine updates and modifications, drawing upon analogous processes described in health care regulations where appropriate, for disability benefit claims including: (a) content for denials of such claims; (b) rule regarding full and fair review, addressing what is an adequate opportunity to develop the record and address retroactive rescission of an approved benefit; (c) alternatives that would resolve any conflict between the administrative claims and appeals process and the participants' ability to timely bring suit; (d) the applicability of the ERISA claims procedures to offsets and eligibility determinations are subject to the claims and appeal process.

The Council heard from Joe Canary, EBSA's Director of Regulations and Interpretations, regarding the current status of the claims and appeals regulations as they apply to disability benefit claims. Joe Canary indicated that the DOL has been reviewing the claims procedure regulations published in 2000 in an effort to determine whether there are provisions or requirements in the regulation that could be improved. He discussed several areas as examples of issues being reviewed. He explained, for example, that even though the regulations establish requirements for the content of adverse benefit determinations and require that the notices be in writing, some claimants have complained about not receiving adequate explanations for benefit denials, including circumstances involving offsets. He also noted that there have been complaints about the way the judicial requirement to exhaust the disability plan's claims and appeals process prior to filing an action in court may in some cases have impeded participants' and beneficiaries' effective access to remedies in courts. Mr. Canary cited complaints about "retroactive" benefit denials. He also noted questions regarding claimants' ability to address additional or new reasons for a claim denial when the additional or new reason is first raised late in the claims review process, including concerns about the claimants' inability to develop an adequate administrative record for judicial review. Mr. Canary noted that issues have been raised about how eligibility determinations fit into the claims regulations. Mr. Canary emphasized that these were just examples of areas being reviewed, and that he was hopeful that the Council's work would provide further input and recommendations for DOL to consider.

The Council heard from three witnesses on the subject of the claims and appeals process. The witnesses did not agree about very many issues related to litigation of denied claims, which was not surprising due to the nature of their practices—defense and plaintiff. However, there was one observation about which none of these witnesses disagreed: the ERISA dockets of most of the federal bench are dominated by disability cases.

On the issue of full and fair review, Mr. DeBofsky and Ms. Rafik expressed a need for DOL to consider clarification of the standard so that when decisions are made on a different basis on appeal, the participant may have the opportunity to be heard. Mr. von Schleicher expressed concern about the impact of such a rule, and testified that it would result in an endless appeal cycle. Through research and testimony, the Council noted a split among the federal district courts regarding what constitutes full and fair review, which has led to uneven treatment for participants, depending on the jurisdiction in which the plan is administered. Consequently, the Council recommends that DOL further evaluate how the full and fair review standard should apply to disability claims, in a similar manner as was done for health claims under the Affordable Care Act.

On the subject of standard of review, Mr. DeBofsky discussed the need for DOL to reconsider its position on the treating physician rule, in light of the Supreme Court's ruling in *Black & Decker v. Nord*. Mr. DeBofsky noted that the modification of such a rule to apply this standard would provide some level of due process, as actual experience supports that there is no opportunity for hearing or cross-examination, as afforded Social Security claimants, of the decision-makers when a claim denied. Mr. von Schleicher did not agree to such modification of the rule to be applied to disability cases. The Council recommends that DOL review its position with respect to standard of review and the application of the treating physician rule to determine if such a modified rule has merit in disability cases, especially in light of perceived and actual conflicts of interest with respect to the administrative process.

Both Ms. Rafik and Mr. DeBofsky testified that, with some frequency, there are plan designs that may leave the participant without clear direction on whether exhaustion of administrative remedies is either necessary or permissible, for purposes of eligibility for benefits. Ms. Rafik and Mr. DeBosky noted that the current claims and appeals process appears to be less than clear on this issue and that some plans will not treat such claims as subject to their claims procedure. However, they noted that when litigation is commenced regarding such claims, exhaustion is asserted as an affirmative defense. The Council recommends that DOL clarify the claims and appeals regulations to address whether claim regarding the determination of eligibility may proceed to court where a plan is silent on the issue.

Ms. Rafik and Mr. DeBofsky testified that exhaustion of appeals procedures has been complicated in some jurisdictions where the statute of limitations for commencing litigation runs from the date the claim is denied, not from the date the appeal is denied. . The Council recommends that DOL clarify the claims regulations to clearly address the waiver of the exhaustion process where the limitations period for commencing litigation is not currently tolled during the appeals process.

Long term disability benefits are generally designed to provide a benefit of 60 to 70 percent of pre-disability wages or salaries. LTD plan designs take into account the possibility that a participant will receive Social Security or other types of income related to the individual's disabling condition. Because the definitions of disability vary, individuals may qualify for LTD under the applicable coverage but not qualify for Social Security disability benefits or for various other combinations of disability supports.

The Council heard testimony regarding the many types of offsets, by other sources of income, that may be applied to reduce the LTD payments. In addition to SSDI, other offsets may include SSDI dependent benefits, cost of living adjustments on SSDI and SSDI dependent benefits, workers compensation payments, pension payments, rollovers of lump sum payments from DB or DC plans, and veterans' benefits. ACLI noted that the specification of which offsets are to be used is a decision for the employer, depending on the type of coverage which is purchased. In addition, ACLI noted that including offsets in the plan design reduces the cost of coverage and impacts the incentive of the disabled worker to return to work. Based upon this testimony, it appears that the principal cost savings come from the SSDI offset.[23] Discussion of the concerns of Council member regarding certain types of offsets is included later in the report.

With respect to the treatment of disability benefits under the claims and appeals process, the Council recommends that DOL clarify the application of the regulation to benefit offsets. The conflicting testimony regarding reduction in disability income under the plan or contract for estimated benefits the worker is expected to receive indicates it is possible that participants who are not awarded Social Security benefits do not receive the full benefits payable under the plan.

Consequently, the Council believes that such clarifications may need to be addressed, especially regarding the amount of the benefit reduction, the recovery of unpaid benefits where no additional income is received, and the type of income that is offset against the disability benefit.

As Mr. Canary pointed out that DOL is expecting to evaluate the claims and appeal regulations, including the application of these regulations to disability claims, the Council concludes that DOL should pay particular attention to disability claims. The witness testimony and Council research demonstrate that disability benefits are not too dissimilar from healthcare claims in that some plans have pre-existing condition provisions and plan documents are often lacking in explaining the benefits and rules of eligibility. In contrast, the period of disability makes the claims and appeals administration a lengthy process, and during the life of a participant's claim the standard for continued coverage changes, which distinguishes disability claims from retirement or health claims. Such characteristics of disability benefits should be considered by DOL when evaluating changes to the claims regulations.

C. Guidance/Clarification Regarding Auto-enrollment, Disability Premiums for DC Plans, and Payment of LTD benefits for Indefinite Periods

Issue guidance for plan sponsors and plan administrators on the following subjects: (a) permissibility of auto-enrollment for employee contributory LTD plans: (b) confirm characterization of benefits paid under a LTD plan in certain situations; (c) payment of insurance premiums for continuing retirement contributions during periods of long-term disability in defined contribution plans, including whether a default feature is appropriate.

1. Permissibility of Auto Enrollment for Employee Contributory LTD Plans

The Council recommends that DOL issue regulatory or sub-regulatory guidance for plan sponsors and plan administrators to clarify that automatic enrollment under a LTD plan is appropriate under ERISA. The Council believes that such clarification will encourage employers to adopt automatic enrollment features for employee- contributory LTD plans, thus increasing employee disability coverage.

While automatic enrollment processes are permitted under current law and regulatory guidance issued by the DOL,[24] testimony from witnesses confirmed that such knowledge is not widespread nor widely understood, and certainly not as widely deployed in welfare benefit plans as it occurs in certain tax-qualified profit sharing plans. Unlike today's commonplace use of automatic enrollment features in qualified profit sharing plans under Internal Revenue Code Section 401(k) (IRC § 401(k)), witness testimony showed that few welfare plans utilize automatic enrollment and underlying defaults to coverage, particularly under welfare benefit plans that require employee contributions. In part, this may be the result of the potential for conflict between such automatic features and the regulations which limit a participant's ability to make, revoke or change elections under an IRC § 125 cafeteria plan.[25]

The use of cafeteria plans to enable pre-tax employee contributions to fund welfare benefit plans is widespread. To facilitate enrollment in LTD plans, an effective accommodation (adopted by at least one employer) is to offer workers a choice between using either pre-tax or after-tax contributions to fund the benefit, and using after tax employee contributions where the default to coverage is adopted. This is important in the LTD benefits context because disability benefits, unlike health benefits that are almost exclusively offered on a pretax basis, may be offered on a pretax basis, an after-tax basis, or both. Existing support for automatic enrollment in benefit plans has been confirmed for tax qualified[26] and welfare plans;[27] thus, the Council believes the underlying analyses should be applicable in the context of LTD Plans with auto- enrollment features.

The Council believes that more plan sponsors would adopt automatic features if regulatory and sub-regulatory guidance, as well as publications, were issued which identified the methods, processes, notices and other options a plan might use to facilitate implementation of these features for welfare benefit plans. Because of the increased importance of disability income coverage, the obvious need for paycheck insurance, and the current low levels of enrollment in such plans when offered by employers, the Council recommends that DOL take action to publicize the potential positive effect automatic enrollment usually generates on participation and coverage.

With respect to the potential conflict between cafeteria plan requirements and automatic enrollment in welfare benefit plans, the Council notes that the limits on making, revoking or changing elections is regulatory in nature, and not statutory. Given the guidance previously provided by the IRS on the use of automatic features in benefit plans, both with respect to tax qualified plans and welfare benefit plans, the Council recommends that DOL engage in outreach/partnership with the IRS and work to clarify the circumstances, processes and notices a plan sponsor could incorporate in a long- term disability plan which would allow a participant to revoke any default election to coverage within a certain period of time without running afoul of the general rule with respect to elections of coverage under a cafeteria plan.

2. Characterization of Post-Retirement Disability Benefits as Welfare Benefits

The Council recommends that DOL issue regulatory or sub-regulatory guidance stating whether an employer-sponsored plan that provides for disability benefits designed to replace income from the date of disability through a long-term period running beyond the time of normal retirement would continue to be characterized as payment from a "welfare benefit plan" for purposes of ERISA. This would increase the financial security for disabled workers, while being relieved from some of the more stringent vesting, funding, and similar requirements that are applicable to "pension benefit plans" under ERISA. In the event DOL arrives at an affirmative determination on this issue, the Council believes the development of these plans could prove to be meaningful to meet the twin goals of assuring that disabled employees receive income needed to pay for day-to-day living expenses, and assuring that such employees, who may have been eligible to save for retirement under a DC plan but lost the opportunity to do so because of the disability, have adequate income during their years that would be classified as retirement. In addition, such arrangements may prove to be a useful alternative to providing "in plan" disability retirement benefit insurance options that would permit insurance coverage for continued contributions to the DC plan during periods of disability. The challenges of providing disability retirement benefits in a DC plan are explained in more detail in the following section of the report.

The issue of a long-term welfare benefit plan was raised for discussion by a Council member during the testimony of Richard Shea and Lou Mazawey who testified on the current barriers to providing more meaningful retirement security for disabled workers who participate in DC plans. The alternative was offered as an option to resolve the problem that DC plans may not be effective retirement savings vehicles for individuals who have an extended disability period, whereas an employer-sponsored LTD arrangement designed to provide disability income could be designed to cover replacement income (i.e., lost wages), as well as respond to the lost opportunity to continue to save for retirement (i.e. lost contributions to the plan). Concerns were raised that an insured or self-insured arrangement, by its terms, that provided both disability income replace and payments during periods that would normally be deemed retirement years would most likely be viewed by DOL as "pension benefit plan" (or "pension plan") rather than a "welfare benefit plan" (or "welfare plan") under ERISA. Under such a classification, the arrangement would be subject to certain ERISA provisions that do not apply to welfare plans, such as minimum participation and coverage, vesting, funding, and other requirements. This would be a real barrier to the development and availability of such a option for employers to offer to employees.

More specifically, ERISA defines a "pension plan" as a plan established or maintained by an employer that by its express terms or as a result of surrounding circumstances (i) provides retirement income to employees or (ii) results in a deferral of income to and beyond the termination of employment.[28] On the other hand, a "welfare plan" means a plan established or maintained by an employer for the purpose of, among other things, providing benefits in the event of disability.[29] A welfare plan is specifically excluded from many of the provisions applicable to a pension plan.[30] The Council noted this issue may arise if a plan provided for payments of LTD benefits upon disability, but provided for the payment of such benefits until death (even if the participant became disabled at a relatively early age). Such a plan by its terms or in operation could be viewed as providing retirement income to employees and thus subject to the "pension plan" ERISA requirements. Mr. Mazawey and Mr. Shea stated that there may be a sufficient basis in the statutory language and DOL's guidance supporting the contention that a disability plan designed to provide income during a period of disability even where that disability last through normal retirement years could be construed as a "welfare" plan, but noted more study was necessary.[31]

Based upon the foregoing, the Council recommends that DOL issues regulatory or sub-regulatory guidance on whether an insured or self-insured LTD program that is designed to provide current income replacement, as well as replacement of DC plan retirement benefits that are lost due to an extended disability period (e.g., by providing for payments up to the date of death), would continue to be characterized as a welfare plan for purposes of ERISA. The Council noted in discussion that this "out of plan" arrangement would serve the purpose of replacing retirement income, but eliminate the need to incorporate a retirement income replacement option within the DC plan, an option that is discussed in more detail below.

3. Implement "In Plan" Options - Purchase of "LTD 401(k) Insurance"

The Council heard testimony that while ERISA and the Internal Revenue Code of 1986, as amended, (the "Code") allow for the provision of disability retirement benefits under DC and DB plans,[32] disability retirement benefits appear to be a much more common feature in a DB plan. Employers have not been as willing to implement disability retirement income benefit features within their DC plans.[33] This lack of "take up" by DC plan sponsors may be tied to how such plans work in comparison to DB plans. In addition, lack of clarity in applicable regulations may make implementation of disability retirement programs in DC plans unattractive. The Council believes DOL can take steps to promote the use of "in-plan" options in DC plans, thus enhancing disability retirement coverage under such plans.

According to Mr. Shea and Mr. Mazawey, some plan sponsors have recognized the fact that an extended period of disability can have a negative impact on employees' retirement savings and have implemented different strategies to help participants to continue to accrue benefits. Such strategies include (a) the plan allows the participant to make contributions during the disability period, (b) the employer implements an "out of plan" arrangement, or (c) employer implements an "in plan" arrangement. However, they testified that options (a) and (b) are not particularly effective. The limitations under Section 415 of the Code make allowing contributions during a disability period impractical.[34] Furthermore, "out of plan" options raise significant compliance, tax, and administrative issues.[35]

Mr. Mazawey and Mr. Shea testified that the limitations imposed under Section 415(c) of the Code and the aforementioned administrative, compliance, and tax issues posed by "out of plan" options were key reasons why plan sponsors and service providers turned to "in plan" options.[36] Under the "in plan" option described by Messrs. Mazawey and Shea, the participant elects to have a portion of his or her own contributions (e.g., pre-tax deferrals) and possibly employer contributions (e.g., matching contributions, profit sharing contributions, etc.) used to purchase LTD coverage that is offered as an investment option under the plan. Such insurance is funded either through an LTD policy issued by an insurance company or a voluntary employee benefits association ("VEBA") established by or on behalf of one or more employers. In the event the participant becomes disabled, the insurance carrier pays cash to the participant's account in the amount of the contributions he or she was making (and possibly the employer was making) prior to disability.[37] These arrangements were presented as "LTD 401(k) Insurance" in testimony to the Council and are referred to as such throughout this report. Mr. Greer of the National Telecommunications Cooperative Association ("NTCA") testified that his organization implemented such an arrangement through the DC plan NTCA offers to its members. The insurance is funded through a VEBA in which NTCA's members participate.

According to Messrs. Mazawey, Shea and Greer, the position taken by the IRS in two private letter rulings[38] (the "Rulings") is conducive to employers implementing LTD 401(k) insurance or similar products within defined contribution plans. However, some proposed regulations issued by the IRS in 2007 have called into question the IRS' position in the Rulings and have stymied the development, implementation and growth of such arrangements. This latter issue is discussed below under "Other Important Issues."

Ms. Howland of the American Benefits Council testified that products like LTD 401(k) insurance were cost-effective options for allowing plan participants to continue saving for retirement notwithstanding periods of disability.

Based upon the foregoing, the Council acknowledges the value of "in-plan" options such as LTD 401(k) insurance and recommends that DOL consider issuing regulatory or sub-regulatory guidance designed to encourage development of such options. Specifically, witnesses suggested that it would be helpful to know if an employer can allow the plan to provide for the auto-enrollment of participants in the LTD 401(k) insurance benefit or a similar program.[39] In addition, while witnesses were confident that ERISA permitted the offering of the LTD 401(k) insurance benefit, there was no clear consensus on how the LTD 401(k) insurance should be treated by the plan's sponsor and fiduciaries for purposes of ERISA (e.g., investment option, benefit, or something else).[40] As discussed below under "Other Important Issues," while the Council recognizes that DOL cannot direct the IRS to take action with respect to clarifying the tax treatment of LTD 401(k) insurance benefits, the Council hopes that the IRS will consider the contents of this report and the testimony the Council received with respect to this important issue.

D. OTHER IMPORTANT ISSUES

1. The Council acknowledges that there is a need to clarify the tax treatment of disability benefits to enable continued accumulation of retirement savings in DC plans during periods of disability.

The Council heard testimony that outlined how certain in-plan options in DC plans may enable continued retirement savings during periods of disability coverage. Regulatory guidance may encourage development of options by insurers and service providers, as well as implementation of those features. Fully recognizing that DOL does not have jurisdiction over tax issues and does not have the authority to direct the IRS to take action, the Council encourages the DOL to communicate with the IRS regarding these plan design options and how the lack of clear regulatory guidance on the tax treatment of certain "in plan" arrangements impedes disability plan designs that may assist in promoting continued retirement savings. The issue calls for attention, in light of expressed concern that the Service's 2007 proposed regulations addressing the use of DC plan assets to pay health insurance premiums effectively eliminated almost all interest in the development or implementation of "in plan" arrangements providing for disability benefits in DC plans.

In the Rulings, the IRS effectively took the position that the LTD insurance was an investment option offered under the plan. As a result, the participant would not recognize any income until benefits were paid from the plan and the plan administrator would not be required to count any insurance payments as plan contributions, both of which were considered very favorable tax outcomes.[41] However, the Treasury Department subsequently proposed regulations in 2007 (the

“Proposal”) addressing the tax effects of using DC plan assets to fund non-retiree health benefits.[42] The Proposal suggested to the plan sponsor and practitioner communities a possible shift in how the IRS would now rule on LTD 401(k) insurance offerings because the proposal came to a conclusion exactly opposite to that in the Rulings and would lead to very unfavorable tax outcomes.[43]

While the Proposal was directed at the funding of health benefits, language in the Preamble indicated that the IRS may be considering changing its position with respect to payment of “in plan” LTD benefits like LTD 401(k) insurance. The resulting regulatory uncertainty appears to be responsible for a decline in service provider and plan sponsor interest in developing and implementing LTD 401(k) insurance and similar arrangements. Mr. Greer testified that NTCA implemented its arrangement prior to the issuance of these proposed regulations and NTCA is concerned that the proposal calls into question the viability of this arrangement, which NTCA believes is a valuable benefit to its members. Mr. Mazawey testified that he believed that all interest in LTD 401(k) insurance arrangements, particularly with respect to providers, ceased upon the issuance of the proposed regulations. The American Benefits Council also encouraged regulatory clarity in this area.

2. **Differing workplace laws, regulations or plans and/or rules that define disability or disabled, are sometimes inconsistent and can create barriers to the ability of an individual to return to work. Acknowledging that the DOL lacks jurisdiction to address the issue through regulatory or sub-regulatory action, the Council encourages DOL outreach to other agencies regarding the subject.**

The Americans with Disabilities Act, along with state and local laws which mirror or expand the protections of the ADA, define the employment rights of disabled employees, with an emphasis on accommodating an employee’s disability to permit him to maintain his job or return to work after being away due to his disability. In contrast, Social Security defines disability for purposes of determining whether applicants qualify for benefits, with a very restrictive definition which provides that the applicant cannot perform his job. LTD plans use several different definitions of disability, some linked to the ability to do your occupation, some linked to the ability to do any occupation that you are suited for by education and experience, some linked to earnings, and some linked to doing any job with pay comparable to your prior job. The most common definitions of disability are as follows:

Source	Definition	Application and comments
Americans with Disability Act	The Americans with Disabilities Act (ADA) has a three-part definition of *disability*. Under ADA, an individual with a disability is a person who: (1) has a physical or mental impairment that substantially limits one or more major life activities; OR (2) has a record of such an impairment; OR (3) is regarded as having such an impairment. A *physical impairment* is defined by ADA as "any physiological disorder or condition, cosmetic disfigurement, or anatomical loss affecting one or more of the following body systems: neurological, musculoskeletal, special sense organs, respiratory (including speech organs), cardiovascular, reproductive, digestive, genitourinary, hemic and lymphatic, skin, and endocrine." The EEOC regulations outline diseases or conditions that are covered. However, it is not an exhaustive list, given the variety of possible impairments. ADA information from the Wisconsin Department of Health Services Website, Last Revised: July 12, 2010	Employment rights
Social Security	Total and permanent disability, expected to last for at least a period of one year or result in death	However, there are indications that claim administration is variable and that in practice, some situations are viewed more strict than others
Long Term Disability	Varies by insurance contract: common definitions include own occupation or any occupation, or a combination based on own occupation first—depends on coverage Some variations consider earnings Some policies also include partial disability coverage	Employer may be able to choose provisions and negotiate
Individual Disability Policies	Varies by insurance contract: can be own occupation or any occupation, or a combination based on own occupation first Some variations consider earnings Some policies also include partial disability coverage	
ERISA	IRC Section 415 contains very strict definition of disability	

Both Social Security and LTD plans state a broader objective of assisting individuals to return to work. In fact, under the Social Security structure and some LTD programs, claimants can work in some capacity (often limited hours, or in an unrelated occupation) while receiving disability income. Recognizing that historically, long term disability and Social Security benefits were fundamentally designed to provide income support to working-age people who are unable to work due to a disabling medical condition, the Council's research and some witness testimony demonstrate that the current legal framework addressing disability in the work place and the award of disability benefits conflict in ways that make an employee's effort to return to work with his employer difficult. This was recognized by the Supreme Court in *Cleveland Management v. Policy Management Systems*, 526 U.S. 795 (1999), where the Court specifically noted that asserting that one is totally unable to perform work for the purpose of securing disability benefits from Social Security makes asserting that one is disabled under the ADA and capable of working with an accommodation possibly conflicted, but can comfortably co-exist.

David Stapleton testimony addressed this issue when he testified that disability benefits are not limited to wage replacement, but include assisting workers to preserve their economic status through either work support or wage replacement. According to Mr. Stapleton, in 2012, the paradigm of what constitutes a significant disability has now changed in a manner that reflects broader social changes.[44] Accepting this proposition, as the numbers of disabled employees increase, the standards pursuant to which these definitions may coexist should be examined to address how an employee may return to work following, or during, the receipt of disability benefits.

The evolution of these conflicting views is reflected in several areas of social programs and the law. The Americans with Disabilities Act (ADA) sets forth rights of disabled individuals.. Social Security and private benefits provide for income supports to disabled persons. The conflicting definitions of disability under these segments have been recognized by others. The Social Security Advisory Board stated: *"A Disability System for the 21st Century* (September, 2006) was based on a three-year review of the nation's approach to disability, building on our 2003 report, *The Social Security Definition of Disability*. It reinforced our opinion that the Social Security definition of disability, based on the inability to work, was inconsistent with the goals of the *Americans with Disabilities Act."*[45] Stapleton's study also underscores that complicating the ability of disabled employees to return to work is the poor economy and lack of jobs. Consequently, disability insurance can become a form of unemployment insurance for those people who have medical impairments.[46]

Employees who are disabled under some definition, may still be able to work with support and accommodations. However, where the disability award is tied to the more stringent Social Security definition, an employer's legal obligation to comply with the ADA is not compelling, as the award of benefits is predicated on the notion that the individual is totally unable to perform any work. The reality is that there are a number of individuals who could perform work, as technology in the work place permits employers to accommodate more medical challenges employees face than possibly as recently as 5-10 years ago. Inasmuch as some disability insurance is designed to support return to work, and Social Security is supposed to support return to work, the Council encourages DOL to create a dialogue on the subject of the legal standards that may assist the return to work efforts, permit a phasing out of disability income and into wages for work, and protect those employees during these periods of transition.[47]

3. **The Council heard testimony stating that offsets to long -term disability benefits are many and varied. Employers voluntarily offer such benefits and can set the design of the plan or contract. However, plan designs, including offsets such as veteran's benefits, rollovers of pension money to IRAs, and cost of living indexes when basic benefits are not indexed, appear to be inconsistent with the purpose of offering disability coverage.**

The Council heard conflicting testimony regarding whether some types of offsets are common. For example, ACLI testified that it polled its members and found that it was not common industry practice to have an offset for veteran's benefits or for cost of living adjustments. ACLI testified that a typical long- term disability policy specifically excludes early retirement benefits that have not been voluntarily taken by the beneficiary, and amounts rolled over from a tax qualified plan to an IRA, unless they were subsequently received by the beneficiary while receiving benefit payments. With respect to SSDI dependent benefits, ACLI stated that it is not typical to have these benefits used as an offset among many plan designs of sponsoring employers.

Witnesses representing plan participants noted that they recognized the principles for including offsets in the insurance arrangement, in particular that people shouldn't be doubly compensated for the same injury, and that offsets are used primarily to keep down the cost of the disability premiums. However, they acknowledged that the types of income/benefits, against which disability benefits are reduced, have expanded beyond SSDI.

Ms. Rafik stated that benefits that are totally unrelated to the claimant's disability are being used to offset the disability benefit. She noted some examples, such as Social Security dependent benefits which are to be used strictly for the benefit of the claimant's dependents (and proof of such use must be submitted to the Social Security agency), but these payments are being used to offset the benefits payable under the employee's private LTD policy. Other examples include severance benefits, which constitute an award for years of service and thus have nothing to do with disability; recoveries claimants gain from third-party settlements for disabilities that result from medical malpractice or a not-at-fault car accident; and retirement benefits entirely unrelated to disability, including when amounts are rolled over from an employer-sponsored plan (DC plan) to an IRA.

Not all of these offsets are detailed in plan documents, and therefore often occur without warning to, or knowledge by the participant (and sometimes the employer). More importantly, as more non-disability related income is used as an offset, the benefit which the employee anticipated receiving becomes more illusory. Some witnesses consider the application of offsets of income that is unrelated to the disability suffered by the participant to be an adverse benefit determination for purposes of allowing the participant to file an appeal, similar to the case of decisions to discontinue treatment previously approved under the health care regulations.

While fully recognizing that DOL does not regulate plan design, the Council is concerned that there is confusion or lack of understanding by employers, particularly about the logic of using certain payments as offsets including veteran's benefits, pension plan rollovers and CPI increases when there is no COLA increase in LTD benefits, and how do such offsets affect the underlying cost of providing LTD coverage. The Council encourages DOL to consider communicating with the NAIC about these issues and to include NAIC in DOL's public outreach.

V. CONCLUSION

The Council learned that access to long- term disability benefits is important to today's workforce largely because (1) there is an increasing risk that a worker will suffer a disability during their work life, and (2) there are major gaps in coverage currently.

The Council learned that while many employers and employees are unaware of the availability of long-term disability coverage, those who are aware often do not make securing such coverage a high priority. Education about the need for and the usefulness of disability benefits is critical for both employees and employers. Further outreach to plan sponsors is also needed addressing key issues with regard to the design of disability benefit plans to replace income while minimizing the likelihood of derailing retirement income savings. The Council is concerned that during periods of disability, retirement savings are in jeopardy of significant loss, as employees discontinue further savings and can use their savings to fill the income gap left when the employee no longer has access to other income replacement.

Having identified regulatory barriers and uncertainties both within and outside of DOL's jurisdiction, the Council encourages DOL to explore how it may contribute to the promotion of plan designs that permit or encourage retirement savings in DC plans during disability periods. DOL can move on the issues both by direct regulatory or sub-regulatory action, and by making others aware of these issues and encouraging them to act.

The Council heard from a diverse set of witnesses on the subject of claims and appeals of disability benefits, who testified that in some cases there are very bad outcomes that are not justified in the situation. The Council recommends that as DOL embark on reviewing the existing regulations, that DOL consider the Council's findings on offsets, full and fair review and review of the treating physician rule. The Council encourages DOL to consider opening a dialogue with NAIC with regard to the issue of what can be included in a LTD plan as an acceptable offset.

Overall, the Council notes that the increased likelihood of a worker becoming disabled and the increasing reliance on disability benefits by participants and beneficiaries justify DOL contributing communications about such benefits that are designed to educate employers and employees about common definitions of disability under such plans, common benefit offsets, the typical requirements for coverage, as well as the enrollment, claims adjudication and appeal processes.

APPENDIX A: WITNESS SUMMARIES

David Stapleton
Director, Mathematica's Center for Studying Disability Policy
David Stapleton stated that the safety net for working-age people with disabilities is failing. He cited that the estimated mean income of households headed by working-age people with disability was 63% of that for working-age households in 1980, and had fallen to 52% by 2009. He linked this decline to the relative decline in employment of working-age people with disabilities. He testified about additional evidence on the failure of the safety net.

Mr. Stapleton noted that the safety net is failing taxpayers stating that federal government spent $375 billion to support working-age people with disabilities in fiscal year 2008 through a total of 63 federal or state programs. This, he noted, represented 12% of all federal outlays in that fiscal year, with about 47% being used for income support and an equal share being used for health - primarily for the federal share of Medicare and Veterans' health benefits. He testified that less than 2% of federal expenditures are to support and help the disable go back to work.

According to Mr. Stapleton's testimony, over the last three decades growth in the number of SSDI beneficiaries has far exceeded growth in the labor force. He noted that if the proportions of disability insured workers within age-sex groups receiving SSDI benefits in 2010 were the same as 1980, then the number of SSDI beneficiaries in 2010 would have been 2.2 million lower than the actual number -- a difference of about 28%, and a difference that represents about $50 billion in SSDI and Medicare expenditures. Mr. Stapleton pointed out that SSDI is now more than just a safety net for those unable to work because of a medically determinable condition, which was the original intent, but also serves as a special unemployment insurance program for people who work despite significant medical conditions. He stated that recent economic downturns and a slow recovery have impacted entry into SSDI. In 2010, the incidence rate was 6.3%, which is nearly 20% higher than the expected incidence rate of just 5.3% with potential acceleration of depletion of the SSDI Trust Fund.

Dr. Stapleton stated that it is now being recognized that disability reflects the interaction of a medical condition with other characteristics including the individual's environment - not the product of a medical condition alone, but that it is difficult to totally shed the medical model. He noted that private employers are adapting more quickly to the new disability paradigm, and private disability insurers have already figured out that helping workers achieve economic success through continuation of work is less expensive than paying long-term benefits. He stated that this expanding role for the private sector must be reflected in policy change to be successful.

He suggested that the Council should recognize that "disability benefits" no longer means just wage replacement. Instead, "disability benefits" means efficiently helping workers preserve their economic status through either work support or wage replacement. He also suggested that the Council could play a leading role in helping the public/private safety net adjust to the new disability paradigm including carefully consideration of key aspects of the changing role of private insurers and disability service providers through increased worker incentives, creating a employment supports, and wage replacement, the effect of layoffs on disability benefits and integrating private benefits with worker's compensation.

Richard Shea
Partner, Covington & Burling

In his testimony Mr. Shea gave an overview of his perspectives on the design of tax-qualified defined contribution (DC) plans in a manner that allows for the accumulation of retirement income during periods of disability (i.e., continued contributions and investment earnings) and some of the underlying legal issues.

He noted that Lou Mazawey, his co-panelist at the hearing, had been involved in this issue several years ago and was glad to see the Council's focus on this topic. He noted that defined benefit pension (DB) plans traditionally had disability retirement features that allowed for the accrual of retirement benefits during disability. However, as most employers have moved away from DB to DC plans, DC plan participants are generally not continuing to accrue benefits during periods of disability.

Mr. Shea pointed out that both ERISA and the Code provide for a "qualified disability benefit." He discussed two different options available under DC plans to promote the continued accumulation of retirement benefits during a period of disability. He spoke of the following options:

First, an employer can continue to make contributions to the plan on behalf of a disabled employee but noted the effectiveness of this approach was limited by Section 415 of the Internal Revenue Code, which generally prohibits making contributions on behalf of participants that do not earn any plan eligible compensation unless the person is disabled as defined under the social security provisions. In his view, this definition was too restrictive, as it requires total and permanent disability resulting in the inability to work in any occupation, which is not consistent with many disabilities experienced by employees and a different standard than most employers' long term disability policies contain.

Second, the plan can include a feature that allows participants to use some of their contributions to the plan to purchase insurance protection through a group policy issued by an insurance company and held by the plan. In the event of a disability, the insurer would make contributions to the plan in amounts that the participant was making prior to becoming disabled. Such features allow for flexibility in design. Mr. Shea pointed to an example of one of his clients that implemented such a feature to illustrate his point.

In response to testimony by Mr. Mazawey, Mr. Shea agreed that DOL should communicate with the Treasury Department about the need for clarification on some its proposed regulations and otherwise help promote the use of products promoting retirement savings during disability. He suggested that the use of auto enrollment should be addressed. He also agreed with a suggestion from a Council member that DOL should consider whether a long term disability ("LTD") plan that allowed for the payment of LTD benefits after retirement would be a welfare plan rather than a pension plan for ERISA purposes.

Lou Mazawey
Principal, Groom Law Group

Mr. Mazawey, who represents both employers and insurance companies with respect to the provision of disability retirement benefits through defined contribution (DC) programs, testified regarding his experience developing and implementing such programs for his clients. He echoed the concerns of his co-panelist, Richard Shea that participants in DC plans were not effectively able to accumulate adequate retirement savings during a period of extended disability.

Mr. Mazawey pointed to different approaches by providers to allow for the accumulation of retirement income under a DC plan during periods of disability. One such approach, he noted, was for the employer to provide a disability benefit via an insurance policy. Upon disability, a portion of the disability benefit would be contributed to a trust or some other account and held there until the participant's retirement. This approach was administratively difficult and posed some ERISA and tax issues.

Mr. Mazawey also advised an insurer and a consultant that established the product referenced by Mr. Shea. He noted that the insurer would pay contributions to the DC plan in the event of disability based upon contributions made in the prior year, to minimize adverse selection issues. He noted that because the contributions were funded through a group policy, the cost of the insurance was modest. Mr. Mazawey also pointed to one of his association clients that implemented a similar feature, but rather than using an insurance group LTD policy, the contributions during disability were funded by a VEBA.

Mr. Mazawey noted that his firm sought, and received, a Private Letter Ruling (PLR)on behalf of a client in which the IRS arrived at a favorable tax treatment related to the insured product discussed above. Mr. Mazawey noted, however, that subsequent to this ruling (and one other favorable PLR), the Treasury Department issued proposed regulations regarding the taxation of plan-funded retiree medical benefits that could be interpreted to reverse the Treasury's and IRS' thinking underlying its prior rulings in the disability context. In the view of Mr. Mazawey, these proposed regulations had a chilling effect on the development and implementation on these types of products and solutions. He believes there would be interest in these products within the employer and provider communities if the tax issues were resolved.

Mr. Mazawey recommended that DOL encourage the Treasury Department to clarify is tax position with respect to disability coverage under DC plans. In addition, DOL could (i) affirmatively state that its current regulations on the selection of annuity providers would apply in selecting insurers of disability income products and (ii) clarify whether this type of investment could be part of a default investment/auto enrollment program, which would, among other things, help minimize adverse selections. He also stated that there was a basis for DOL to conclude that a LTD plan could provide disability benefits after retirement without being a "pension benefit plan" for purposes of ERISA.

Stephen J. Mitchell
Unum Insurance

Mr. Mitchell's testimony provided insight into the marketplace and structure of disability benefits, the value of disability coverage and public knowledge about it. He summarized the business of Unum as follows: a Fortune 500 market leader in employer-sponsored disability, life, critical illness, and accident protection, providing workplace benefits to approximately 170,000 companies worldwide – from Fortune 500 companies to small businesses - covering nearly 25 million people and their families. Mr.Mitchell noted that disability protection is underappreciated and is not viewed as important, but pointed out the public grossly underestimates the chances of becoming disabled, and many people are very poorly prepared for an emergency. He stated that fewer than one-third of American workers have employer sponsored long term disability coverage.

He noted that about one-third of workers between the ages of 35 and 65 will experience a disability of least six month before they reach retirement age. He testified that once someone has been disabled for 90 days, he/she will remain disabled for an average of 2 years, noting that over 70% of households could not pay their normal living expenses if a wage earner was disabled and unable to work for six months. In his testimony, he stated that some of the consumer research indicated that people would be willing to pay $20-$30 a month for LTD if they were aware of the value of the coverage. The research, he noted, shows big gaps in knowledge about SSDI and private disability coverage.

Mr. Mitchell testified that the level of SSDI benefits is not enough for most people. He stated that under Unum coverage, the disability benefits are reduced (offset) by Social Security claims that are paid, and worker's compensation. He noted that the typical percentage of pre-disability income that is covered is 60% to 66% of the individual's pre-disabled income.

With respect to support for back to work, Mr Mitchell stated that Unum works with its clients to get people back to work and help them stay at work. He noted that it is very important to work with the disabled individual as quickly as possible to help them get back to work, or develop steps to make that happen. Unum has a number of programs to support getting people back to work, including assessing where claimants might be headed, identifying where intervention may be most effective, supporting the job search process, and working with employers on accommodations. He stated that the usual definition of disability in LTD is linked to a "your occupation" definition for 2 years and then after that time period an "any occupation" definition. He responded to questions and noted that while Unum has standard definitions, the company will work with a plan sponsor client to modify the definition as appropriate.

Mr. Mitchell noted that Unum highly values education. He suggested that DOL create an awareness campaign with consumers, employers, and others about the risks and consequences of disability including information on facts such as that nearly 70% of individuals do not have access to group LTD benefits, and could establish a clearinghouse for disability information. He recommended establishing a website parallel to the long term care website (longtermcare.gov.)

Cary Burnell
United Steel Workers Collective Bargaining

In his testimony, Mr. Cary Burnell indicated that defined benefit (DB) plans negotiated by USW typically have disability benefits incorporated in them. The structure of the long term disability benefit in USW DB plans differs from that of an insured LTD benefit. He noted that eligibility generally begins after the employee achieves 5, 10 or 15 years of service and that the amount of the benefit is not keyed to a percentage of earnings, but rather is usually a dollar amount times years of service. He pointed out that because the benefit is service based, it is higher for the longer service employees and lower for shorter service employees. He explained that the negotiated plans in some of the USW industries also contain a supplement of $400 per month, which does not increase or decrease with service and which is paid until the employee starts receiving social security disability benefits or reaches normal social security age. He stated that eligibility for the disability benefit under the plans is typically based on the person's inability to perform work in the plant or facility.

Mr. Burnell indicated that where disability benefits are incorporated in DB plans, there are no marketing costs, no retention costs and no profit component. He stated that because the long term disability benefit is an integral part of the pension plan, the disabled employee is treated as retired and service accrual ceases. He noted that this is distinguished from short term disability benefits which are sometimes included in the collective bargaining agreement but are provided outside the pension plan. He pointed out that under short term disability service accrual continues while this benefit is paid.

Mr. Burnell indicated that when, in collective bargaining, DB plans are replaced with defined contribution (DC) plans an attempt is made to negotiate a LTD plan to supplement the DC plan benefits. These plans cover all bargaining unit employees and are paid for by the employer. He noted that usually the bargained LTD benefits are obtained by the employer through insurance companies; generally provide income replacement at 50%, 60% or 66% of the disabled person compensation; generally have provisions that will offset benefits by amount paid under Social Security disability, and often workers compensation benefits.

In response to questioning, Mr. Burnell noted where disability benefits are negotiated with DC plans to ensure continued retirement savings during the years of disability, there is concern about the tax treatment, given the current Internal Revenue Service (IRS) proposed regulations that has cast a chilling effect on the incentive for employers to secure such insurance or other coverage through providers. He noted that clarification in this area is likely to encourage greater focus on products to facilitate continued LTD coverage under DC plans.

Mr. Burnell pointed out that ecently, in partnership with the Hartford, the USW Health and Welfare Fund began offering a long-term disability program for collectively bargained groups.

Donald Fuerst
Senior Fellow, American Academy of Actuaries

Mr. Fuerst's testimony reviewed the historical model of retirement security – consisting of a base level of retirement income from Social Security, a lifetime income from a defined benefit (DB) pension plan (often with accruals while disabled), and individual savings. He confirmed that the historical model worked well for those who actually experienced it, but that the "three legged stool" model was never universal and it is neither our current model nor our model of the future.

He noted that everyone is at risk of becoming disabled - between 15% and 30% depending on age and gender. He confirmed that 90% of long term disabilities were due to illness not injuries (2002 US disability study) and that a 90+ day disability was a greater risk than premature death.

Mr. Fuerst touched on the shift in retirement savings and pointed out that retirement plans are now predominantly defined contribution (DC) plans, a structure, he noted, that the employer generally has no role in assuring that the future retiree has lifetime income. He confirmed that disability significantly disrupts the DC model – a threat that workers cannot avoid, nor a challenge that can effectively be mitigated by typical DC strategies (save more, start earlier, etc.) He also noted that disability frequently compounds the challenge because workers often respond to the lack of income (or reduced income) and higher medical expense with specific actions – first, a worker often becomes a dependent who now needs care that will often impede other family members' ability to provide an income; second, because of the loss of income, workers often stop saving; and third, continued disability prompts many to access accumulated savings. He confirmed 25+% of disabilities starting at age 35 continue for 5+ years; 33% of disabilities starting at age 45, 50+% of disabilities starting at age 55.

Mr. Fuerst concluded that an extended period of disability can have long-lasting effects on retirement preparation, and that poverty rates more than double following disability. He noted that few workers have adequate savings available to support themselves during an extended disability. He pointed out that relatively inexpensive insurance is available through group coverage, but noted that less than a third of workers have LTD coverage. He stated that: (1) LTD insurance should be more widely available as a welfare or voluntary benefit, and (2) LTD should include replacement of retirement savings contributions. He futher confirmed that employees and employers must become aware of the risk that disability poses to both current income and retirement security. He noted he favored the use of tools such as automatic enrollment and defaults in 401(k) plans.

In response to numerous questions with respect to LTD, Mr. Fuerst confirmed that: (1) the costs are less than health, auto and homeowners, and are comparable to term life; (2) designs incorporate a Social Security (SSDI) offset to avoid windfalls by limiting the percent of pre-disability income replacement; (3) eliminating the offset would increase costs "probably significantly; (4) continuing medical coverage might be included to improve coverage value; (5) about 1/3 of large employers who sponsor a DB pension include disability accruals; (6) take-up rates may be low, even if DC plans had access to an add-on disability benefit; (7) the trend has moved directly away from programs that reduce costs by pooling risks.

Tony Cost
Vice President, Silgan Containers

Mr. Cost explained that Silgan, a multi-billion dollar consumer goods packaging company, has a wide variety of employee benefit plans covering its employees at its 27 unionized and 13 non-union facilities. He noted that these include defined benefit (DB) and defined contribution (DC) plans, as well as health and welfare plans. He noted that Silgan believes that a total benefits package is important in attracting and retaining quality talent, and that LTD coverage is certainly part of this program.

He noted that Silgan covers short term disability (up to 6 months) and offers employees the ability to purchase long term disability insurance at group rates through a national provider. He pointed to the fact that while the cost of the LTD coverage is entirely employee-paid, that 75% of eligible employees had purchased this benefit. He explained that the high take-up rate on this employee-paid benefit is a result of Silgan's active participation in educating their employees. He shared that new hires have the LTD plan explained to them and many sign up at that time. Also, he noted that Silgan employees also receive regular mailers which cover the LTD plan; there are regular meetings, and a robust website that mention the program. Finally, he noted that as part of the DC plan counselors are made available and will focus employees on the value of LTD plans.

Mr.Cost testified that under their structure LTD coverage ceases at age 65; that Silgan continues health care coverage while the employee is on disability; and that with respect to the preexisting exclusion issue, it is waived for employees at the time of initial employment and at any time ther is a change in the carrier.

As part of its 401(k) plan, Silgan offers an annuity type product. It is a fund that employees can put their 401(k) monies in. When they are 55 or beyond, they can trigger an annuity payout. The annuity option is not the default. Currently the 401(k) default option is the life cycle option.

When asked what further could be done to encourage employees who were offered LTD coverage to take it, Cost indicated that currently counselors had to be careful how far they went in pointing out LTD as an option to be considered because of the current rules and regulations governing education advise versus investment advice. He noted it would be nice if the counselors could offer a little advice, and noted this may be an area where DOL could provide more structure and clarification to motivate greater growth in LTD coverage.

Joe Canary
Director of the Office of Regulations and Interpretations, Employee Benefits Security Administration, United States Department of Labor

Mr. Canary's remarks to the Council were primarily to provide background information regarding the application of the claims and appeals regulations promulgated under ERISA for disability claims. He noted that the regulations published in 2000 provided, among other things, a new timeframe and enhanced requirements for notices and disclosures with respect to claims decisions at both the initial claim decision stage and on review.

Mr. Canary noted that with the passage of more than ten years since the regulation was issued DOL was interested in evaluating the past ten years to determine whether there are ways in which the claims procedure could be improved to make it even more effective. He noted some of the issues DOL hoped to learn from the Council's inquiries on the claim procedure requirements applicable to disability benefits and indicated a number of areas in which he expected focus in regulation reformation. He noted that the regulation's written notice requirement is problematic, according to some claimants, but it was unclear whether the problem is the content of the regulation or compliance with the regulation. He noted some claimants have complained about not receiving adequate explanations for benefit determinations of denial.

In his testimony, Mr. Canary noted that there may be potential conflicts of interest in making benefits determinations. He added that DOL was interested in determining whether the issue is better addressed through regulation or in the courts. He noted that there have been issues about exhaustion impeding participants and beneficiaries access to courts, or in bringing their action to the court and having them return to the claims process for an exhaustion of the administrative process. He noted that DOL had become aware of issues regarding retroactive rescission of coverage and is interested in hearing whether such circumstances should be covered under the claims procedure regulation. In addition, he stated that DOL has heard of claims adjudication processes in which a plan may first deny a claim on the basis of one conclusion, and then as a result of information that may be submitted by the claimant, in the decision on appeal rely upon a different or additional basis for denying the claim. Thus, he noted, the issue arising in these circumstances is whether there was an adequate opportunity for the claimant to address the additional issues as part of the claims process and to develop an adequate record for that additional issue if and when the issue is presented to a court.

Mr. Canary noted that there appeared to be questions regarding how eligibility determinations fit into the claims regulations. Noting that the regulations and other guidance have been read to say that determinations that are pure eligibility determinations are not claims for benefits under the regulation, but noted there remains the question of whether a mixed eligibility and benefit denial would be subject to the claims procedure regulation, and to what extent. He noted that the issue may require additional clarification. He also noted that there is interest in hearing the Council's findings and insights about the use of offsets to disability benefits; whether disability definitions are clear and understandable in the SPD; whether a participant considering electing such benefits is entitled to the SPD at the time such an election is being made; and when exhaustion of the claims procedures should apply.

Steven Clayburn
Senior Director & Actuary, American Council of Life Insurers

In his testimony, Mr. Clayburn noted that he provided to the Council several papers on varying aspects of long term disability (”LTD”) insurance programs in the marketplace that included information on subjects such as (i) the definition of disability, (ii) the use of offsets, (iii) an overview of the LTD product, and (iv) an overview of the applicable legal landscape. He focused his testimony on two specific questions directed to him at the hearings in June that included (i) the definition of disability and (ii) the use of Social Security offsets. Mr. Clayburn also answered several questions from various Council members.

Mr. Clayburn noted that a majority of LTD programs provide for one or two common definitions of disability. The first definition provides that a disability occurs upon the incurrence of a condition that prevented the employee from performing the major duties of his or her “own occupation.” The second definition provides for a disability if the employee was unable to perform the duties of “any occupation” for which he or she was reasonably qualified based upon education, training and experience. He stated that about 69% of employers with insured LTD programs use a combination of these two definitions thereby making the program more affordable.

With respect to Social Security Disability Insurance (“SSDI”) offsets, Mr. Clayburn stated that such offsets were common in insured LTD programs for the purposes of (i) creating a return to work incentive (e.g., preventing the combination of LTD benefits and SSDI from replacing too much or exceeding the employee’s wages while employed) and (ii) making the benefits affordable. He noted that the offset procedures were typically outlined in the policy, the summary plan description, and other written communications with the claimant.

He testfied that typical industry practice was to not require claimants to apply for SSDI unless the insurer reasonably believed such claim would be successful. Furthermore, insurers do not typically apply estimated offsets because the policies allow the employee to opt out of the application of a SSDI offset and many claimants often opt out. He noted that LTD policies typically provide for a mechanism whereby the insured will be reimbursed for any underpayments of their disability income in the event SSDI is denied (or the payments are lower than originally estimated) or the payments will be reduced in the event the estimated SSDI offset was lower than the actual SSDI award.

Mr. Clayburn noted that was not aware of situations in which LTD benefits were offset by Veterans benefits or cost of living increases in SSDI benefits. Also, he noted that offsets by rollovers from retirement programs to IRAs were not common. He was aware of LTD policies under which dependent benefits paid by Social Security were offset against the LTD benefits paid under the policy. He believed the premise of this latter offset was that such payments were in lieu of income that would have been earned by the claimant. He stated he was not aware that payments for dependents under SSI were restricted to be spent solely on the dependent and required verification of compliance to the Social Security Administration.

Diann Howland
Vice-President for Legislative Affairs, American Benefits Council ("ABC")

Ms. Howland's testimony focused on the importance of long term disability ("LTD") benefits to the employees of its members, which primarily are large employers. She also pointed to concerns ABC had with a legislative proposal in Congress, which provides for mandatory credit insurance in defined contribution plans and is designed to prevent defaults of plan loans in the event of a participant's death or disability.

Ms. Howland reiterated what several witnesses before the Council stated regarding the value of long term disability benefits. She stated that the Department of Labor ("DOL") should engage in outreach and education efforts designed to encourage employees to take advantage of these benefits, noting that many of ABC's member companies offer such programs. She noted that in her work she has noticed a significant under-appreciation of the value of LTD benefits within the employee population. She stated that LTD programs offered through private employers also reduce the burden on Social Security Disability Insurance and other public assistance programs. Finally, she encouraged DOL to work with the Internal Revenue Service to clarify its position on the tax treatment of long term disability benefits offered through defined contribution (DC) plans to assure accumulation of retirement benefits during periods of disability, and that are funded through LTD insurance contracts or VEBAs.

Ms. Howland also discussed ABC's concern with a legislative proposal in Congress and noted that was gaining some support. She stated the bill provides that DC plans that include a loan feature would be required to offer credit insurance. Such credit insurance would be used to prevent loan defaults (and the subsequent deemed distributions) in the event of the participant's death or disability. Participants who took a loan would be automatically enrolled in the insurance program unless they affirmatively opted out. Ms. Howland noted that ABC was concerned about this proposal because (1) the costs associated with such a program were not clear; (2) people could be misled about the nature of the coverage disability coverage, and (3) because of the mandatory nature of the program, especially in light of the fact that offering DC plan benefits is optional for employers. Furthermore, with respect to participant's confusion over the nature of the coverage, Ms. Howland stated that ABC believed such a program would frustrate the efforts of the Council to encourage increased participation in traditional LTD plans because plan participants would think this credit insurance afforded income protection benefits, while in reality it only preserves the extent of the existing account balance if there is a plan loan outstanding in the case of disability or death of the participant.

During the question and discussion period Ms. Howland offered to go back to ABC's members and get information comparable to that provided by the American Council of Life Insurers regarding insured LTD programs (e.g., definition of disability, use of offsets, etc.) to the extent ABC members offered LTD benefits through self-insured plans.

Leslie Greer
National Telecommunications Cooperative Association

Mr. Greer testified that NTCA is a trade association serving over 570 small and rural telephone companies. He noted that as part of its services, it offers a selection of employee benefit plans to its member companies, including health, dental, life and disability benefits through a VEBA. He stated that 387 of the companies participate in the self-funded disability plan, and that 77% of them provide disability waiver of benefits that continue contributions to retirement plans.

Generally, he testified that employees are initially considered disabled if they cannot work at their present job, however this standard changes after a two-year period when disability is defined as the inability to perform any occupation for which the employee is or becomes qualified. He noted that the plan pays the disabled person 70% of pre-disability income with offsets for SSDI, workers' compensation and retirement plan income.

He testified that in an effort to get employees back to work, a service provider evaluates every disabled individual who has not qualified for Social Security Disability, focusing on their physical and vocational needs to return them to previous employment or, if that is not an option, giving them other vocational or educational opportunities. He noted that a disabled person who refuses to participate in these programs has benefits reduced by 50%, and benefits are terminated after one year. He stated that under NTCA's program disability income payments are discontinued at age 65.

Mr. Greer stated that with regard to the SSDI offset, the plan does not hold any income back in anticipation of an award; rather, it trues up payments after the award.

During the question and discussion period, Mr. Greer indicated that the preexisting condition exclusion is not a significant issue because it does not apply once an individual has been covered by the plan for 18 months, and most of the employees of the member companies are long-service employees. He added that the preexisting condition language is being looked at now in light of the preexisting condition provisions in the new health care law. He further pointed out that with respect to health care benefits, that NTCA continues health care coverage during disability.

In answer to a general question about how LTD coverage could become more widespread, Mr. Greer opined that there needs to be an encouragement of education between employers and employees on the value of disability income protection. He stated that auto enrollment would be a useful tool in this regard, but encouraged that it should be at the option for each company.

Warren von Schleicher
Smith/von Schleicher & Associates

Warren von Schleicher, a partner at Smith von Schleicher & Associates, stated in his testimony that employers should be encouraged to provide long term disability plans, noting that only 30% of employers provide long term disability plans to their employees. He noted that with limited plan sponsor budgets, the challenge is to make these plans viable benefit options for the remaining 70% of employers who do not offer disability benefit plans. He noted that there is a disparity between the perception of possible disability risk and the occurrence of the actual risk. He pointed out that the educational challenge for employers and employees is to make them aware that the actual risk is greater than the perceived risk. When compared to other insurable risks, he noted that the risk of a disability is not immediately calculable; whereas a benefit such as dental or vision is immediately calculable.

Mr. von Schleicher testified that most disability plans are provided by employers on an insured basis, since employers lack the infrastructure and expertise to self-fund and administer their plans.

He stated that from his experience, the number of disability claims that are ultimately approved is between 80-85% and can be as high as 90%. He further stated that of the claims that are not approved, only a small number are litigated. He acknowledged that disability claims are subject to the DOL claims regulation and a "full and fair review" must be provided to the participant. Further, he acknowledged that if the decision relating to the disability appeal relates to a medical issue, then the plan fiduciary considering the appeal must consult with a health care professional with appropriate training and experience.

Mr. von Schleicher highlighted the issue of whether participants who are appealing the denial of disability benefits should receive pre-decision access to documents generated during the appeal and be provided the opportunity to rebut the evidence. He noted that in his view, if this rule was adopted, it would be unworkable and create a circular process in which a participant's rebuttal evidence would require further review and would generate additional pre-decision documents which would then require another opportunity for rebuttal. Such a process, he said, would lead to a never-ending cycle of rebuttals, which would unnecessarily prolong the administrative process and make it exceedingly difficult to satisfy the 45-day regulatory review period for a disability appeal. Mr. von Schleicher stated that a better approach is to allow the disability claims administrators the flexibility to adapt to the unique circumstances of each claim.

He noted that many, but not all, disability benefit plans are integrated with SSDI. He stressed that without such integration, premiums for insurer funded disability benefit plans would increase by approximately 30%-50%. He pointed out that in addition to the monetary benefits, LTD plans also provide an array of non-monetary benefits, including coverage for reasonable accommodation expenses, retraining, counseling and rehabilitation services.

Mark DeBofsky
Daley, DeBofsky & Bryant

In testimony, Mr. DeBofsky noted that "the lot of employees has not improved under ERISA but, rather, had been made worse since the enactment of ERISA in 1974. He noted that prior to ERISA, and even a number of years after, claimants whose employer-sponsored disability claims were denied would take their cases to court in the same manner as a homeowner's claim, an auto theft claim, or a commercial insurance claim and have the opportunity to utilize the full civil process of the courts. He stated that ERISA claimants are denied that opportunity and it has not resulted well for them. He noted that there is still a dire need for the Congressional purpose of ERISA to be met, i.e., the true protection of employee benefits and rights to those benefits.

Mr. DeBofsky made the following recommendations:

Adjust the existing regulations to provide participants a final opportunity to challenge evidence used in denying a claim. A full and fair review[48] should include knowing what evidence the decision-maker relied upon, the opportunity to address the accuracy and reliability of that evidence, and ensuring the decision-maker considers evidence from both parties prior to rendering a decision[49]. Any other standard, he noted, would deny the claimant the opportunity to cross-examine authors of adverse reports.

Amend the regulations to include a treating physician rule. Under this rule, Mr. DeBofsky noted, deference would be given to the treating physician's opinion if a specialist, after performing a clinical examination, and reaches a decision consistent with all the evidence as a whole. Mr. DeBofsky noted that the Supreme Court confirmed that it would give appropriate deference to any DOL decision to adopt such a rule. He pointed out that the number of "so-called independent medical examinations" significantly decreased after that Court decision.

Replace the standard of review with a de novo standard. He stated that a deferential standard of review places an excessive burden on the claimant, who must prove not only that the decision-maker made a mistake, but that the decision itself was unreasonable, and must do this without any access to a right to cross-examination, to call or subpoena witnesses, and where insurance company decision-makers may not be neutral, objective fact finders.

Amend the regulations to toll all limitation periods during the claims appeal process noting that claimants sometimes face confusing and inconsistent limitation periods within which to bring suit.

In addition, Mr. DeBofsky stated: (1) that awarding damages must be made available as a deterrent for insurance company bad faith behaviors, noting that merely awarding attorney fees is not likely to have that much impact on a claims decision; (2) offsetting dependent SSI benefits may be inconsistent with claiming a tax exemption and offsetting with Veterans disability benefits could be improper when made to compensate for combat related illness.

Mala Rafik
Rosenfeld, Rafik & Sullivan, P.C.

Ms. Rafik testified that: "… I have witnessed the transformation of a law that Congress enacted to protect employees into a shield to protect insurance companies who fail to provide the fair and principled reviews required of them by statute and regulation. Without having to face the likelihood of a trial by jury or the possibility of damages, insurance companies are free to deny claims with impunity." She noted that some individuals would be willing to pay more for benefits if it would mean greater protection of their rights to the benefits.

Ms. Rafik proposed that the claims regulations be changed to enable ERISA claimants adequate guidance so that they can maximize the opportunity to perfect an appeal. She also proposed that the regulations be adjusted to give the claimant the opportunity to rebut any new medical and vocational information that is developed and used in an appeal. She noted there is a gap within the existing regulations because they require only that all information used to deny a claim prior to filing an appeal be disclosed but do not cover any new information that is used during the appeals process.

Ms. Rafik made the following two recommendations:

Modify the regulation to remove maximum duration limits on benefits to those who suffer from mental illness or self-reported conditions, and preclude the application of such limits against those who suffer from both physical and mental/self-reported conditions.[50] She stated that this would create disability benefits "parity" - regardless of diagnosis. She noted that the legislative change was necessary to enable such duration limits to withstand challenges under ERISA and the Americans with Disabilities Act.

Modify the regulation to eliminate various offsets, or in the alternative, require that a disability policy without such offsets be made available. She specifically targeted offsets of pension, 401(k), severance payments, SSDI benefits for dependents, and third party recoveries.

Also, Ms. Rafik noted that generally, employment for the individual generally ends once FMLA protections have been exhausted even in cases where disability has been approved. She pointed out that this often triggers a loss of other employee benefits, including much needed health insurance coverage. She agreed with Mr. DeBofsky that claims for damages should be permitted, noting that remedies such as consequential damages (for lost wages or pain and suffering) or punitive damages (to punish outrageous conduct) that are traditionally available to consumers are not available to participants in ERISA plans. In addition, she supported the requested modification that would toll the limitation period within which the individual can bring suit, until completion of the appeals process. She stated this was necessary to eliminate inconsistencies that exist in the courts as to when ERISA benefits claims accrue. Ms. Rafik noted that workers should not have to choose between disability benefits and employment, and that disabled individuals should be permitted to return to work on a part-time basis to test the waters without being in danger of losing their disability benefits.

[1] For purposes of this report the phrase “work life” refers to the period following secondary education, during which one is engaged in gainful employment and prior to reaching normal retirement age.
[2] American Academy of Actuaries Statement, p. 2.
[3] Social Security Administration Basic Facts, April 4, 2012, http://www.ssa.gov/pressoffice/basicfact.htm. Statement of Stephen J. Mitchell, Senior Vice President, Unum, p. 1.
[4] CDA Whitepaper, “Worker Disability: A Growing Risk to Retirement Security, www.disabilitycanhappen.org.
[5] Society of Actuaries, (1987) Commissioners Group Disability Table; Consumer Federation of America and Unum statement, p. 2.
[6] David Stapleton, Mathematica Policy Research, Inc., transcript p. 15.
[7] Council for Disability Awareness Long-Term Disability Claims review, http://disabilitycanhappen.org/research/CDA_LTD_Claims_Survey_2011.asp. Mitchell statement p. 2.
[8] David Stapleton, Mathematica Policy Research, Inc., transcript p. 11
[9] Stapleton, tr. p. 11-12.
[10] Skwire and Beal, “The Impact of Disability”, Milliman, 2009, www.lifehappens.org
[11] Stapleton, transcript p. 12. Stapleton Statement, p. 1-2., citing Livermore, [etc.]
[12] Reno and Walker, “Social Security Benefits, Finances and Policy Options – a Primer” National Academy of Social Insurance, www.nasi.org.
[13] Council for Disability Awareness, 2011 Long-Term Disability Claims Review, www.disabilitycanhappen.org; Millman (May 2009). Group long-term disability offset study sponsored by the Society of Actuaries, www.soa.org/research.
[14] Statement of Warren von Schleicher, p. 3.
[15] BLS National Compensation Survey, March 2011 Table 17, www.bls.gov/ncs/ebs/benefits/2011/ownership/private/table12a.htm
[16] This is typically known as “own occupation”.
[17] This is typically known as “any occupation”.
[18] Most insurers may require the insured to be examined by a physician, other medical practitioner and/ or vocational expert of their choice, and determine the frequency as they deem reasonable.
[19] **Key Terms**

Residual- With a Residual definition, total disability during the elimination period is *not* required. The insureds can continue working at some capacity throughout the period of disability and still be eligible for a benefit.
Limited- means what the insured cannot do or is unable to do.

Material and substantial duties- are duties that are normally required for the performance of an employee’s regular occupation and which cannot be reasonably omitted or modified

Regular occupation- means the occupation the insured is routinely performing when the disability begins. Occupation refers to the insured's trade, profession or business as it is normally performed in the national economy - not how the work tasks are performed for a specific employer or at a specific location.

Sickness- means an illness or disease. Disability must begin while the individual is insured under the plan.

Injury- means a bodily injury that is the direct result of an accident and not related to any other cause. Disability must begin while the insured is covered under the plan.

Gainful Occupation -after a person has been disabled for a period of time, many definitions of disability will change to also consider what *other* occupations an individual might be capable of performing. We use the term "gainful occupation" to help define this intent. To be considered "gainful" another occupation must be reasonable for the individual based on his/her education, training and experience. As shown here, the definition of "gainful" also takes into account what the individual might be expected to earn in the other occupation compared to their regular occupation. Notice that the "gainful occupation" test differs depending on whether or not the person is working (to encourage return to work). Gainful occupation means an occupation that is or can be expected to provide insured’s with an income within 12 months of their return to work that exceeds:

80% of their indexed monthly earnings *(if working)*; or 60percent of their indexed monthly earnings *(if not working)*.

Pre-disability earnings- "Monthly Earnings" means your gross monthly income from your employer in effect just prior to your date of disability. It includes your total income before taxes. It is prior to any deductions made for pre-tax contributions to a qualified deferred compensation plan, Section 125 plan or flexible spending account. It includes income actually received from commissions and bonuses but does not include renewal commissions, overtime pay or any other extra compensation or income received from sources other than your employer.

Bonuses will be averaged for the lesser of:

a. the prior calendar year's 12 month period of your employment with your employer just prior to the date disability begins; or

b. the period of actual employment with your employer.

Commissions will be averaged for the lesser of:

a. the 12 full calendar month period of your employment with your employer just prior to the date disability begins; or

b. the period of actual employment with your employer.

[20] The loss of a professional or occupational license or certification does not, in itself, constitute disability.

[21] Table adapted from Benefits Magazine article, November 2011 by Anna Rappaport. Table has been expanded.

[22] There are several different ways that disability coverage can be secured by workers. The Chart included in the background section, "*Sources of LTD Coverage and Methods of Computing Benefits"* offers a general comparison the basic types of LTD including Social Security disability coverage, employer- sponsored long-term disability, disability benefits offered within DB plans, and individual coverage. As employers focus on employer- sponsored coverage, they have a variety of decisions to make with regard to what type of coverage to offer their employees. Generally, there is a link between the amount of coverage and costs – the more coverage the higher the cost. Employers who want to offer the benefit at reduced cost can consider a type of plan under the following options: (1) require employees to pay a part of the cost, (2) reduce the employer- paid benefit with lower coverage, (3) use a more restrictive definition of disability, (4) include more offsets, or (5) reduce the benefit period. It is the goal of the Council that the educational material will assist the employer in understanding the generic types of LTD options available to them, and the decisions they can make in deciding to offer disability coverage to their employees.

[23] Milliman, "Impact of Disability Insurance Policy Mandates proposed by the California Department of Insurance, Nov. 14, 2005. "In general, benefit offsets from sources other than Social Security come from Worker's Compensation awards and, to a lesser extent, retirement income plans. Whereas Social Security offsets reduce the cost of insurance by 40% to 45%, these other types of benefit offsets reduce the cost by 4% to 5%. If offsets from permanent Worker's Compensation awards and retirement income plans are prohibited, we estimate that the cost of insurance will increase between 2% and 3%."

[24] DOL Advisory Opinion 2008-02A, February 8, 2008, confirmed that Employee Retirement Income Security Act of 1974 Section 415 (ERISA § 514) preempts a Kentucky state wage withholding law (section 337.060(1) of the Kentucky Revised Statutes (KRS)) so that the statute's requirement to obtain written consent is preempted with respect to withholding amounts from an employee's wages for contributions to an ERISA-covered group health or other welfare benefit plan where such contributions are made pursuant to a plan subject to Internal Revenue Code Section 125 (IRC § 125). The plan in question defaults employees to medical coverage and confirms the default election to the participant in a written, mailed statement where such elections and default coverage assignments are generally binding until the next annual enrollment period.   The Advisory Opinion confirmed that: "It is well settled that when Congress enacted section 514(a) of ERISA it intended, among other things: 'to ensure that plans and plan sponsors would be subject to a uniform body of benefits law; the goal was to minimize the administrative and financial burden of complying with conflicting directives among States or between States and the Federal Government . . ., [and to prevent] the potential for conflict in substantive law . . . requiring the tailoring of plans and employer conduct to the peculiarities of the law of each jurisdiction.' Citing New York State Conference of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645, 656-57 (1995) (quoting Ingersoll-Rand Co. v. McClendon, 498 U.S. 133, 142 (1990)). The department concluded that "the Kentucky state law at issue here has a prohibited connection with ERISA plans because it prohibits automatic enrollment arrangements." DOL Advisory Opinion 94-27A confirmed that a written consent requirement in a New York wage withholding law was preempted

to the extent it prohibited employers from allowing their employees to implement or change salary reduction contributions to ERISA-covered plans via telephone or voice response system. We concluded that New York Labor Law Section 193, by requiring written authorization for employee wage deductions of contributions or payments for "insurance premiums, pension or health and welfare benefits," and "similar payments for the benefit of the employee," clearly "relates to" benefits provided under employee benefit plans in that it is specifically designed to affect employee benefit plans and seeks to restrict the choices of such plans with regard to the administration of their funding policies. The Department opined that, to the extent that Section 193 is interpreted to limit, prohibit, or regulate the funding of employee benefit plans covered by Title I of ERISA, including wage deductions to employee benefit plans covered by Title I, it is preempted by section 514(a) of ERISA. Rev. Rul. 2002-27, 2002-1 CB 925, May 17, 2002, modified by Rev. Proc. 2002-73, 2002-2 CB 932 confirmed that cafeteria plans may use an automatic enrollment process whereby the employee's salary is reduced each year to pay for a portion of the group health coverage under the plan unless the employee affirmatively elects cash. In addition, employers may treat all participants as being in the cafeteria plan for section 415 purposes even though the plan mandates salary reduction and coverage for uninsured participants. In this situation, the Plan provides for an automatic enrollment process so that each new employee, and each current employee for the first plan year the automatic enrollment process is effective is automatically enrolled in employee-only indemnity coverage, with the employee's salary reduced pretax to pay for a portion of the cost of the coverage, unless the employee affirmatively elects cash. Alternatively, if the employee has a spouse or child, he or she can elect family coverage. The employee receives a notice explaining the automatic enrollment process and the employee's right to decline coverage and have no salary reduction. The notice includes the salary reduction amounts for employee-only coverage and family coverage, procedures for exercising the right to decline coverage, information on the time by which an election must be made, and the period for which an election will be effective. The notice is also given to each current employee before the beginning of each subsequent plan year, except that the notice for a current employee includes a description of the employee's existing coverage, if any. This ruling confirmed that contributions used to purchase group health coverage under § 125 are not included in the gross income of the employee solely because the plan uses an automatic enrollment process whereby the employee's salary is reduced each year to pay for a portion of the group health coverage under the plan unless the employee affirmatively elects cash.

[25] Proposed Treasury Regulations 1.1215-2, confirms that a cafeteria plan must require employees to elect annually between taxable benefits and qualified benefits. Elections must be made before the earlier of the first day of the period of coverage or when benefits are first currently available. The determination of whether a taxable benefit is currently available does not depend on whether it has been constructively received by the employee for purposes of section 451. Annual elections generally must be irrevocable and may not be changed during the plan year. However, §1.125-4 permits a cafeteria plan to provide for changes in elections based on certain changes in status. An employer that wishes to permit such changes in elections must incorporate the rules in §1.125-4 in its written cafeteria plan.

[26] Pension Protection Act of 2006, Pub. L. 109-280, encouraged the addition of automatic enrollment features in IRC § 401(k) plans by confirming existing automatic features were generally permitted and creating a process for adding those features to other plans (disclosure, communications, default investments, etc.) PPA 2006 provided fiduciary relief by amending ERISA § 404(c) to specify that automatic enrollees will be treated as exercising control over their investments if the default investment election is consistent with Department of Labor (DOL) regulations. In addition to regulations from both the DOL and the Internal Revenue Service (IRC), such designs have been further encouraged by the specific publications such as the brochure: *Automatic Enrollment 401(k) Plans for Small Businesses*, a joint project of the U.S. Department of Labor's Employee Benefits Security Administration (EBSA) and the Internal Revenue Service (IRS), available at www.dol.gov/ebsa. This brochure specifically endorses automatic enrollment features in profit sharing plans qualified under IRC § 401(k) by confirming that such a plan "provides a high level of participation". The brochure notes that: "Approximately 30 percent of eligible workers do not participate in their employer's 401(k) plan. Studies suggest that automatic enrollment plans could reduce this rate to less than 15 percent, significantly increasing retirement savings. Whether you already have a 401(k) plan or are considering starting one, automatic enrollment 401(k) plans offer many advantages. … Helps attract and keep talented employees … Increases plan participation among both rank-and-file employees and owners/ managers". See also the nondiscrimination safe harbor for automatic contribution arrangements under IRC § 401(k)(13).

[27] Patient Protection and Affordable Care Act of 2010, Pub. L. 111-148, Section 1511 (PPACA § 1511) added Fair Labor Standards Act of 1938 Section 18A (FLSA § 18A) that mandated automatic enrollment in group health plans for employees of large employers. Forthcoming regulations will identify the process employers of more than 200

full time employees will use to automatically enroll new employees and to continue enrollment of current employees in employer-sponsored health coverage. Such enrollment processes will include requirements to provide adequate notice and the opportunity for an employee to opt out of any coverage where enrollment was automatic. The new provisions specifically do not supersede any State law which establishes, implements, or continues in effect any standard or requirement relating to employers in connection with payroll except to the extent that such standard or requirement prevents an employer from instituting the automatic enrollment.

[28] ERISA § 3(2).
[29] ERISA § 3(1).
[30] ERISA § 201(a) (welfare plans excluded from participation and vesting requirements); ERISA § 301(a) (welfare plans excluded from funding requirements).
[31] The Council did not receive testimony on whether such plans may violate the Age Discrimination in Employment Act ("ADEA"), but recognize that such an evaluation may be necessary.
[32] Both ERISA and the Code allow for a "qualified disability benefit" in both defined contribution and defined benefit plans. A "qualified disability benefit" is defined as a benefit at normal retirement age that equals the benefit the plan participant would have earned had he or she not become disabled. *See* I.R.C. § 411(a)(9); ERISA § 3(22).
[33] The following explains some of the fundamental differences on how DB and DC plans work and how that impacts disability retirement benefits.

Defined Benefit Plans

In a defined benefit pension ("DB") plan, the plan provides for a benefit payable to a participant at normal retirement age with some plans offering early retirement benefits that are reduced from the amount paid at normal retirement. The employer sponsor (not the plan participants and their beneficiaries) bears the risk of investment loss and thus whether sufficient assets are held by the plan to pay the promised benefits. Disability retirement benefits may be offered through the defined benefit plan in a number of ways. The following are some examples.

> Continued Benefit Accruals During Periods of Disability: The plan may provide that participants will continue to accrue a benefit while disabled. For example, the plan may continue counting accrual service during the disability period. In so doing, the plan assumes that the participant will earn compensation during the disability period at the same rate he or she was compensated immediately before the disability occurs.[33]
>
> Disability Retirement Pension Benefits: The plan may provide that a participant will receive his or her accrued pension benefit under the plan upon becoming disabled prior to normal retirement age. In many cases, the benefit is subsidized by the employer. This means that the participant may receive the same benefit (or a significant portion of the benefit) he or she would have received at normal retirement age (e.g., 65) notwithstanding the need to retire prior to normal retirement age by reason of disability. The disability retirement pension is paid until the participant dies with a death benefit payable to his or her spouse.[33]
>
> Supplemental Payments during Disability: The plan may provide for a supplemental retirement benefit as a set dollar amount per month (such as $100) for the disability period until normal retirement age or, if earlier, upon the participant's becoming eligible for SSDI. This supplemental payment is paid in addition to the early retirement benefit as described in the immediately preceding bullet point and bridges the gap between becoming unable to work by reason of a disability and becoming eligible for SSDI.

Effectively, in all of the above examples, the disability retirement benefit is built into the plan's benefit formula and allows the participant to keep accruing a benefit or to receive benefits during the disability period as well as have the opportunity to receive benefits during the normal retirement benefit (generally, upon reaching age 65). The employer bears the risk of paying this benefit and the funding of such benefits is factored into the plan's actuarially-determined annual funding requirements.

Defined Contribution Plans

In a defined contribution ("DC") plan, the employer and/or the participant make contributions to an individual account within the plan on behalf of participant. The participant bears the risk of investment loss. Contributions are typically based upon compensation (e.g., a percentage of a participant's compensation), though other allocation methods may be applied (e.g., flat dollar). The total retirement benefit available to the participant at retirement (or some other permitted distribution event) is based upon his or her account balance, which consists of employer and participant contributions and any investment gains realized on those contributions. Any period of time during which a participant cannot continue the accumulation of contributions in his or her account balance could have a significant impact on the participant's ability to have adequate savings at retirement. According to a *Wall Street Journal* article cited in testimony by Messrs. Mazawey and Shea, an employee who is disabled from ages 50 to 55 will lose five years of retirement savings that he will not be able to recover over his remaining working career.[33] Furthermore, unlike in a defined benefit plan in which disability benefits are in most cases paid as part of a stream of retirement benefit payments (e.g., an annuity), most defined contribution plan benefits are paid in the form of a single lump sum payment. Thus, even if the defined contribution plan provides for payment of benefits upon disability, many participants receive the lump sum, at which point they can spend that money to meet current expenses, thus making those funds no longer available for their retirement years.

[34] The plan terms may allow a participant to make contributions during a disability period to the extent permitted under Section 415(c) of the Code. However, the availability of this feature is very limited due to restrictions found in Section 415(c) of the Code.

Section 415(c) of the Code limits the amount of allocations, which include contributions, to a participants defined contribution plan account during a measurement period (generally, the calendar year) to the lesser of (i) 100% of the participant's compensation, as defined under Section 415 of the Code or (ii) a dollar amount that is indexed to inflation ($50,000 in 2012). Because a participant is disabled and not actively employed, he or she does not receive "compensation" as defined for purposes of the Section 415 limits. Thus, the Section 415 limits effectively prevent any contributions being made on behalf a participant that does not receive compensation from the employer.

Furthermore, while the Code permits employers to make contributions on behalf of participants who are disabled, the ability to take advantage of this is limited because Section 415 only permits such contributions if the participant is "permanently and totally disabled" as defined in Section 22(e)(3) of the Code, which in essence requires that the disability cause the person to be unable to work in any occupation. Specifically, Section 22(e)(3) of the Code provides that the person "is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months. This definition of disability is not consistent with the definition of disability in many LTD plans, which often provide only that the disability result in the employee not being able to work in his or her own occupation. Thus, while the employee may be eligible for LTD income replacement benefits offered by the employer, he or she in many cases will not qualify for disability replacement contributions pursuant to Section 415 of the Code under the defined contribution retirement plan.

We also note that Section 415 of the Code does not permit such contributions to be made on behalf of highly compensated employees. Thus, employees who made over $110,000 in 2011 or owned more than 5% of his or her employer in 2011 or 2012 could not make or receive contributions even if they were in fact "permanently and totally disabled."

[35] The employer may establish an "out of plan" arrangement whereby the employer purchases additional LTD insurance (i.e., current income replacement insurance) on behalf of its employees. Upon the occurrence of a disability and the subsequent triggering of payments under the LTD policy, the proceeds from this additional coverage are invested on behalf of the participant in an annuity or IRA. The proceeds of such annuity or IRA would then supplement the retirement benefit otherwise accumulated under the defined contribution plan during active employment. The intent of the arrangement is to make up for the benefits that would have been made to the defined contribution plan but for the disability. Mr. Mazawey testified that employers have not implemented these arrangements due to several administrative and compliance issues.

Mr. Mazawey noted that such arrangements can be difficult to administer. This is because a mechanism for transmitting payments from an insurance company to an IRA or annuity provider, without first paying the money to the participant, typically does not exist. In addition, such arrangements pose several compliance issues. For example, the receipt of the disability benefit payments by an IRA or annuity provider could result in prohibited transaction issues under ERISA and the Code if such provider is an affiliate of the insurer providing the insured LTD benefits. Furthermore, an employer offering an arrangement whereby payments pursuant to a LTD insurance policy were directed to an IRA or annuity may result in the IRA/annuity being viewed as part of an "employee benefit plan" for purposes of ERISA, thus causing the IRA to be viewed as an ERISA-governed employer-sponsored plan. This raises questions regarding whether ERISA's trust and other fiduciary requirements can be met, whether Form 5500 reporting is required, what participant disclosures must be satisfied, and other ERISA-related issues.
Mr. Mazawey also stated that these arrangements may not be as favorable to employees for federal income tax purposes. Some or all of the LTD benefit payments may be includible in income during the year of payment even if they are then immediately contributed to an IRA. Furthermore, the Code's limits on contributions to IRAs and individual retirement annuities may limit an employee's ability to make the contributions on a pre-tax basis or after-tax basis. In either case, the effectiveness of the arrangement is very limited when compared to the tax advantages of a qualified retirement plan that allows for continued accruals during periods of disability.

[36] LTD disability retirement benefits paid pursuant to an insured or self-insured LTD plan (offered outside of a defined contribution retirement plan) are taxable pursuant to Section 105 of the Code and the underlying Treasury Regulations. Disability income benefits are subject to income tax to the extent that the cost of the coverage was born by the employer and has not been included in the income of employees. So, where coverage is paid for entirely by the employer, the benefit is fully taxable. It is also fully taxable if the entire cost of coverage is paid for by employees on a pre-tax basis (i.e. through a cafeteria plan under IRC § 125). Conversely, the disability income benefit is not subject to income tax when paid if it is paid for by employees on a post-tax basis (conventional payroll deduction).
On the other hand, in a LTD 401(k) Insurance arrangement, the disability benefits are treated more favorably from an income tax standpoint. As a general rule, contributions made by an employee to a defined contribution plan are made on a pretax basis. Thus, such contributions made to the plan (and any investment gains thereon) are not included in income for federal income tax purposes until they are distributed to the employee. Under the LTD 401(k) Insurance arrangement, a portion of those pretax contributions are used to purchase LTD insurance premiums. Under the above-cited Private Letter Rulings, the use of those assets to purchase premiums does not result in current income tax inclusion with respect to such assets. Furthermore, in the event of disability, payments pursuant to the LTD policy used to make additional pretax contributions to the employee's plan account for the disability period are not included in income at that time even though the insurance was purchased with pretax dollars. Rather, the employee recognizes income only upon taking a distribution from the plan just as if he or she made or received pre-tax contributions throughout both the period of employment and the period of disability.
[37] The Council heard testimony that there was a considerable amount of flexibility available in such an arrangement. For example, employee contributions and/or employer contributions could be used to purchase the insurance. In addition, to mitigate against the costs associated with adverse selection, the plan could be designed to make up contributions based upon the participant's contribution rate effective during the immediately preceding plan year rather that the contributions made immediately before the disability period began.

[38] *See* Private Letter Ruling 200031060 & Private Letter Ruling 200235043.
[39] One possibility would be to allow the insurance option to a be a part of the qualified default investment alternative.
[40] One witness testified that a fiduciary could look to DOL Interpretive Bulletin 95-1 for guidance in determining whether an insurer that would pay benefits due pursuant to a 401(k) LTD Insurance arrangement was appropriate for purposes of ERISA.
[41] More specifically, the Rulings provided that plan contributions used to pay premiums were not taxed at the time of such payment and the payment of LTD insurance benefits by the insurer to the participant's plan account did not result in current taxable income to the participant. The IRS concluded the following:

1. The portion of the contributions used to pay for LTD insurance premiums was not currently included in the income of the participants.;

2. Benefits paid by the insurer to the plan account (i.e., contributions) pursuant to the LTD insurance policy were not includible in the participant's income or subject to the Code section 415(c) limits on contributions at the time such benefits were paid; and
3. Distributions from the plan, which would include the benefits (i.e., contributions) paid to the plan pursuant to the LTD insurance policy would be taxed just like any other distribution from the plan.
4. Amounts paid pursuant to the LTD policy were not counted as contributions for Code limits on tax-qualified plans such as those found in Sections 415 and 402(g) of the Code.

[42] 72 Fed. Reg. 46421 (August 20, 2007).
[43]In such regulations, the IRS concluded that defined contribution plan contributions used to pay health insurance premiums would be included in income in the year such payments were made. In addition, any benefits payable under the health benefits policy would be treated as contributions subject to the Code limits mentioned above. The proposal, in effect, required an income tax result exactly the opposite of what was established in the Rulings with respect to LTD 401(k) Insurance.
[44] It used to be understood that a significant disability is an inability to do a major social activity, such as work, because of a medical condition. This *medical model* is plainly reflected in the definition of disability used by SSDI and SSI. In 2012, researchers, practitioners, disability advocates and others recognize that a significant disability reflects the interaction of a medical condition with an individual's other characteristics and the individual's environment; it is not the product of a medical condition alone. In 2002, the World Health Organization promulgated such a model, known as the International Classification of Functioning, Disability and Health. Several factors are important as these issues are considered today. First, advances in medicine and technology make it feasible for people with very significant medical conditions and impairments to be quite productive. Second, the nature of work has changed, away from physically demanding tasks toward mentally demanding tasks. That makes work less challenging for many with physical disabilities, but perhaps more challenging for those with intellectual, cognitive and psychiatric disabilities. Finally, people with disabilities themselves are demanding better economic opportunities. A modern view of disability supports focuses on a combination of helping people work and income supports.
[45] Social Security Advisory Board, February 2012, Aspects of Disability Decision Making: Data and Materials. p.1.
[46] Stapleton testimony, June 12, 2012, p. 16-22.
[47] Witnesses Rafik, Debofsky and Council member Clark, have all had individual clients whose efforts to return to work are thwarted by the fact that they applied for and received disability income from a LTD plan and/or Social Security, and arguments that the individual could return to work with an accommodation are met with the applications for such benefits in which the employee had to state they could not work and were totally disabled. The notion that these conditions can be temporary appears lost on employers and most courts asked to address these issues. Further legal guidance addressing this transition may permit individuals to more successfully return to work.
[48] The ERISA claim "full and fair review" requirement is at 29 U.S.C. § 1133
[49] Citing Grossmuller v. Int'l Union, United Auto. Aerospace & Agric. Implement Workers of Am., U.A.W., Local 813, 715 F.2d 853, 858 n.5 (3d Cir. 1983)
[50] Morgan v. The Prudential Ins. Co. of America, 755 F.Supp.2d 639 (E.D.Pa. 2010).