Long-Term Disability Insurance

2017 Report to the Joint Standing Committee on Appropriations and Financial Affairs

MainePERS Disability Retirement Task Force

January 18, 2017

maine PERS
Public Employees
Retirement System

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By________________

Sandra J. Matheson, *Executive Director*

December 9, 2016

Senate Chair and House Chair
Joint Standing Committee on Appropriations and Financial Affairs
5 State House Station
Augusta, ME 04333-0005

Re: Report Required by P.L. 2015 c. 392 (LD 1463 in the 127th Legislature)

Dear Chairs of the Appropriations and Financial Affairs Committee:

MainePERS is required under P.L. 2015 c. 392 to submit a report on its long-term disability insurance study to the joint standing committee of the Legislature having jurisdiction over retirement matters no later than January 4, 2017. I am writing to request an extension of that deadline to January 18, 2017.

We have been working diligently on the study and report for several months. We would like to give our Board of Trustees the opportunity to review the report before we submit it to the Committee. We had planned to do that at the Board's regular monthly meeting on December 8, 2016, but the unexpected illness of a key staff member prevented this. The Board does not meet again until January 12, 2017.

We respectfully request an extension of the report deadline until January 18, 2017, which would give us the opportunity to present the report to the Board and make any final changes based on the Board's feedback.

Please let us know if you have any questions.

Respectfully,

Michael J. Colleran
General Counsel

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Executive Summary

The 127th Legislature Joint Standing Committee on Appropriations and Financial Affairs (Committee) requested that the Maine Public Employee Retirement System (MainePERS) study and report back to the 128th Legislature on the feasibility of procuring and offering long-term disability insurance to the members it serves. This request was the result of a presentation by MainePERS to the Committee on the work of the MainePERS Disability Retirement Task Force and L.D. 1463, a bill authorizing MainePERS to offer this type of insurance that was sponsored by Representative Robert Foley, Wells. MainePERS worked with the Task Force and Mercer, a global benefits consulting firm, to conduct this study.

While the current MainePERS disability retirement program works for many members, it can be a frustrating experience for others. The most difficult obstacle is for members who are experiencing a long-term disease or condition where they are unable to work. They frequently need financial resources to get through this period and apply for MainePERS disability retirement. However, if they are not (or not yet) permanently disabled, MainePERS cannot grant benefits.

MainePERS provides disability *retirement* benefits, limited by statute to members with a *permanent* disability. In contrast, common disability insurance products cover short-term and long-term (non-permanent) disabilities that typically resolve with time and rehabilitation. MainePERS' statutory requirements potentially leave members who have not yet reached permanence, but who are unable to do their job, without some level of income protection for a period of time. This can create a significant financial hardship for these members and their families.

Short- and long-term disability insurance policies are vehicles that can fill this gap. These products are commonly made available by private sector employers to their employees. Long-term disability insurance (LTDI) refers to an insurance policy that protects an employee from complete loss of income if he or she is unable to work for a long period due to illness, injury, or accident.

Short-term income replacement needs often can be met for many members through accrued sick and vacation leave credits. The more challenging need is long-term income replacement. MainePERS and the Disability Retirement Task Force conclude that MainePERS should provide optional long-term disability insurance to all participating members through a third-party administrator. MainePERS would look to provide options to individual participating employers that may wish to fully or partially fund the cost of the program for their employees.

Under any approach where employers are contributing toward the costs, the scenarios priced for the Task Force show that an employer would pay between $95 and $229 per member per year depending on the level of participation and the particular benefits offered. Under approaches where members would contribute, member costs would range from $87 to $430 under the same scenarios. For equivalent coverage, the costs per member decrease significantly when coverage is fully employer-paid or mandatory.

MainePERS and the Task Force conclude that MainePERS should provide long-term disability insurance through a third-party administrator. MainePERS would structure this program to have optional participation for employers. Each participating employer would determine the level of funding it would provide. Enrollment would be automatic for employees of participating employers, with an opt-out provision. Having an opt-out structure would protect employees from inadvertent lack of coverage, help highlight disability risks and available protections, and lower per-employee costs by increasing participation levels.

MainePERS and the Task Force recommend legislation expressly authorizing MainePERS to offer optional long-term disability insurance to help mitigate the severe financial challenges members may incur when unable to work due to a long-term medical condition.

Background of this Report

The Maine Public Employees Retirement System (MainePERS) formed a stakeholder task force in 2014 due to continuing concerns among stakeholders about the disability retirement program administered by MainePERS. The Disability Retirement Task Force (Task Force) was formed to include equal representation from members, employers, and MainePERS. The MainePERS Executive Director acts as the chair.

The Task Force familiarized itself with the MainePERS program. MainePERS provides qualifying members with two types of retirement benefits, both of which are based in statute. The first is a service retirement based on length of service and age. The other is a disability retirement benefit based on having a *permanent* disability.

While the current MainePERS disability retirement program works for many members, it can be a frustrating experience for others. The most difficult obstacle is for members who are experiencing a long-term disease or condition where they are unable to work. They frequently need financial resources to get through this period and apply for MainePERS disability retirement. If they are not (or not yet) permanently disabled, MainePERS cannot grant benefits. This can be an extremely difficult challenge for these members and their families.

The Task Force agreed on a set of principles that a strong disability retirement program should embrace and against which they could measure any suggested changes to the MainePERS program based upon further study.[1] (See Attachment 1) Task Force participants agreed to approach the review of the disability retirement program by identifying modern best practices in disability benefits management and comparing them to state law and MainePERS' practices. Any differences could be more closely examined to determine if changes should be considered for the MainePERS program. Each change would be evaluated to determine if it was within the authority of MainePERS or required legislation. MainePERS and the Task Force issued an RFP and selected Mercer, a global benefits consulting firm, to provide the list of best practices for modern disability programs.

Comparison

The comparison of the MainePERS program's characteristics and disability insurance best practices illuminated that the MainePERS program is limited in scope and distinctly different from disability insurance. While the MainePERS program is limited to diseases and conditions that make someone permanently unable to work, commonly offered short-term and long-term (non-permanent) disability insurance products have components that aim to resolve medical conditions with time and rehabilitation, thereby allowing an employee to return to work.

This important distinction provided initial insight into frustration expressed by employers and members about the MainePERS program. Task Force members conducted an employer survey to determine if the MainePERS program might be confused with long-term disability insurance by members and employers. Mercer developed the survey with the assistance of Task Force members and sent it to 417 employer representatives in June 2015. (See Attachment 2)

The survey results demonstrated that:

- The MainePERS disability retirement program appears to be viewed as a form of long-term disability insurance as well as disability retirement.
- Employer human resource departments that counsel MainePERS members about benefits do not have a clear understanding of the program or its limits and therefore may not counsel members correctly about its purpose.
- Access to and use of short and long-term disability insurance policies is inconsistent among members eligible for MainePERS' disability retirement.
- Standard benefits such as vacation, sick time and sick time banks often substitute for short-term disability insurance benefits.

[1] The Task Force divided its work into two segments. The first is the study of long-term disability benefits, and the second is administrative improvements to the MainePERS program. These improvements are underway.

- Even for members with workplace access to long-term disability insurance, participation is minimal.

Task Force Observations

MainePERS provides retirement disability benefits as part of the retirement plans it administers for over 50,000 active employee members and 325 employers. Task Force participants concluded that most of these members do not have adequate income protection for long-term illness and injury. Conversely, it appears that many members and their employers mistakenly believe they have broad income protection through their MainePERS benefit.

This discrepancy exists because MainePERS disability retirement benefits are limited to members diagnosed with a disease or condition that has permanent functional limitations associated with it that make it impossible for them to perform the duties of their job. The MainePERS benefit does not cover extended illness or absences that may occur before the member reaches a point of impossibility and permanence.

Members who apply for MainePERS disability retirement before the standards of permanence and impossibility are met cannot be approved for disability retirement benefits.

The combination of a shortage of long-term income protection options for public employees and the statutory requirements regarding disability retirement can leave members who have not yet reached permanence, but who are unable to do their job, without income protection when they need it most. If they pursue MainePERS disability retirement and do not qualify, but still are unable to work, they may experience extremely distressing personal financial consequences.

Based on Task Force findings and MainePERS' experience, Task Force participants concluded that one approach for reducing this exposure to stressful member financial situations would be for MainePERS to offer long-term disability insurance options to participating employers. This conclusion was reached for the following reasons:

1. Short-term disability insurance, long-term disability insurance, and disability retirement programs serve distinctly different roles in supporting employees dealing with health challenges that affect their ability to work and their need for income replacement.
2. Based on MainePERS' experience, some members may turn to MainePERS when they find it is too difficult to work, but before their condition becomes a permanent disability.
3. Income protection for employees affected by a long-term disease or condition who do not qualify for disability retirement is a significant unmet need in Maine's public sector. Further, many MainePERS members are not covered by Social Security Disability Insurance because

their employer does not participate in Social Security. Members who have determined they can no longer work due to a disease or condition have several options for short-term income continuity. The first is to use their accrued sick and vacation leave time until they can return to work. The second is to apply for any donated sick and vacation time that may be available to them. They can also use any short-term disability insurance they may have purchased to provide income protection until they can return to their jobs.

4. Access to and use of long-term disability insurance is inconsistent and sparse. No single option is available to all MainePERS members.[2]
5. Extensive misunderstanding about the limited benefits provided by MainePERS disability retirement exists with both employers and MainePERS members. The relative infrequency of inquiries at most employers regarding disability retirement adds to the climate of misunderstanding. (Approximately 1,300 of the approximately 38,500 MainePERS retirees are retired under the disability retirement program.)
6. Existing MainePERS benefits cannot be modified to model long-term disability insurance benefits without funding the full costs of the modification up front. Otherwise, the change might create an unfunded liability in violation of the Maine Constitution.[3]

Request to the Legislature

Based on this information and what appears to be confusion and insufficient income protection in effect for some MainePERS members facing a long-term injury or medical condition, MainePERS and Task Force members supported L.D. 1463, sponsored by Representative Foley, to study the possibility of MainePERS providing long-term disability insurance to help fill this gap.

The 127th Legislature Joint Standing Committee on Appropriations and Financial Affairs (Committee) discussed this and requested that MainePERS study and report back to the 128th Legislature on the feasibility of procuring and offering long-term disability insurance to the members it serves.[4]

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[2] The Maine State Employees Association offers short-term disability insurance with costs paid by participating employees. Similarly, the Maine Education Association offers long-term disability insurance at employee cost. Some Participating Local Districts offer short- and/or long-term disability insurance at employee or shared employer-employee cost. It appears that employees are more likely to purchase short-term disability insurance than long-term when paying the full cost themselves. Based on insurance industry experience, the reason for this is that short-term disability insurance is less costly, and few employees expect to ever need long-term disability insurance. Participation in both rises significantly as the employer-paid share of the premium increases.

[3] Me. Const. art. IX, § 18-A.

[4] "**Sec. 3. Study.** The Maine Public Employees Retirement System shall conduct a study on the feasibility of procuring and offering long-term disability insurance, including the means by which the Maine Public Employees Retirement

Long-Term Disability Insurance Study

The Task Force asked Mercer to provide the most common scenarios used in the private sector for long-term disability insurance. Employer-sponsored long-term disability insurance is relatively common in the private sector and relatively uncommon in the public sector.

As with other benefits provided by employers to their employees, payment of costs can be exclusive to one party or shared. Long-term disability insurance providers use their experience regarding participation rates when setting prices, and the source of premium payments plays a role in determining those rates.

Uptake of long-term disability insurance is generally significantly higher when employer-paid. Whether premiums are paid by employers, employees, or shared, a significant benefit of a MainePERS-sponsored long-term disability insurance program would be access to a standardized policy for all members working at participating employers. Further, this would enhance the ability to educate MainePERS members and employers on the difference between long-term disability insurance and MainePERS disability retirement. This hopefully would reduce some of the confusion of members when applying for disability retirement.

How Long-Term Disability Insurance Policies Are Structured

Long-term disability insurance can be offered with any number and combination of options or provisions. The specific provisions included in each policy vary by employer, particularly in relation to the point in time when employees qualify for coverage, the income protection provided, and the duration that benefit payments will be made. The provisions included in a policy drive the per-employee costs and the size of the insured pool.

Long-term disability insurance policies can be structured with automatic enrollment for employees, requiring them to opt-out if the coverage is not desired, or as an opt-in benefit where each employee is required to request enrollment. In general, an opt-out long-term disability insurance policy is less expensive on a *per employee* basis than one requiring an employee to opt-in because expected participation rates are significantly higher, increasing the insured pool size.

System would procure and offer the insurance, the anticipated administrative burdens and expenses associated with offering the insurance and any other factors determined relevant by the Maine Public Employees Retirement System. The Maine Public Employees Retirement System shall report the results of its study under this section together with any recommendations and suggested legislation to the joint standing committee of the Legislature having jurisdiction over retirement matters no later than January 4, 2017. The joint standing committee may report out a bill based on the report to the First Regular Session of the 128th Legislature."
P.L. 2015 c.392.

Commonly Purchased Long-Term Disability Insurance Scenarios

MainePERS and the Task Force followed Mercer's recommendation to narrow pricing scenarios to the most common combinations of provisions for purposes of giving a general sense of costs. (See Attachment 4 for details)

Mercer presented three scenarios to insurance carriers to get an indication of potential costs:

(1) Employer-paid coverage;

(2) Limited employer-paid coverage with optional additional employee-paid coverage; and

(3) Optional employee-paid coverage.

Disability insurance costs vary depending not only upon the type of coverage, but how many people are in the covered population and enroll in the program. (See Attachment 3 for the experience in a current 100% employee-paid plan offered by the Maine Education Association.) In general, the following costs give a sense of what each of the three most common scenarios studied could cost the employer and/or employee:[5]

(1) Employer-paid coverage where all members in the MainePERS population are covered – approximately $175 to $229 per year per employee;

(2) Limited employer-paid coverage with optional more comprehensive employee-paid coverage:

   a. Employer – Approximately $95 to $113 per year per employee

   b. Employee – Approximately $87 to $183 per year assuming 25% participation

(3) Optional employee-paid coverage – approximately $334 to $430 per year depending on terms and assuming 25% employee participation;

The costs of a long-term disability policy vary widely depending upon the terms. Scenario 1 has terms accommodating to the employee. The costs are lower primarily because the covered population is high, i.e. 100% of employees. Scenario 2 has less comprehensive employer-paid terms, with optional buy-up paid by participating employees. Scenario 3 generally reduces the covered population significantly, making the policy more expensive per person.

[5] It is essential to recognize that all the costs shown here are for a policy that is standard in the insurance industry, including the potential for payment of long-term disability benefits until an employee's normal retirement age. Given the existence of disability retirement for MainePERS members, actual costs to cover members with long-term disability insurance could be lower. Actual costs would need to be quoted given policy provisions that would be appropriate for public sector employees in Maine.

These costs were determined using the entire MainePERS active membership, which is approximately 80% state employees and teachers, and approximately 20% Participating Local District (PLD) employees. Decisions about employer-paid coverage would have to be addressed by each employer.

Options for Providing Long-term Disability Insurance to MainePERS Members

Based on the work of the Task Force, three primary options were identified for MainePERS to provide long-term disability insurance to MainePERS members:

(1) 100% optional employee coverage offered to all MainePERS members through MainePERS;

(2) Full or partial employer paid coverage through a MainePERS administered policy;

(3) Optional individual policies independently obtained by each employer.

Option 3 is the how long-term disability insurance is currently available, if at all, to MainePERS members, i.e. it is available through a limited number of employers. Options 1 and 2 can be created through a MainePERS program. All MainePERS members would be offered optional coverage at the beginning of their employment. Pricing structures would vary depending on any optional individually determined employer share of the premiums.

Task Force members discussed incorporating a long-term disability insurance-like benefit into the existing MainePERS program by statutorily removing the permanence requirement from the first two-year benefit period of a MainePERS disability benefit. This would enable temporarily disabled members to receive 59% of their salary while they attempted to recover and return to work. If at the end of that two-year period the member was unable to return to work and was then permanently disabled from performing any form of meaningful employment, the member would be placed on disability retirement.

This change would increase the costs of the MainePERS program. Because the disability retirement program is part of the pension plans administered by MainePERS, the increased cost would create a liability that may have to be fully-funded under Article 9, section 18-A of the Constitution of Maine. The Office of the Attorney General may provide guidance on its constitutionality.

Conclusion

The benefits of a single program available to all MainePERS members are substantial. The first benefit is that all MainePERS members would have access to income protection should they face an extended absence due to illness. The second is that all members, and HR professionals, would understand the difference between long-term disability insurance and the MainePERS disability retirement benefit. The importance of this cannot be overstated. Task Force participants found that members may learn the difference between long-term disability insurance and a MainePERS disability retirement benefit at a point in their lives when they are most in need of income protection and it is too late to obtain it. The third benefit is that MainePERS members would be part of the decision on how they wish to prepare for unforeseen circumstances.

A MainePERS program would be offered through a third-party administrator, so there would be minimal administrative burden on MainePERS.

MainePERS and the Disability Retirement Task Force conclude that MainePERS should provide a long-term disability insurance option to all participating members through a third-party administrator. The goals of this program would be to 1) provide an income protection opportunity for members experiencing an extended absence due to a disease or medical condition; 2) provide a structure to maximize participation; 3) educate members about their financial risks associated with unforeseen medical circumstances; and 4) differentiate MainePERS retirement benefits from disability insurance.

MainePERS would structure this program to have optional participation for each of its approximately 325 employers. Each participating employer would choose how the benefits will be funded – employer-paid, shared, or employee-paid. Enrollment would be automatic for employees of participating employers, with an opt-out provision. This provision is critical for MainePERS members to understand their disability risks and how those can be mitigated. Specifically, this requirement would encourage human resource personnel to differentiate between long-term disability benefits and disability retirement. This would be a great service to members who may currently view their MainePERS retirement benefit as disability insurance. Having an opt-out structure also would increase employee participation, which would lower the per-employee cost.

MainePERS and the Task Force recommend legislation expressly authorizing MainePERS to offer this program to help mitigate the severe financial challenges members may incur when facing long-term diseases or conditions.

Attachment 1 – Task Force Principles

- MainePERS provides a fair and transparent process for the determination of benefits that respects the member and their employer.
- MainePERS provides a fair and transparent process refined through System rules, policies and practices that fulfills statutory intent and mandate.
- MainePERS provides each individual with a thorough review of their request for benefits, providing all benefits to which the individual is entitled by law.
- The benefit administrative process is user friendly and able to be understood by all applicants and their employers, providing critical information each one needs to know to fulfill their respective responsibilities.
- The process is efficient.

Attachment 2 – Task Force Employer Survey Results

Thirty-four percent of employer representatives receiving the survey responded. Twenty-nine percent completed the entire survey, with the remaining 5% completing some but not all of the questions.

- 22.5% of respondents indicated they offer a short-term disability program, three-fourths of whom offer a voluntary program and one-fourth offer some form of employer cost sharing of premiums.

- Short-term disability benefits ranged from 40-100% of weekly pay, with the majority providing 60-70%.

- 10.5% of respondents indicated they offer a long-term disability program, slightly more than half of whom offer a voluntary program, and the remaining offering some form of employer cost sharing of premiums.

- Long-term disability benefits ranged from 40-70% of pay, with the majority providing 60%.

- Significant variation exists on how members find out about MainePERS disability retirement, with responses indicating some level of confusion about the program itself.

- The level of sick time members can earn and bank is generally not sufficient to provide continuing income once an adverse health condition has made it too difficult to work.

Attachment 3 – Long-Term Disability Insurance Uptake Rates for Teachers through Horace Mann

Count of active MainePERS covered employees: 50,198

Count of active teachers, principals, and superintendents: 25,714

Count of Maine Education Association (MEA) long-term disability insurance insured pool: 1,126

Count of MEA program participants opting-in: 724

* All numbers valid as of October 31, 2016

MEA makes long term disability insurance available to teachers, principals, and superintendents. MEA's program is known as the Voluntary Disability Income Plan. It is available statewide from the MEA vendor, Horace Mann, via a payroll deduction. Seven hundred twenty four individuals had opted-in to the program as of October 31, 2016, which is less than 3% of the eligible individuals.

The insurance policy provided by MEA's vendor also covers a subset of 402 employees who have bargained for coverage. As a result, the total number of individuals covered under the MEA policy is 1,126.

Attachment 4 – Long-Term Disability Insurance Sample Pricing Based on 100% MainePERS Active Member Population

The following characteristics are common to all the options presented:

- Income replacement is based on pensionable wages;
- Maximum time period that payments will be made (i.e., benefits duration) is until normal retirement age;
- Period when consideration of the ability to work is limited to the individual's own occupation is two-years;
- Conditions treated within three-months prior to qualification and arising within 12-months after qualification are ineligible for disability because pre-existing;
- Reclaiming disability within 180-days of being cleared from a prior claim does not require a new elimination period;
- Income replacement increases by 10% for participation in rehabilitation;
- Earned income and certain other payments offset the policy benefit dollar-for-dollar;
- Death benefit equals three-months of benefit payments;
- Certain situations, like medical condition clearing, end the payments;
- COLA is applied annually;
- Benefits paid for a maximum of two years when claim is psychological or alcohol/drug based.

The research conducted by the Task Force to arrive at the three options was restricted to typical provisions most commonly found in the marketplace. This meant that the results are not tailored to the system currently in place for public employees in Maine (e.g., the availability of disability retirement for those who meet the permanence criteria and other requirements). As a result, the ultimate cost for providing long-term disability insurance through MainePERS may be less than demonstrated below. Also worth noting is that the quotes provided were generated using employee census data that included every active member in a MainePERS-covered position (i.e., state, teacher, and Participating Local District positions). In a situation where all MainePERS-covered employees were not part of the insurance pool, pricing would vary depending on changes in the risk profile.

The primary factors a carrier would consider when assigning risk include the types of positions covered (e.g., public safety vs. professional office staff, etc.) and the ages and gender of pool members. All option-specific provisions are described under each scenario below.

Option 1 – Employer-Paid. All costs associated with this scenario are paid by employers. Provisions specific to this policy are: (1) Eligibility immediately upon hire; (2) Gap of less than one month does not count as a break in service; and (3) Income replacement is 60% of pensionable earnings, but with a monthly maximum benefit of $10,000.

90-day elimination period	Annual Cost	$11,500,000
	(average annual cost per employee = $229)	
180-day elimination period	Annual Cost	$8,800,000
	(average annual cost per employee = $175)	

Option 2 - 40% Employer-Paid with 20% Optional Employee Buy-up. The costs associated with this scenario are shared. Provisions specific to this policy are: (1) Eligibility after six months of employment; (2) Gap of three months or less does not count as a break in service; and (3) Income replacement is up to 60% of pensionable earnings, but with a monthly maximum benefit of $10,000. The costs presume payments are made by the employer for 100% of employees, and 25% of the employees take advantage of the buy-up.

90-day elimination period (total)	Annual Cost	$8,000,000
Employer Portion	Annual Cost $5,700,000	
	(average annual cost per employee = $113)	
Employee Portion	Annual Cost $2,300,000	
	(average annual cost per employee = $183)	
180-day elimination period	Annual Cost	$5,900,000
Employer Portion	Annual Cost $4,800,000	
	(average annual cost per employee = $95)	
Employee Buy-up	Annual Cost $1,100,000	
	(average annual cost per employee = $87)	

Option 3 – Employee-Paid. The costs associated with this scenario are paid by individual employees. Provisions specific to this policy are: (1) Eligibility after six months of employment; (2) Gap of three months or less does not count as a break in service; and (3) Income replacement is up

to 60% of pensionable earnings, but with a monthly maximum benefit of $10,000. The costs presume that 25% of employees voluntarily participate in the program.

90-day elimination period	Annual Cost	$5,400,000
	(average annual cost per employee = $430)	
180-day elimination period	Annual Cost	$4,200,000
	(average annual cost per employee = $334)	