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BACKGROUNDER

No. 3037 | JULY 20, 2015

Private Disability Insurance Option Could Help Save SSDI and Improve Individual Well-being

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Abstract

Social Security Disability Insurance (SSDI) is on course to run out of money in 2016 as rapid expansion in the program has caused benefits to exceed incoming revenues for years. Immediate action is needed to improve the solvency and integrity of the program. As part of a comprehensive SSDI reform package, policymakers should consider allowing employers the option of providing private disability insurance in exchange for a reduction in payroll taxes. Private disability insurance has the potential to reduce costs and improve integrity within the SSDI system, and to improve outcomes for disabled individuals.

The Social Security Disability Insurance (SSDI) program will run out of money in a little over a year. Absent reforms, SSDI benefits will be cut about 20 percent, bringing the average benefit to below the poverty level. Before jumping to the quickest, allegedly easy, fix—a reallocation of payroll taxes from the Social Security retirement program to SSDI—policymakers need to examine the reasons why the SSDI system is effectively insolvent.

While some of the growth in SSDI costs and enrollment was predictable, a significant portion arguably stems from unintentional expansion of the system beyond its original purpose. In short, too many people enter the program and too few leave it. When it comes to managing disability determinations and beneficiaries, private disability insurance (DI) does a better job helping workers remain on the job and assisting disabled individuals return to work. Optional private DI programs covering the first years of disability could potentially reduce SSDI costs and improve individual outcomes for disabled workers. Furthermore, because the programs would be

Key Points

- The SSDI program is rapidly approaching insolvency as recipiency rates have more than doubled since 1990. Absent reform, benefits will be cut nearly 20 percent beginning in 2016.
- Rather than raid Social Security's retirement program, policymakers should act immediately to assemble a comprehensive reform package addressing SSDI's many problems.
- Compared to SSDI, private disability insurance offers a faster, fairer, and more efficient adjudication process; assistance and accommodations that can keep workers on the job and help more return to work; more effective screening and monitoring to weed out fraud and abuse; and lower costs.
- If incorporated partially into the SSDI system, private disability insurance could improve the integrity and efficiency of the SSDI system, as well as the physical and economic well-being of disabled individuals.
- Policymakers should consider a tax credit for employers providing private disability insurance covering the first years of benefits.

This paper, in its entirety, can be found at **http://report.heritage.org/bg3037**

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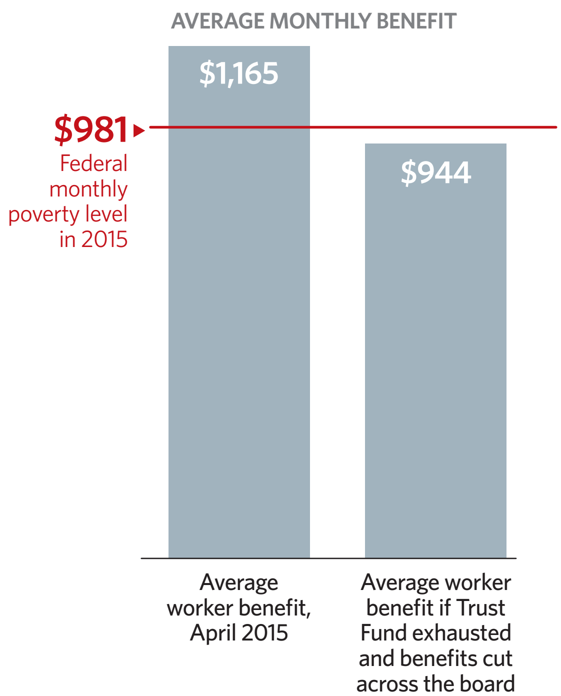
CHART 1

Absent Reform, Average Disability Benefit Could Fall Below Poverty Level



Source: Social Security Administration, *2014 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, July 28, 2014, http://www.socialsecurity.gov/OACT/TR/2014/index.html (accessed July 16, 2015).

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optional, employers could experiment with which policies work best for their workforce, and SSDI could then learn from the best practices of successful private DI programs.

SSDI's Financial Insolvency

SSDI has been running cash flow deficits since 2010. In 2013, it took in $111.2 billion in revenues and paid out $143.4 billion in benefits, for a cash flow deficit of $32.2 billion.[1] According to the most recent estimates from the Social Security Trustees, the Trust Fund will run dry in just over a year, at the end of 2016. When this happens, the program will only have enough incoming revenues to pay roughly 80 percent of benefits. If this happens, the average disabled worker's benefit will fall below the federal poverty level.[2]

This is not the first time that SSDI has faced financial insolvency. In 1994, the program faced a similar shortfall. As a result, Congress reallocated a portion of the Social Security payroll tax from the Old-Age and Survivors Insurance (OASI), or retirement, program to the Disability Insurance program. This required an act of Congress because OASI and SSDI were never meant to be comingled. In fact, fear that a disability insurance program could take away from Social Security's retirement program led to passage of an amendment specifically preventing SSDI from taking money from OASI. As Senator Walter George (D–GA) stated during debate of the amendment:

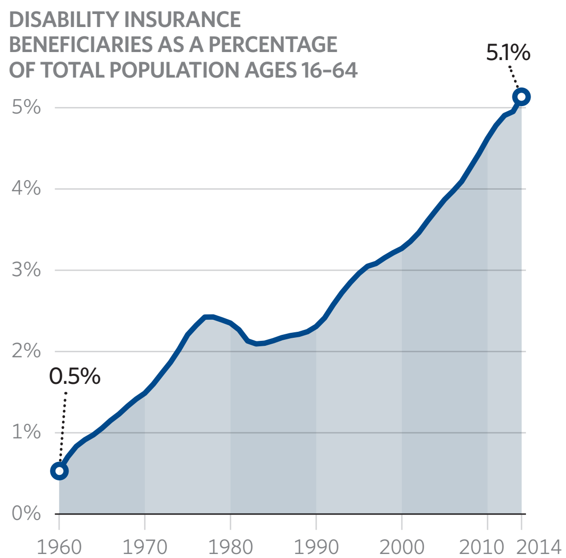
> The moneys for disabled persons will not be commingled in any way with the funds for old-age insurance or for widows and spouses. The contribution income and the disbursements for disability payments will be kept completely distinct and separate. [The DI trust fund] can never encroach upon the fund for widows, and for those who reach age 65, and for children and other beneficiaries.[3]

Despite the original legislation, SSDI has encroached upon OASI. In 1994, Congress reallocated a portion of the Social Security tax to the SSDI trust fund, effectively increasing SSDI revenues by 50 percent. Along with the 1994 reallocation, the Social Security Trustees issued stark warnings that, even with the additional tax revenues, SSDI required significant reforms to remain viable over the long run.

1. Social Security Administration, *The 2014 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds*, July 28, 2014, http://www.socialsecurity.gov/OACT/TR/2014/index.html (accessed June 4, 2015).
2. Social Security Administration, "Monthly Statistical Snapshot: April 2015," May 2015, Table 2, http://www.ssa.gov/policy/docs/quickfacts/stat_snapshot (accessed June 15, 2015).
3. "Social Security Amendments of 1956 Volume 1," Senate Debate, Congressional Record, July 13/16/17, 1956, p. 13040, http://www.ssa.gov/history/pdf/Downey%20PDFs/Social%20Security%20Amendments%20of%201956%20Vol%201.pdf (accessed July 1, 2015).

CHART 2

More People Receiving Disability Insurance from Social Security



Notes: 2014 is an estimate based on 10-year growth rates in beneficiaries. Beneficiaries include workers, widowers, and adult children of workers.
Source: Author's calculations based on data from the U.S. Census Bureau, "Annual Population Estimates, Ages 16 to 64"; and Social Security Administration, *Annual Statistical Report on the Social Security Disability Insurance Program, 2013,* December 2014, http://www.ssa.gov/policy/docs/statcomps/ di_asr/ (accessed June 23, 2015).

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Nevertheless, policymakers disregarded the Trustees' warnings and used the reallocation to kick the can down the road. Now, just over two decades later, SSDI has expended that 50 percent increase in the SSDI payroll tax and will soon be insolvent again. Another reallocation would simply kick the can to 2033 when *both* the OASI and SSDI Trust Funds will be exhausted.

If a family looked back at past bills and realized its electricity use had doubled without necessity, it would not turn to its children's education savings accounts to finance the additional costs just because the money was there. Doing so would reduce the children's future educational resources and would fail to address the family's problem of unnecessary electricity consumption. Likewise, robbing OASI to finance SSDI's shortfalls would harm future retirees while allowing significant inefficiencies, and unintended uses and abuses of the SSDI program to continue to grow unchecked.

Why Is SSDI Insolvent?

The most obvious explanation to SSDI's insolvency is its rapid increase in beneficiaries and costs. Since 1990, the share of the working age population (ages 16 to 64) that receives SSDI benefits has more than doubled, from 2.3 percent to 5.1 percent in 2014.[4] SSDI costs have risen even more quickly, roughly doubling (in real, inflation-adjusted dollars) since 2000. And yet, workers are healthier and jobs are less physically demanding today.[5] So why the rise in SSDI beneficiaries?

Demographic factors, such as the aging of the baby-boom population and women's increased labor force participation, as well as the increase in Social Security's retirement age have contributed to the rise in SSDI enrollment. According to a study by the Federal Reserve Bank of San Francisco, however, only about half of the increase in the number of SSDI recipients since 1980 can be explained by these factors.[6] The rest of the rise—roughly 3 million beneficiaries ($42 billion in annual SSDI benefits)—is likely

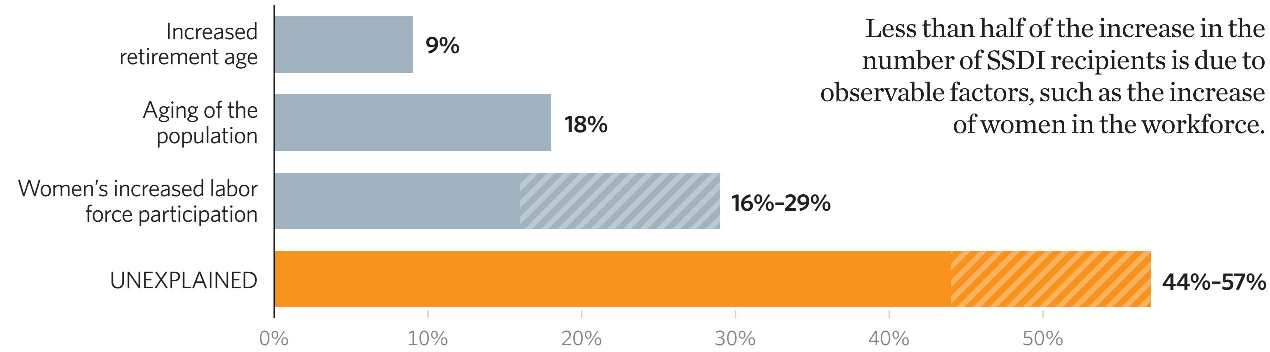
4. Author's calculations using data from the U.S. Census Bureau Population Estimates and the 2013 *Annual Statistical Report on the Social Security Disability Insurance Program*, Table 3. "All Disabled Beneficiaries," http://www.ssa.gov/policy/docs/statcomps/di_asr/ (accessed July 8, 2015). The recipiency rate equals the percentage of the population ages 16 to 64 that receives worker, widower, or adult-children disability insurance benefits. The 2014 rate is an estimate obtained by applying the average growth rate in beneficiaries from 2004 to 2013 to the number of beneficiaries in 2013.

5. Mark Duggan and Scott A. Imberman, "Why Are the Disability Rolls Skyrocketing? The Contribution of Population Characteristics, Economic Conditions, and Program Generosity," in David M. Cutler and David A. Wise, eds., *Health at Older Ages: The Causes and Consequences of Declining Disability Among the Elderly* (Chicago: University of Chicago Press, 2009), pp. 337–379.

6. Mary C. Daly, Brian Lucking, and Jonathan A. Schwabish, "The Future of Social Security Disability Insurance," Federal Reserve Bank of San Francisco *Economic Letter*, June 24, 2013, http://www.frbsf.org/economic-research/publications/economic-letter/2013/june/future-social-security-disability-insurance-ssdi/ (accessed July 8, 2015).

CHART 3

Factors Behind Increase in Number of SSDI Recipients



Source: Mary C. Daly, Brian Lucking, and Jonathan A. Schwabish, "The Future of Social Security Disability Insurance," Federal Reserve Bank of San Francisco, June 24, 2013, http://www.frbsf.org/economic-research/publications/economic-letter/2013/june/future-social-security-disability-insurance-ssdi/ (accessed June 11, 2014).

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the result of greater access to benefits and an increase in the value of benefits.[7] This roughly $42 billion in unexplained cost growth is significantly more than the roughly $27 billion average shortfall projected for the SSDI program over the next 10 years.[8]

The liberalization of SSDI-qualification standards began in 1978 with the addition of non-medical, vocational factors, such as age, education, and inability to speak English, as potentially disabling qualifications. Today, about 43 percent of all SSDI awards are based on these vocational grid factors.[9] Amidst rising SSDI claims and costs in the 1980s, Congress initially tightened SSDI qualification standards. Public backlash, however, led Congress to reverse its actions and further liberalize SSDI-qualification standards.

With this liberalization came increased incidents of difficult-to-verify claims, such as depression and musculoskeletal pain. Greater subjectivity in claims contributes to vastly different approval rates across hearing levels and judges. And finally, in addition to increased entry into the system, is reduced exit. The SSDI program's lack of adequate Continuing Disability Reviews (CDRs) allows individuals to remain on the program, largely unchecked, despite medical or vocational improvement.

It is difficult to address the many factors that play a role in the rise of SSDI beneficiaries, but private disability insurance offers some valuable lessons that could help improve the SSDI program.

7. Author's calculations: The estimated 3 million beneficiaries was calculated by adjusting the current total number of beneficiaries to that which would exist if the recipiency rate today were equal to that of 1980. The difference between this figure and actual SSDI recipients is the growth in beneficiaries. Multiplying this growth by the midpoint of the Federal Reserve Bank study's 44 percent-to-57 percent range (50.5 percent) yields 3.01 million SSDI recipients. Total spending of $42 billion is the product of 3.01 million beneficiaries multiplied by the average disabled worker benefit of $1,165/month in April 2015. See Social Security Administration, "Monthly Statistical Snapshot," Table 1. "Number of People Receiving Social Security, Supplemental Security Income (SSI), or Both," April 2015, http://www.ssa.gov/policy/docs/quickfacts/stat_snapshot/2015-04.pdf (accessed May 26, 2015).
8. Rachel Greszler, "Social Security Disability Insurance Trust Fund Will Be Exhausted in Just Two Years: Beneficiaries Facing Nearly 20 Percent Cut in Benefits," Heritage Foundation *Backgrounder* No. 2937, August 1, 2014, http://www.heritage.org/research/reports/2014/08/social-security-disability-insurance-trust-fund-will-be-exhausted-in-just-two-years-beneficiaries-facing-nearly-20-percent-cut-in-benefits.
9. David R. Mann, David C. Stapleton, and Jeanette de Richemond, "Vocational Factors in the Social Security Disability Determination Process: A Literature Review," Mathematica Center for Studying Disability Policy *Working Paper* No. 2014-07, July 21, 2014, http://www.disabilitypolicyresearch.org/~/media/publications/pdfs/disability/drc_wp_2014-07_voc_factors_determinations.pdf (accessed June 4, 2015).

Private Sector Offers Significant Disability Insurance Improvements

The bulk of SSDI's troubles boil down to two factors: (1) too many people apply for and receive benefits, and (2) too few people leave the SSDI rolls and return to work. Private disability insurance arguably does a superior job of determining who is disabled, helping disabled individuals remain at work, and improving employment prospects for those who receive DI benefits. Utilizing the private sector's advantages on the front end of the disability process—initial determination, accommodation assistance, and recovery support—could significantly improve both SSDI's financial solvency, as well as the physical and economic well-being of disabled individuals.

Better Assistance and Accommodations to Help Workers Remain on the Job. Before someone even applies for private long-term disability (LTD) benefits, private disability insurers work with employees and employers to pursue proper health care and workplace accommodations that often allow individuals to remain on the job—perhaps in a different position or with different duties, but still employed.

A recent report commissioned by America's Health Insurance Plans (AHIP) found that private LTD insurance reduces the SSDI rolls by at least 65,000 people at any given point in recent years.[10] This reduction is the result of private DI's assistance in recovery and medical improvement, which causes fewer individuals to enter the SSDI program and more to exit it, or exit sooner. Subsequently, the report estimated that private disability insurance reduces federal expenditures on SSDI and other transfer programs (mainly Medicare and Medicaid) by $2 billion annually, and $25 billion over the next 10 years.[11]

Employers have an incentive to accommodate their current workers' disabilities, as opposed to simply hiring new workers. Not only do employers have a stake in the time and money they have invested in existing workers, but high disability rates also drive up employers' costs for private disability coverage. The federal SSDI program lacks any incentive for employers to accommodate workers with disabilities.

More Efficient and Timely Determination Process. Even if an accommodation—adequate or not—does not prevent an individual from seeking private LTD benefits, the private determination process does an arguably better job of granting LTD benefits based on true medical need.

Private insurance determinations are based on medical disability, as opposed to non-medical factors such as age, education, and inability to speak English. And while the federal program relies on outdated medical definitions and technologies, private LTD makes use of emerging information and modern-day technology to assess individuals' work capabilities.

Equal representation in private LTD determinations likely contributes to more accurate determinations. In private LTD claims, both the claimant and provider are represented; the applicant can state and defend his case while the insurance provider can ask questions and seek evidence as proof of the claimant's stated disability. Under the federal program, most claimants have third-party representation (someone who is hired, and later paid, by the SSDI program if the individual is granted benefits), but no one represents the government. Rather, administrative law judges (ALJs) are to represent the claimant, even when that claimant has his own representative.

Lopsided representation produces lopsided determinations, with a not insignificant number of able-bodied individuals receiving SSDI awards. This hurts truly disabled individuals by draining SSDI revenues as well as creating a negative public perception of SSDI beneficiaries.

In addition to being arguably more equitable, the private LTD application and adjudication process is undeniably more efficient. Under the federal system, workers must be unable to work for five months before they can apply for SSDI benefits. After applying, the average federal SSDI beneficiary waits 107 days for their initial SSDI claim to be processed.[12] If an individual is denied benefits at the state level

10. Charles River Associates, for America's Health Insurance Plans, "Private Disability Insurance and Return-to-Work: Cost Savings to SSDI and Other Federal Programs," September 26, 2013, http://www.ahip.org/PrivateDIReturntoWork92013/ (accessed June 4, 2015).

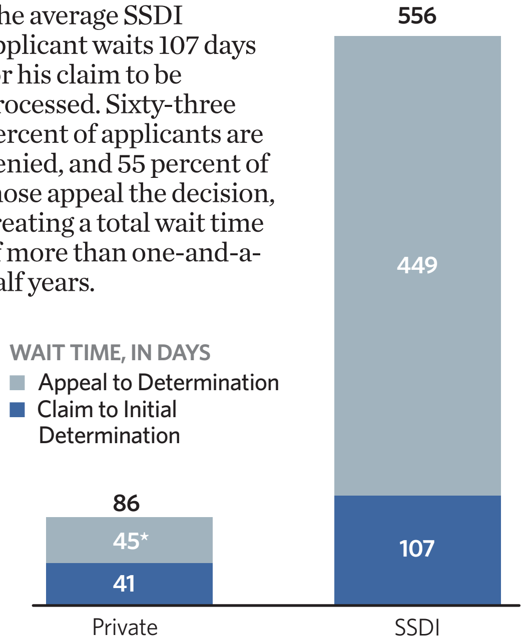
11. Ibid.

12. Social Security Administration Office of the Inspector General, "Evaluation Report: The Social Security Administration's Progress in Reducing the Initial Disability Claims Backlog," April 2014, http://oig.ssa.gov/sites/default/files/audit/full/pdf/A-07-13-13073_0.pdf (accessed June 4, 2015).

CHART 4

Shorter Wait Times with Private Disability Insurance Providers

The average SSDI applicant waits 107 days for his claim to be processed. Sixty-three percent of applicants are denied, and 55 percent of those appeal the decision, creating a total wait time of more than one-and-a-half years.



* Data was not available on the average wait time for private appeals decisions, but federal law (ERISA) requires private DI to make both initial and appeal determinations within 45 days of claims receipt.

Sources: Social Security Administration, Office of the Inspector General, "Evaluation Report: The Social Security Administration's Progress in Reducing the Initial Disability Claims Backlog," April 2014, http://oig.ssa.gov/sites/default/files/audit/full/pdf/A-07-13-13073_0.pdf (accessed July 15, 2015), and Administrative Law Judge Case Statistics, "All States," http://www.disabilityjudges.com/state (accessed July 15, 2015); and Gen Re, *Disability Fact Book*, 7th ed., 2013–2014, p. 7.

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by the Disability Determination Services (DDS) and then appeals his decision (63 percent of applicants are initially denied benefits and of those, 55 percent appeal the decision),[13] the average applicant waits 449 days for a hearing and determination from the Office of Disability Adjudication and Review.[14]

In stark contrast to SSDI, private LTD providers operate under strict claim and appeal procedures set forth in the Employee Retirement Security Act (ERISA). Private LTD plan administrators must notify a claimant with respect to his disability determination within 45 days. While it is possible for providers to extend this period by up to 60 days under some circumstances, the average decision time for new, private LTD claims in 2011 was 41 days.[15] Appeals for private LTD claims must also be determined within 45 days.

Timely claims and appeals procedures are only one of the many employee protections that exist for private LTD beneficiaries but not for public beneficiaries. Other protections include: employee disclosures on plan benefits and rights; investigation, audit, and enforcement to protect benefits and rights; and the ability of employee-participants to sue a plan to recover benefits or enforce rights. Lack of these protections under SSDI is particularly troublesome as the program faces insolvency and beneficiaries have no claim to their promised benefits.

Additionally, initial decisions may be more accurate at the private level. In 2008, 63 percent of all SSDI applications were denied at the initial stage. Of those initially denied, 55 percent appealed their decisions and 61 percent of those appeals resulted in SSDI awards.[16] The fact that applicants are significantly more likely to receive benefits upon appeal—after having been determined ineligible at the DDS level—is troubling. The reverse should be the case; award rates should be lower upon appeal. Although industry-wide data on private LTD appeals is not available, evidence from select providers shows extremely low appeals rates of about 1 percent, with even fewer resulting in litigation.

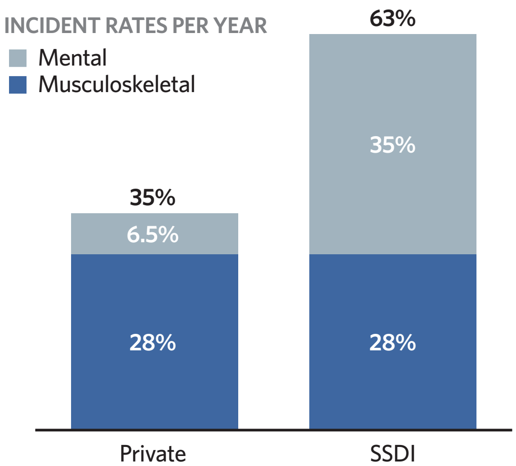
Lower appeal and reversal rates among private LTD may be attributed to a better ability to assess disability at the initial stages. In 2013, 63 percent of all SSDI benefits were based on mental or musculoskeletal disorders.[17] In comparison, 35 percent of

13. Jeffrey Liebman, "Understanding the Increase in Disability Insurance Benefit Receipt in the United States," *Journal of Economic Perspectives*, Vol. 29, No. 2 (Spring 2015), p. 126.
14. Administrative Law Judge Case Statistics, "All States," http://www.disabilityjudges.com/state (accessed July 13, 2015).
15. Gen Re, *Disability Fact Book*, 7th ed., 2013–2014, p. 7.
16. Liebman, "Understanding the Increase in Disability Insurance Benefit Receipt in the United States," p. 126.
17. Social Security Administration, *Annual Statistical Report on the Social Security and Disability Insurance Program, 2013*, Table 11. "Number and Percentage Distribution by State or Other Area and Diagnostic Group," December 2013, http://www.ssa.gov/policy/docs/statcomps/di_asr/ (accessed June 4, 2015). In 2011, mental and musculoskeletal disorders accounted for a similar percentage of SSDI claims, at 62 percent.

CHART 5

Harder-to-Diagnose Disorders More Prevalent in SSDI

According to the most recent data, 63 percent of all SSDI benefits were based on mental or musculoskeletal disorders. Only 35 percent of private benefits were for similar claims.



Note: The most recent private figures are from 2011, while the most recent SSDI figures are from 2013. In 2011, the incidence of musculoskeletal and mental disorders within SSDI was 62 percent.
Sources: Social Security Administration, *Annual Statistical Report on the Social Security and Disability Insurance Program*, 2013, Table 11, http://www.ssa.gov/policy/docs/statcomps/di_asr/(accessed June 19, 2015), and Gen Re, *Disabilty Fact Book*, 7th ed., 2013-2014 (p. 11).

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private LTD claims in 2011 were based on mental or musculoskeletal disorders.[18]

More People Back at Work: Successful Rehabilitation and Superior CDRs. Private LTD is structured in a way that encourages insurers to work closely with employees, their physicians, and employers to achieve return-to-work success through early intervention and the provision of workplace accommodations. Private LTD provides more than just cash; many plans include work incentives, rehabilitation, workplace accommodations, and child or dependent care during rehabilitation.

Most truly disabled individuals want to work. Their disabilities are not a means of collecting income without having to work, but rather conditions that prevent them from engaging in work and other daily activities. Private LTDs' comprehensive benefits better assist disabled individuals to re-enter the workforce.

Furthermore, private LTDs' establishment of ongoing relationships with beneficiaries helps provide them the resources necessary to re-enter the labor force, and better prevents individuals with substantial recovery from remaining on disability benefits. Private LTD providers go beyond mailing "check the box" postcards to beneficiaries to ask if they are still disabled. They maintain contact with individuals and their medical providers, monitoring their improvement or lack thereof and providing medical and other rehabilitation resources to improve chances of recovery.

Better monitoring and comprehensive resources prevent individuals with significant medical improvement from remaining on the SSDI system for life. A comparison of SSDI "termination" for work rates versus private LTD "recovery" rates shows that a significantly higher percentage of private LTD beneficiaries return to work in a given year: Between 2001 and 2006, an average of 0.52 percent of all SSDI beneficiaries had their benefits terminated for work while 1.9 percent of all private LTD beneficiaries "recovered" sufficiently to return to work.[19] This 1.9 percent recovery rate does not, however, take into account individuals who received LTD assistance that prevented them from receiving benefits.

Termination is different than recovery, as termination results when an individual earns more than the substantial gainful activity (SGA) level ($1,090 per month in 2015) whereas recovery occurs when an individual resumes employment in his previous or a similar job (typically with earnings similar to predisability income). While the private LTD definition of recovery is more stringent than the SSDI definition of SGA, private LTD recovery rates include individuals who "recovered" in less time than it takes those applying for SSDI to be approved for benefits. Excluding private LTD beneficiaries who "recovered" within six months reduced the recovery rate to 1.14

18. Gen Re, *Disability Fact Book*, p. 11.

19. Charles River Associates, for America's Health Insurance Plans, "Private Disability Insurance and Return-to-Work: Cost Savings to SSDI and Other Federal Programs."

percent, while excluding all who recovered within 12 months reduced the rate to 0.72 percent. These rates correspond to a roughly 40 percent to 120 percent improvement in re-entry rates compared to individuals only receiving SSDI. This is consistent with the AHIP-commissioned study's finding that private LTD beneficiaries are 50 percent to 100 percent more likely to re-enter the workforce than individuals who receive only SSDI benefits.[20]

Increasing employment among the disabled is not only a financial matter of interest to preserving the SSDI system. Increasing employment among the disabled is also a means of empowering individuals and improving their economic circumstances. In addition to higher income, employment also offers individuals freedom and dignity that an SSDI check alone simply cannot provide.

Lower Costs, Higher Benefits, Greater Coverage. Cost comparisons between public and private LTD are difficult because they provide different coverage and different benefits. For starters, when an individual who receives private LTD qualifies for and receives SSDI benefits, it typically serves as an offset to his private LTD benefit, reducing private LTD costs. Also, the SSDI system tends to provide a more generous list of disabling conditions and more lenient determination process, but private LTD typically provides broader coverage based on individuals' inability to perform one's *own* occupation as opposed to the SSDI system's basis of individuals' inability to perform SGA in *any* occupation.

Although not an apples-to-apples comparison, evidence suggests that private LTD could provide the same level of benefits as SSDI for significantly lower costs. The average private LTD policy costs $245 per year (in 2011) and provides a 60 percent replacement rate.[21] The SSDI system effectively costs a worker with median earnings ($39,950 in 2014) $719 per year and provides a 46 percent replacement rate.[22] Most workers with private LTD, however, have above-average earnings ($48,000), meaning the corresponding SSDI cost is significantly higher at $867 annually with a 44 percent replacement rate.[23] Private LTD costs are roughly 0.51 percent of income compared to the SSDI system's 1.8 percent payroll tax.[24]

SSDI replacement rates vary because the program applies the same progressive benefit formula as the Social Security retirement program. SSDI provides about a 60 percent income replacement rate for low earners (those making about $20,000), a 46 percent replacement rate for median earners (about $40,000 in 2014) and a 28 percent or lower replacement rate for high earners (anyone making over Social Security's taxable maximum of $118,500 in 2015).[25] In contrast, most private LTD coverage provides 60 percent or 67 percent income replacement, with monthly benefit caps ranging from $5,000 to $10,000.[26]

Public and private LTD benefits are not mutually exclusive; individuals can simultaneously receive both. When this happens, SSDI benefits usually offset private benefits dollar for dollar. Thus, dual eligibility of some private LTD beneficiaries reduces the cost of private LTD. According to the Council for Disability Awareness, 72 percent of individuals receiving LTD benefits in 2013 also qualified for SSDI payments.[27]

20. Ibid.

21. Gen Re, *Disability Fact Book*, p. 17. The 60 percent replacement rate remains constant regardless of SSDI benefits, so if an individual receives 40 percent replacement from SSDI, LTD provides the remaining 20 percent.

22. SSDI accounts for 1.8 percentage points of the total 12.4 percentage point total payroll tax. Calculations for the median earner come from: Bureau of Labor Statistics, "Usual Weekly Earnings of Wage and Salary Workers, Fourth Quarter 2014," January 21, 2015, http://www.bls.gov/news.release/archives/wkyeng_01212015.pdf (accessed June 8, 2015).

23. Average monthly salary of private LTD recipients in the Autor, Duggan, and Gruber study (footnote 26) was $4,014 ($48,168 annually). The DI tax rate is 1.8 percent of earnings, or $867 for the average private LTD beneficiary.

24. Private LTD costs as a percentage of wages are based on average monthly salary of private LTD recipients in the Autor et al. study ($48,168) and the average private LTD cost ($245/year) provided in the Gen Re *Disability Fact Book*.

25. Author's calculations based on the Social Security Administration's AIME and PIA formulas.

26. The study sample showed that only 4 percent of policies provided less than 60 percent income replacement, about 83 percent provided 60 percent replacement, and 13 percent provided 66.7 percent or higher replacement. See David Autor, Mark Duggan, and Jonathan Gruber, "Moral Hazard and Claims Deterrence in Private Disability Insurance," *American Economic Journal: Applied Economics*, Vol. 6, No.4 (2014), pp. 110–141.

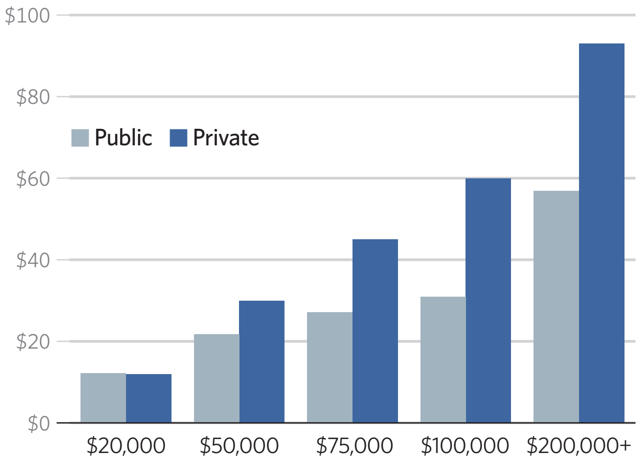
27. Council for Disability Awareness, *2014 Long Term Disability Claims Review*, http://disabilitycanhappen.org/research/CDA_LTD_Claims_Survey_2014.pdf (accessed June 4, 2015).

CHART 6

Private Disability Insurance Proves More Advantageous

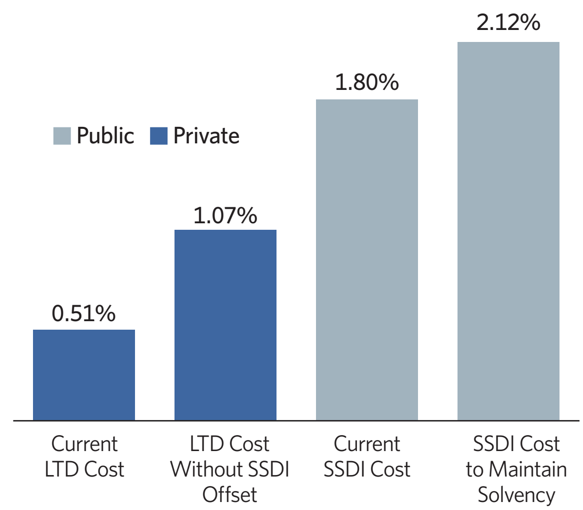
HIGHER BENEFITS. Private disability coverage provides significantly higher benefits than SSDI in all but the lowest of income brackets.

ANNUAL INDIVIDUAL BENEFITS, IN THOUSANDS, BY INCOME LEVEL



LOWER COSTS. Private coverage costs about 0.51 percent of a worker's income, and SSDI is funded by a 1.8 percent payroll tax. To make SSDI solvent, the payroll tax would have to rise to 2.12 percent.

PERCENT OF ANNUAL INCOME



Note: SSDI benefits are capped at $56,849 for anyone earning $118,500 or more in 2015, and most private DI programs place a monthly cap on benefits ranging from $5,000 to $10,000. In the charts above, a cap of $7,750 was used.
Sources: Author's calculations using Social Security Administration's benefit calculation formula and typical private DI benefits equal to 60 percent of prior earnings with a $7,750 monthly benefit cap; author's calculations based on average private LTD cost of $245/year (Gen Re, *Disability Fact Book* 2013-2014); and average $48,186 wage of private LTD recipient (Autor et al.).

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So what effect does the existence of SSDI have on private LTD costs? Assuming an average salary of $48,168 (as found in a study by David Autor and his colleagues),[28] the average initial private LTD benefit would be $2,408 per month, or $28,900 per year. If an average applicant were to qualify for and receive SSDI benefits—equal to $1,764 per month or $21,160 per year—his private LTD benefit would be reduced by the amount of the public benefit. This amounts to a 73 percent decline in private LTD benefits and costs for individuals receiving SSDI benefits.

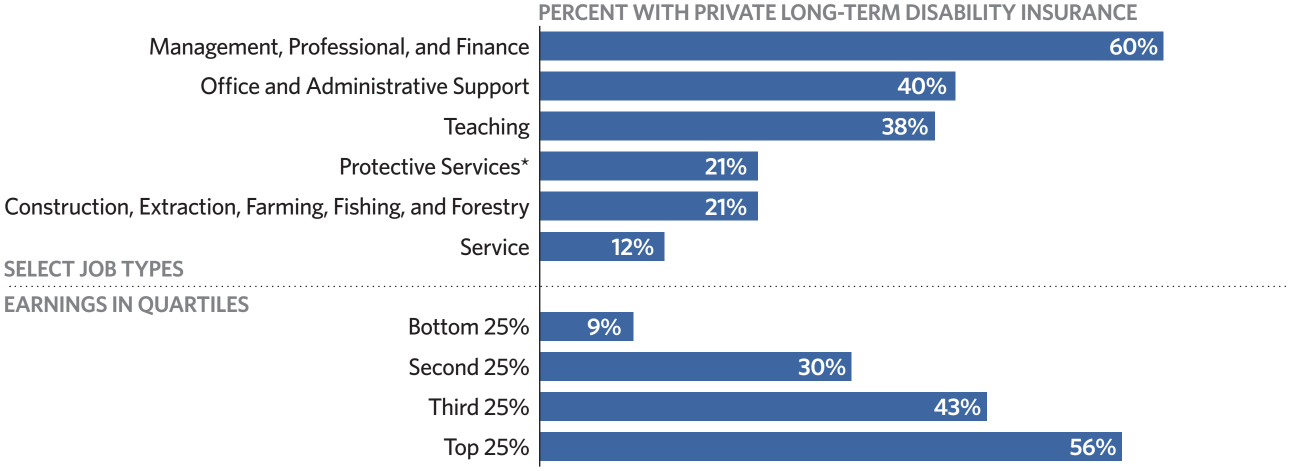
Although private LTD typically pays out benefits long before SSDI kicks in (see average wait times above), for a conservative cost comparison, the assumption is that both payments begin at the same time. If 72 percent of all private LTD beneficiaries simultaneously receive SSDI and private LTD, SSDI offsets the cost of private LTD by 53 percent.[29] In other words, private LTD would have to increase costs by 111 percent absent the SSDI offset. For lower-income workers, SSDI replaces a higher portion of total benefits, so the corresponding increase in

28. Autor, Duggan, and Gruber, "Moral Hazard and Claims Deterrence in Private Disability Insurance."

29. With an average annual benefit of $28,900 for private LTD beneficiaries (based on an average annual salary of $48,168), private LTD pays only 27 percent of the cost for 72 percent of beneficiaries and 100 percent of the cost for 28 percent of beneficiaries. Thus, as a whole, private LTD providers pay 47 percent of what they would pay absent the existence of SSDI. This means SSDI reduces private LTD costs by 53 percent compared to no SSDI offsets. This assumes no difference in age of disability onset or life expectancy among private LTD beneficiaries who qualify for SSDI versus those who do not.

CHART 7

Access to Private DI Varies Significantly by Job Type and Earnings



* Includes firefighting, policing, and similar professions as defined by the Bureau of Labor Statistics.
Source: Bureau of Labor Statistics, "National Compensation Survey," March 2014, "Table 16. Insurance Benefits: Access, Participation, and Take-Up Rates, Civilian Workers," http://www.bls.gov/ncs/ebs/benefits/2014/ownership/civilian/table16a.pdf (accessed June 22, 2015).

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private costs would be less than 53 percent, and the opposite would be true for higher-income workers.

Absent the existence of SSDI offsets, this estimate projects that the average private LTD policy would rise from $245 to $516. This is still $351 less per year (40 percent) than the corresponding $867 cost of SSDI. A $516 private LTD policy equals 1.07 percent of income (for the sample worker with $48,164 income), as opposed to 1.8 percent for SSDI.

The cost advantages of private LTD grow even larger in light of the fact that SSDI is operating in the red. The taxes that individuals pay for SSDI are not even close to covering the costs of the system; in 2014, SSDI paid out 32 percent more in benefits than it collected in revenues. According to the Social Security Trustees, to maintain solvency over the next 75 years, the SSDI payroll tax rate would need to increase by 18 percent, to 2.12 percent of payroll.[30] This is nearly double the 1.07 percent rate estimated for private LTD absent SSDI offsets.

In other words, more is less: Workers pay significantly higher taxes for SSDI and receive significantly lower benefits. In addition to lower costs, most private LTD policies provide more comprehensive "own occupation" coverage as opposed to "any occupation" coverage, and benefits kick in within 45 days, as opposed to months or even years for SSDI benefits.

SSDI provides benefits based on an individual's ability to earn income—namely, SGA income of about $1,090 per month—regardless of the occupation. If a dance instructor sustains a permanent injury to her leg and can no longer teach dance lessons, she is not eligible for SSDI benefits as long she can earn $1,090 a month, even at a menial or undesirable job.[31] Under most private LTD plans, however, she would be eligible for disability benefits based on her inability to perform her own occupation.[32] This type of generous "own occupation" coverage is beyond the intent of SSDI, which is an anti-poverty program.

30. Author's calculations using Table IV.B1. of the 2014 Social Security Trustees Annual Report. The Actuaries estimate an annual cost rate of 2.17 percent of taxable payroll from 2014 to 2090 and an annual income rate of 1.84 percent. This is a gap of 17.6 percent between income and costs. A 17.6 percent increase in the current 1.8 percent SSDI payroll tax equals 2.12 percent.

31. The Social Security Administration set the SGA level for 2015 at $1,090.

32. America's Health Insurance Plans, "An Employer's Guide to Disability Income Insurance," https://www.assurantemployeebenefits.com/816/aebcom/xhtml_clip/disabilityedu/employersguide.pdf (accessed June 4, 2015).

Prevalence of Private LTD

Only 33 percent of all U.S. workers have private LTD coverage, while 36 percent have private short-term disability coverage.[33] Coverage rates vary widely, however, across workers and sectors. For example, 60 percent of all workers in "management, professional and finance" jobs have private LTD coverage compared to only 12 percent of those in "service" jobs, and while 59 percent of workers in the top 10 percent of earnings have LTD coverage, only 3 percent of those in the bottom 10 percent of earnings are covered.[34]

Private LTD can help keep workers on the job and help more disabled individuals return to work, and it also can delay the receipt of SSDI benefits for those who eventually enter the public system. Consequently, the existence of private LTD reduces the cost of the SSDI program by an estimated $2 billion per year, or $25 billion over the next decade.[35] Higher private LTD coverage rates would translate into higher SSDI savings.

The U.S. Private Example. The U.S. has a small-scale example of a completely private DI system. In 1981 and 1982, before Congress closed the loophole that allowed them to do so, three Texas counties (Galveston, Matagorda, and Brazoria) opted out of the Social Security and Disability Insurance system, creating their own Alternative Plan (AP). Individuals and employers in those counties still make payroll tax contributions, but instead of going to the federal Social Security and Disability Insurance Trust Funds, those contributions go to privately managed retirement, disability, and life insurance accounts. Workers under the AP contribute between 2.5 percent and 4.0 percent of their payroll toward private disability and life insurance, compared to 1.8 percent for SSDI.[36]

The AP plan offers roughly double the DI benefits of SSDI:[37] The AP provides workers with 66 percent to 80 percent of their monthly salaries, up to a maximum of $8,000 per month, compared to a 52 percent replacement rate for a median worker and average benefit of less than $1,200 per month under SSDI.[38] Additionally, the AP provides a significant life insurance benefit equal to four times a worker's annual salary, up to $215,000.[39] Social Security, in comparison, provides a measly $255.[40]

In short, existing private LTD coverage and the AP example show that SSDI is a bad deal for workers who could receive significantly higher benefits for less than they and their employers currently pay in payroll taxes. Workers and employers should not have to pay a premium to receive subpar benefits; they should have the option of purchasing private LTD coverage that is at least as generous as SSDI.

Proposal: Optional Private LTD to Cover Initial Disability Period

Allowing private LTD a role within the public system could generate significant savings for SSDI while also improving the lot of disabled individuals through a more efficient and accommodative program that increases work capacity and economic well-being.

An optional private LTD program covering the first two or three years of benefits would work like this:

- Employers, including the self-employed, would choose whether to purchase private LTD coverage for their workers.

33. Bureau of Labor Statistics, "National Compensation Survey: Employee Benefits in the United States," March 2014, Table 16. "Insurance Benefits: Access, Participation, and Take-Up Rates, Civilian Workers," http://www.bls.gov/ncs/ebs/benefits/2014/ownership/civilian/table16a.pdf (accessed June 4, 2015).
34. Ibid.
35. Charles River Associates, for America's Health Insurance Plans, "Private Disability Insurance and Return-to-Work: Cost Savings to SSDI and Other Federal Programs."
36. Merrill Matthews, "The Private Sector Can Reform Social Security's Disability Program," The Institute for Policy Innovation, May 26, 2015, http://www.ipi.org/ipi_issues/detail/the-private-sector-can-reform-social-securitys-disability-program (accessed June 4, 2015).
37. U.S. General Accounting Office, "Social Security Reform: Experience of the Alternative Plans in Texas," report to the Chairman and Ranking Minority Member, Subcommittee on Social Security, Committee on Ways and Means, U.S. House of Representatives, February 1999, http://www.gao.gov/archive/1999/he99031.pdf (accessed June 4, 2015).
38. Matthews, "The Private Sector Can Reform Social Security's Disability Program."
39. Ibid. There is also a minimum life insurance benefit of $50,000.
40. Ibid.

- Those who choose to provide qualified benefits—at least equivalent to SSDI benefits—would receive a payroll tax credit that would help cover the costs of providing private LTD.
- Workers with private LTD coverage would first apply for DI benefits through their employer's plan. If awarded benefits, private LTD would provide benefits for the first two or three years, and then transfer beneficiaries to the SSDI program.

The transition from private LTD to SSDI could work in any number of ways, but a well-functioning private system would allow most beneficiaries to seamlessly transition to the public system. One could imagine the shift requiring little more than filling out a form and the private LTD provider submitting documentation of the individual's case to the public program. All this would be done in advance of the actual transition to prevent any disruption in benefits.

Additionally, employers may choose to offer private LTD coverage extending beyond the initial two-year or three-year period, allowing workers to maintain partial private LTD benefits even after transferring to SSDI. Private LTD coverage typically provides a 60 percent replacement rate. Replacement rates for SSDI vary, depending on income levels; a median earner receives about a 46 percent replacement rate whereas a high-income earner receives a 28 percent or lower replacement rate. Extension of private LTD coverage beyond the initial period could result in higher monthly and lifetime incomes for disabled workers. Based on existing costs of private LTD coverage, it is likely that the payroll tax credit could be large enough to provide higher initial and long-term benefits than SSDI. Although not required, private LTD policies could extend coverage beyond the initial two-year or three-year period, providing a supplement to individuals who transition to SSDI.

Workers with private LTD coverage would not lose access to the SSDI system; if denied benefits through private LTD coverage, workers could subsequently apply for benefits from the public system. To help reduce the administrative burden on applicants and federal adjudicators, the evidence and findings from the private determination could be used in the public determination process.

The advantage of using private LTD for the first three years of benefits is that it would capitalize on the private sector's ability to keep more people employed, as well as on its arguably more efficient adjudication process. Not only would fewer people likely enter the federal program because accommodations and verification of continued disability would keep more people in jobs, but the federal program would save most of the costly administrative expenses of determining benefit eligibility for individuals with private LTD coverage.

According to a study on private disability insurance commissioned by AHIP, private DI coverage effectively prevents about 9 percent of all private DI beneficiaries who would otherwise receive SSDI benefits from doing so.[41] Private LTD providers do this through collaboration with employers and medical providers, helping more employees remain on the job. SSDI does nothing to help current workers stay in their jobs—it is not until an individual has been unable to work for five months that he can apply for SSDI benefits. In addition, the comprehensive accommodations provided by private LTD help individuals recover more quickly. According to the AHIP study, people who receive private LTD benefits and accommodations returned to their pre-disability "Ability to Work" condition more than a year earlier—33 months compared to 48 months—than SSDI beneficiaries.[42]

Additionally, expansion of private LTD through optional employer enrollment would provide employers the opportunity to better tailor the insurance needs of their workforce. As employers and employees work with private LTD providers, they will likely learn valuable lessons—such as accommodations and treatments that best improve employee health outcomes according to their unique disabilities—that can help improve the SSDI system.

Conclusion

The SSDI program is about to run out of money, threatening the physical and economic well-being of nearly 11 million disabled workers and dependents.

41. According to Charles River Associates' "Private Disability Insurance and Return-to-Work: Cost Savings to SSDI and Other Federal Programs," private LTD prevents about 64,667 of 712,000 total private LTD beneficiaries from receiving SSDI benefits.
42. Charles River Associates, for America's Health Insurance Plans, "Private Disability Insurance and Return-to-Work: Cost Savings to SSDI and Other Federal Programs."

Congress must act now to reform the program in ways that will return SSDI to its original purpose of preventing poverty among the truly disabled. There is not enough time for necessary reforms to generate enough savings to keep the program solvent in the short term, but reforms that make the program solvent for the long term *must* accompany any short-term fix, such as temporary borrowing.

One of the reforms that policymakers should consider is offering employers a payroll tax credit in exchange for providing private LTD coverage to their workers. Private LTD offers a faster, fairer, and more efficient adjudication process; assistance and accommodations that can keep workers on the job and help more return to work; more effective screening and monitoring to weed out fraud and abuse; and lower costs. Extending these private-sector benefits to the public program through optional employer-provided coverage could generate significant savings for the program and far better outcomes for the disabled.

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