CHAPTER 34

GROUP LIFE INSURANCE PLANS

Introduction

Many employers provide death benefits for survivors of deceased employees. There are two types of plans designed specifically for this purpose: *group life insurance plans,* which normally make lump-sum payments to a designated beneficiary or beneficiaries, and *survivor income plans,* which make regular (usually monthly) payments to survivors. Additionally, benefits may be paid to survivors from other employee benefit plans (e.g., profit-sharing, thrift, and pension plans). Survivor benefits are also available through the Social Security program (see Social Security chapter). This chapter discusses group life insurance plans.

The concept of *individual* life insurance was developed centuries ago, but *group* life insurance developed more recently. In 1911, the first known group life insurance contract was created at the Pantasote Leather Company in Passaic, NJ. The contract was called the *yearly renewable term employees' policy* and included many features that are standard in today's group term life policies. According to the American Council of Life Insurers (ACLI), by the end of 1920, there were 6,000 group life insurance master policies[1] in force, providing total coverage of $1.6 billion; by 1940, there were 23,000 master policies providing total coverage of $15 billion; and by 1945, there were 31,000 master policies providing total coverage of $22 billion (American Council of Life Insurers, 2002).

The wage freeze of World War II spurred a boom in group life insurance. Employees, knowing they could not get wage increases, requested additional benefits. Employment-based life insurance coverage was one of the most-demanded benefits. As a result, by 1950 there were approximately 56,000 group life insurance master policies in force, providing total coverage of $48 billion.

Employment-based life insurance has continued to grow. At the end of 2005, 167.1 million group life insurance certificates were providing $7.1 trillion of coverage to Americans—most of it employer sponsored. This group coverage accounted for 44.9 percent of the face value of *all* life insurance in force in the United States at the end of 2005 (American Council of Life Insurers, 2006).

[1] A master policy is a policy issued to an employer or trustee establishing a group insurance plan for designated members of an eligible group.

In 2006, 50 percent of employees in private industry participated in employer-provided life insurance protection (U.S. Department of Labor, 2006).

The Insurance Contract

The contract between the insurance company and the employer is usually for *group term* life insurance. Many associations and multiemployer plans also provide group term life benefits.[2] The word *term* means that the coverage is bought for a specific time period (usually one year), with a renewable provision, and remains in effect only as long as premiums are paid. It may be referred to as *yearly* or *annual renewable term.* Term insurance has no savings features and no buildup of cash value. It is pure insurance protection, paying a benefit only at death.

The cost of providing group life coverage varies, depending on the insurer and the covered group. For small groups, charges usually are taken from a *standard rates table.* Monthly premiums typically range from $0.08 per $1,000 of coverage for employees under age 30 to $1.17 per $1,000 of coverage for employees in their early 60s. For large groups, the initial premium might also be taken from a standard rates table; however, in the second and subsequent years of coverage, plans are often designed such that the premium varies according to the group's claims experience. After the first year, the net premium for a large group is essentially the sum of claims incurred plus the insurer's administrative costs and an amount to provide for profit and risk.

Plan Provisions

Eligibility—Most group term life plans allow permanent full-time employees to be eligible for coverage on the first day of active employment. Some plans require that participants work a minimum period (typically one to three months) to qualify for the plan.

Amounts of Insurance—Employers provide varying levels of coverage. The amount of coverage can be based on one or more factors (e.g., occupation and/or salary). According to the Bureau of Labor Statistics (BLS), the most common method of determining basic coverage for employees in private industry in 2003 was the *multiple-of-earnings* benefit. Fifty-seven percent of employees in the BLS survey had a basic life insurance plan determined by the multiple-of-earnings method. A *dollar amount* benefit, which occasionally

[2] Other major types of group life insurance are *permanent* forms, including *paid-up* and *ordinary* life insurance. For more information on these two other types, see Rosenbloom, 2005. Since *term* insurance is the most popular group coverage, this chapter will focus primarily on group *term* life insurance.

varies with earnings or service, was the other prevalent means of providing life insurance protection. Thirty-eight percent of employees in the BLS survey had basic life insurance determined by a flat dollar amount (i.e., not varying with earnings or service), often $5,000–$15,000. Although it typically provides smaller amounts of insurance than earnings-based formulas, flat-amount coverage has improved considerably over the years (U.S. Department of Labor, 2005).

Employee Cost—Employers typically pay the entire cost of basic life insurance. When life insurance benefits are offered as part of a cafeteria plan or reimbursement account, employee contributions may be required. Another form of employee contribution is a specified flat dollar amount (e.g., $0.20 per $1,000 of coverage per month). In supplemental plans, the cost is usually paid entirely by the employee. Supplemental coverage is more prevalent for employees who have their basic insurance determined by a multiple-of-earnings formula than for those with a flat dollar amount of coverage.

Dependent Life Insurance—As part of the group life insurance plan, some employers offer insurance coverage for dependents. The cost of dependent coverage is usually paid by employees who elect such protection. Dependent life insurance usually provides a flat dollar benefit for a worker's spouse and an equal or smaller benefit for children (usually between the ages of 14 days and 19 years), although the benefit may vary by employee option or may be a percentage of employee coverage. Spousal coverage typically provides benefits of $5,000 or more, while coverage for children usually offers benefits of $1,000, $2,000, or $5,000 per child.

Accidental Death and Dismemberment (AD&D) Insurance—Frequently, group life insurance plans include AD&D insurance. This insurance provides additional benefits if a worker dies in an accident or loses an eye or a limb in an accident. In the case of accidental death, the AD&D benefit commonly equals the basic life insurance benefit, whereas in the case of dismemberment, the AD&D benefit is usually equal to only a portion of the basic life insurance benefit.

Beneficiary Provisions—Under a typical group plan, employees may designate and change the beneficiaries who are to receive their group life insurance proceeds. At an insured employee's death, the stipulated benefit is paid directly to the named beneficiary. If payment cannot be made to a designated beneficiary, group contracts usually permit payment by the insurance company to one or more of a group of the employee's surviving relatives.

Benefits for Retired Persons and Older Active Workers—Most group life policies are designed to cover active employees. Coverage for active older employees can be reduced to reflect the increase in the cost of life insurance as a result of age. This practice will not violate the Age Discrimination in Employment Act as long as the reduction for an employee of a particular age is justified by the increased cost of coverage for that employee's specific age bracket, encompassing no more than five years. Plans that reduce coverage typically make their first reduction at age 65 or 70. Many plans reduce coverage for older workers only once, but other plans reduce coverage in several stages. At retirement, basic life insurance coverage may continue (often for the rest of the retiree's life), but the amount of the benefit is usually reduced at least once during retirement.

Conversion Privileges—If an employee's insurance ceases under certain situations (e.g., employment termination or retirement), the employee may convert his or her group coverage to an individual policy. Under state law, the employee is generally permitted to obtain an individual ordinary life insurance policy of an amount equal to the amount of the employee's previous coverage. Application must be made in writing and a premium (based on the employee's age, type of insurance, and the class or risk involved) paid within 30 days after termination of group coverage (Mamorsky, 1992).

A second conversion situation exists when the group master policy itself is terminated or amended so as to terminate the insurance on all employees or on the class of employees to which the employee belongs. In this situation, the conversion privilege is available for employees who have been insured at least five years, and the maximum amount that may be converted on any one life is $2,000 (Rosenbloom, 2005).

Disability Benefits—Group plans generally continue to provide some life insurance protection for a covered employee who becomes totally and permanently disabled. Although group term life plans contain three basic types of provisions regarding the continuation of coverage in the event of a covered person's disability, the most common is a *waiver-of-premium disability benefit.*[3] Under such a provision, coverage is continued at no cost to the disabled employee, providing:

- The employee is under a specified age (such as 60 or 65) at the onset of disability.
- The employee is covered under the plan at the onset of disability.
- Disability continues until death.
- Proof of total and continuous disability is presented as required by the plan.

Optional Forms of Payment—The standard payment method for group life insurance claims is a lump-sum distribution. However, virtually all insurers permit other settlement arrangements at the insured employee's

[3] The two other provisions are a *maturity value benefit* and an *extended death benefit.* For more information on these provisions, see Rosenbloom and Hallman, 1991.

option (or the beneficiary's option, if the employee did not make an election before death). Alternative payment arrangements include installment payments and life income annuities.

Taxation

The employer's premiums for group term life insurance are tax deductible as a business expense, and the benefits paid to beneficiaries are exempt from federal income taxation up to a limit. However, the proceeds are generally subject to estate taxes.

Employees may receive up to $50,000 in employer-provided life insurance coverage without paying income tax on the amount. On coverage beyond $50,000, the employee is taxed on the cost[4] of the balance. In cases where an employee contributes toward the cost of the insurance, that part of the contribution is credited to any coverage in excess of $50,000.

Group Universal Life Programs

Group universal life programs (GULPs) were first introduced in 1985 and developed from individual policy universal life (UL) programs. UL is issued on an individual basis, whereas GULP coverage is available on a group basis. GULP plans may supplement a regular group term life insurance plan or may exist as stand-alone plans.

GULPs combine group term life insurance with a savings element or cash accumulation feature. This investment element can be used to create nontaxable permanent insurance or to accumulate savings. GULPs are made available to employees by an employer to which a master policy has been issued, and employees pay the entire premium. According to ACLI, in 2000, life insurance companies issued 981 certificates for group universal life insurance, and 8,048 certificates for group universal life insurance were in force in 2000 (American Council of Life Insurers, 2002).

Participation by employees is voluntary. A formula in the plan is used to establish the amount of life insurance coverage available to employees (e.g., one or two times compensation). Employees may choose to contribute only to the cost of term protection and administrative expenses, but many also contribute to the savings element. All employee contributions (including those to the cash value) are withheld from after-tax pay, although the investment earnings on the cash value are not taxed until coverage is surrendered or until the cash values are taken as income or withdrawn. This tax-deferred buildup of the cash values is an attractive feature for the employees.

[4] A table in the Internal Revenue Code determines cost, although this cost may differ somewhat from the actual cost of the insurance.

Another feature important to employees is the portability of GULPs. When a participating employee terminates employment (e.g., to change jobs or to retire), he or she may make premium payments directly to the insurance company and hence continue coverage. Employees may withdraw cash values at any time and may take loans against their cash values.

Some GULPs limit coverage to employee life insurance, but others allow employees to include accidental death and dismemberment insurance and dependent coverage for spouses and children. Children are usually only covered for term insurance, whereas spouses may be able to accumulate cash values. Some plans also allow employees to add coverage payable in the event of the employee's disability.

Premium rates for the term insurance portion of each employee's group coverage are stated in the plan and usually increase with the employee's age. These rates are usually guaranteed for some amount of time (e.g., one, three, or five years) and may be lower than individual term rates. The interest credited to cash values is set periodically by the insurance company. Once a rate is set, it may be guaranteed for a limited period of time (e.g., one year). There is also a guaranteed minimum interest rate that is set for purposes of state insurance and federal tax laws.

Living Benefits

Living benefits, also known as *viatical* settlements, allow the insured to receive the proceeds payable on death while still living. The amount received is the actuarially discounted value based on the individual's expected remaining lifetime and is paid by a third party (a living benefits company) rather than by the insurance company that issued the life insurance policy. The living benefit company typically takes an irrevocable absolute assignment of the life insurance policy and in return pays (in cash) 50 percent to 80 percent of the face amount of an individual life insurance policy of a terminally ill individual (and sometimes of an individual who has attained a specified age, such as 83 or over). As terminally ill patients reach lifetime health benefit limits in an employment-based health benefit plan, they may find living benefits attractive since they allow individuals to access the cash value of the life insurance policy while still living, usually to help pay medical bills.

Conclusion

The death of a worker can be financially devastating to his or her family. Employer-sponsored life insurance benefits can ease the ensuing financial difficulties. The number of employer-sponsored life insurance plans has grown significantly, attesting to their importance. To design effective programs and to ensure an adequate amount of compensation for family members in the case of the covered employee's death, employers and employees should consider how these plans fit in with other potential private and public sources of life insurance, survivor benefits, and death benefits.

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Additional Information

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