

## **8. Disability Insurance: What to Look For**

If it's human nature to avoid thinking about our own death, it is also typically human to shun thinking about becoming disabled. Yet each year in America thousands of people become permanently disabled and can no longer perform the duties of their regular job. Thousands more become temporarily disabled.

Losing your earned income due to an illness or injury can seriously impact your ability to meet today's obligations and your future goals. How can income continue even though you cannot work? Here are several ways:

- Personal
- Investment assets
- Qualified retirement plans
- Business interests
- Inheritances
- Another person's ability to earn income
- Government sponsored programs (e.g., public assistance)

When you compare the amount of money these sources produce to the amount of income you require, there may be a shortfall. Disability income insurance is a way to cover the shortfall.

Insurance can produce the necessary income level to give you the time to accumulate or reposition other income sources. You will want to ask three questions and design the insurance coverage accordingly: How much? How soon? How long?

How much monthly income is required? Allow for fluctuations in income, both increasing and decreasing. Inflation increases the requirement while other income sources decrease it. Also, look at the possibility that the income level you require may change depending on the time frame you deal with: the present, intermediate, or long term. Insuring more than 80% of your personal income is difficult to do on an individual basis, but an individual policy can be supplemented with a company-sponsor group

disability plan. Individual policies may also be issued with a “cost of living” rider to offset the effects of inflation over time.

How soon from the time your earned income decreases or stops would you be faced with looking at a shortfall? 30 days, 60 days, 90 days, ... 2years? Individual policies can be designed to pay benefits at any of these intervals, plus others.

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How long is the income going to be needed? Again, think about other income sources. If those alternatives do not ensure that you will have lifetime income, then you may want to own insurance coverage with a lifetime benefit. Other choices for the protection period can be two years, five years, or to age 65.

### **What Kinds of Policies Are Available?**

We have looked at how you determine the amount and timing of a disability benefit. Now we will look at the policy types. The following types of coverage are available:

- Group Insurance
- Association Group Insurance
- Individual Guaranteed Renewable Insurance
- Individual Non-Cancelable Insurance

*Group Insurance and Association Group Insurance* are renewable at the option of the insurance company providing the coverage. Employer-sponsored group policies are usually issued without evidence of insurability (examination of health history) – at least up to a stated monthly income level. Individual and most association groups do require evidence of insurability. If you have some health history problems, you may be able to get coverage through your employer but not on your own.

Employer-provided group insurance is usually not portable. If you leave the company, you leave the coverage behind. Association plans are available as long as you are a member. The premiums--annual cost of the insurance--are not guaranteed to remain

the same. There is also no guarantee that your employer or plan sponsor will continue to provide this group benefit.

***Individual Guaranteed Renewable Insurance*** guarantees that you can renew your benefit, but the amount of premiums are not guaranteed. That is, the insurance carrier has the right to increase the premium rate for all policyholders in your state, if approved by the state insurance commissioner.

***Individual Noncancelable Insurance*** also guarantees renewability of the benefit and, in addition, guarantees the premiums.

Industry trends have led to variations in the four types of coverage just mentioned. One example is premium discounts for individual coverage if the insurance carrier obtains an exclusive endorsement from an association. However, association discounts are increasingly difficult to obtain because many insurance companies have experienced adverse claims history for these arrangements.

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There are limits to how much of your income can be insured. Group plans commonly insure 60% of an employee's income. Individual plans can usually cover a little more. Often you will find that combining the two types will blend the contractual advantages of each (more about that later) and enable you to insure up to 80% of your earned income (if that's necessary).

### **The More Assurances, the Greater the Premium**

When you look at the costs of disability insurance, you will find the premium will be affected by the type of coverage that you buy and the way in which it is arranged. Let's first look at the factors which affect it by type.

First, your occupation class will partially determine the premium. Then, as you might sense, the more assurance and guarantees a policy has, the more costly the policy will be. For example, a policy with benefits beginning after 30 days and lasting for a lifetime with guaranteed benefit amounts, guaranteed premiums, and guaranteed renewability is more expensive than one with benefits beginning after 180 days with benefits that terminate in two years, nonguaranteed premiums, and nonguaranteed renewability. Health history may also impact premiums for contracts that require evidence of insurability.

One of the major impacts on cost is the wording in the insurance contract that defines the “definition of disability.” That is, when are you sick or injured enough so that the insurance company will pay you a benefit? How much of the benefit the company has to pay and the requirements for you to continue qualifying for the benefit also will come into play.

Group and association insurance, and less liberal individual contracts, typically will base benefit payments on your inability to do your present job for two years. After two years, if you can be employed at some other job based on your training, education, or experience, the company could stop paying benefits even though you might not choose the other job and do not end up working in it.

Policies with these stricter definitions of disability are less expensive than policies with liberal definitions. With a more liberal policy, benefits may continue being paid despite your holding another job. These more liberal contracts have language about “your own occupation” built into their disability definition. If it’s not possible to continue working in your occupation, this protects you from having to perform other work to age 65. Also, these more flexible contracts sometimes provide a partial income benefit if due to disability you have a partial loss of income instead of a total loss.

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### **Keeping the Cost Down**

There are ways to reduce the cost of disability insurance and not compromise the coverage.

One way is for you to assume more of the risk in the early stages of a disability. For example, instead of buying a policy paying benefits after 30 days choose one that starts paying after 90 days. The premium you save by waiting longer to collect benefits may allow you to buy a longer protection period. For instance, benefits paid to age 65 instead of five years.

Another technique is to integrate a disability benefit equal to the amount the government would pay with a Social Security disability benefit. If you become disabled yet do not qualify for the Social Security benefit, then the insurance company would pay. In a way, the insurance company shares its risk with Social Security system. This reduces the cost. However, since you actually have to pay for Social Security while you are working, some practitioners feel that this rider is redundant and prefer to buy a specific amount of guaranteed coverage.

### **Who Buys It? You or Your Business?**

You can buy disability insurance two ways: personally or through a business.

If you have business ownership interest, you would typically own an individual or association group policy, pay premiums and receive the disability income benefits tax free. If your employer offers a group disability plan, you would typically enjoy tax-free employer-paid premium payments but your disability income would be taxable.

If you own an interest in a “C” corporation, you can have the company pay that same individual or association policy and take a tax deduction for the premium as a business expense. The disability income benefits, however, are then taxable. If you are an “S” corporation shareholder, a partner or sole proprietorship, this advantage isn’t available to you.

If you are a business owner, there are other issues to consider in addition to protecting your own income stream. Some of these are: disability coverage to pay business overhead expense while you or another owner is unable to work; disability coverage on key employee to protect profits if that person is unable to work and produce; or disability insurance to fund a buy/sell agreement so you’ll be sure to receive your equity if you have to stop working. In these situations the business usually buys the insurance.

The issue of protecting your income is not answered simply by looking at a disability policy but rather by answering these three questions: How much? How soon? How long? Once your needs are clearly established and you have determined that other income sources are insufficient, then it is appropriate to conduct a search to find the insurance products that have the benefits and features your particular situation requires