

The Need for Disability Income Protection

Imagine what would happen if your ability to earn income were to suddenly disappear. What would your life look like? Even though your income had abruptly stopped, your living expenses would continue. The mortgage and car payments would be due—missing several payments could result in foreclosure or repossession. You and your family would still have to eat, use electricity, heat your home, etc. How would you cope?

You might have enough savings to cover a month or two of living expenses should you become disabled because of sickness or injury. Health insurance will take care of your medical needs, but will not replace your lost income. Social Security may help provide you with some amount of income replacement, but you must wait six months after your disability before any benefits can be paid, and many claims, except for the most serious disabilities, are denied. Only 40% of Social Security applications were approved in 2001.

The statistical evidence on disabilities is sobering: Between the ages of 35 and 65, there is a 30% chance of suffering a disability lasting three months or more; and, should you suffer a disability lasting longer than six months, there is a 30% chance that the disability will last longer than five years (Commissioner's Disability Table A, Society of Actuaries).

The best way to protect yourself from the financial harm that a disability can cause is to purchase **disability income insurance**. Disability income insurance is designed to replace lost income in the event that a disabling illness or injury prevents you from working. It makes an enormous difference at a time when you should be focused on your health and recovery—not on how your bills are going to be paid.

Case Study

Steven is a 34-year-old father of two small children. He and his spouse both work full-time to support their growing family. They have a mortgage, two car payments, and a host of other living expenses to pay on a monthly basis. Suppose Steven's spine was broken in a car accident, rendering him paralyzed. How would his family cope financially with his disability in the short and the long term?

Fortunately for Steven and his family, he purchased an individual disability income policy. As a self-employed CPA, Steven understood the hardship that a disability would cause his family and planned appropriately, by insuring his ability to earn income on an ongoing basis. While Steven may never return to full-time employment because of his physical condition, two-thirds of his salary prior to disability will be replaced by his disability income policy, protecting him and his family for many years to come.

Sources of Disability Income

Disability income protection is provided through three sources:

- Government-sponsored programs, such as Social Security disability insurance or workers compensation insurance;
- Employer-paid or employer-sponsored group disability insurance; and
- Individual disability income policies (private insurance), which can protect individuals when they are not covered by government or employer programs, or when these programs fail to provide adequate coverage to protect an individual's income needs.

Government Disability Programs

Social Security will provide benefits to individuals with qualifying disabilities expected to last at least 12 months. The amount of your disability benefit depends on your salary, the number of years you have been covered, your marital and family status, and whether you are entitled to benefits under workers compensation or other government programs.

Note that eligibility is based on being unable to perform any gainful employment, *not just the job you were performing* at the time the disability began. Social Security disability payments are taxable if your income exceeds certain levels.

Workers compensation pays disability benefits if you suffer an accident at work or an illness that results directly from your employment. You may be eligible for disability benefits under the Veterans

Administration pension program, as a federal or state government worker, under a state vocational rehabilitation program, or if you are a miner covered by the black lung program.

Some states—notably California, Hawaii, New Jersey, New York, and Rhode Island—provide significant short-term disability benefits for non-work-related accidents and illness.

Employer-Paid or Sponsored Group Disability Insurance Programs

Most employers allow some **short-term sick leave** lasting from a few days to as long as six months. In addition, many employers provide **long-term disability benefits**. Typical benefits, which usually start three to six months after the disability begins, replace about 60% of salary and continue usually for five years, and sometimes to age 65.

The cost of group long-term disability insurance is generally very economical and, as such, is usually fully paid by the employer. Employer-paid disability income benefits are income taxable when received, thereby reducing the monthly benefit. Ask your employer for a booklet describing these benefits and get answers to such questions as:

- How long must I wait before benefits begin?
- How long will payments continue during my disability?
- How will other disability coverage, such as that offered by government programs, affect my long-term disability payments?

Other Disability Income Sources

Private programs are another important source of disability income. These programs may be offered by a union group, through your automobile insurance policy for an auto accident, or through credit disability insurance, which makes monthly loan payments when you are disabled.

Individual Disability Insurance

Despite these wide-ranging disability income sources, a disproportionately large number of people don't have any disability insurance or are vastly underinsured. If your income stops when *your ability to work* stops, then putting disability insurance in place is absolutely essential. Even if you can rely on disability benefits from your employer, the government, or another source, you still need to determine whether the monthly benefit would be enough for your needs.

You can make this calculation by adding up all the benefits you are entitled to under various programs and other sources such as your own savings. If this amount approaches your required income after taxes, then you would be able to pay your day-to-day bills while recuperating from a disability. However, if the total amount of your benefits—

plus your own resources—will not be close to your income needs, you should consider buying additional disability insurance.

Business Uses for Disability Income Insurance

Disability income insurance is also essential for owners of small businesses, to protect their income and their business in the event of a disabling illness or injury. Additional protection may be provided through disability coverage specifically for certain business overhead expenses. For businesses with more than one owner, or a partnership, a **disability buy-out policy** will disburse funds for one partner or the business entity to buy a disabled partner's share of the business. A business owner can protect his business against the loss of income resulting from the disability of a key employee through the purchase of **key person disability insurance**.

What Should You Look for in a Disability Insurance Policy?

When selecting an individual disability income policy, the following are important coverage areas to check:

Definition of disability—Policy definitions can vary. Does the policy define disability as the inability to perform your own job or any job? Select a policy that will pay benefits when you are unable to work in your occupation or one appropriate for your education and experience.

Extent of coverage—Are benefits available for total or for partial disability? Are full benefits paid for loss of sight, speech, hearing, or use of limbs whether or not you are able to work? Does the policy cover both accidents and illness?

Amount of monthly benefit—What percentage of income will the benefit replace?

Most insurers limit benefits from all sources to 70% or 80% of net monthly income.

Waiting period—Will benefits begin 30, 60, or 90 days, or even six months after the onset of the disability? The longer the waiting period, the lower your premiums will be.

Duration of benefits—Are benefits payable for one, two, or five years, to age 65, or for a lifetime? Most people need a benefit period that covers their working years—at least to age 65 or normal retirement age.

Inflation rider—Does the policy offer a cost-of-living adjustment? This important rider should always be considered, for as the cost of living continuously increases you will want your benefit to keep pace with inflation.

Renewability—Is the policy noncancelable, guaranteed renewable, or conditionally renewable? A noncancelable policy will continue in force, at the same premiums and benefits, as long as you pay timely premiums; a guaranteed renewable policy will be automatically renewed for an entire class of policyholders, but the premiums may be increased; optionally or conditionally renewable policies are extended each anniversary or premium due date if the company decides to do so.

Waiver of premiums—How long must you be disabled before premiums are waived? Under most policies, you won't have to pay any more premiums after you have been disabled for 90 days.

Option to buy more coverage—Can coverage be increased without further evidence of insurability?

For more help with your disability insurance planning, work with your financial service professional. He or she can analyze your sources of disability income and determine whether additional coverage is advisable.

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