



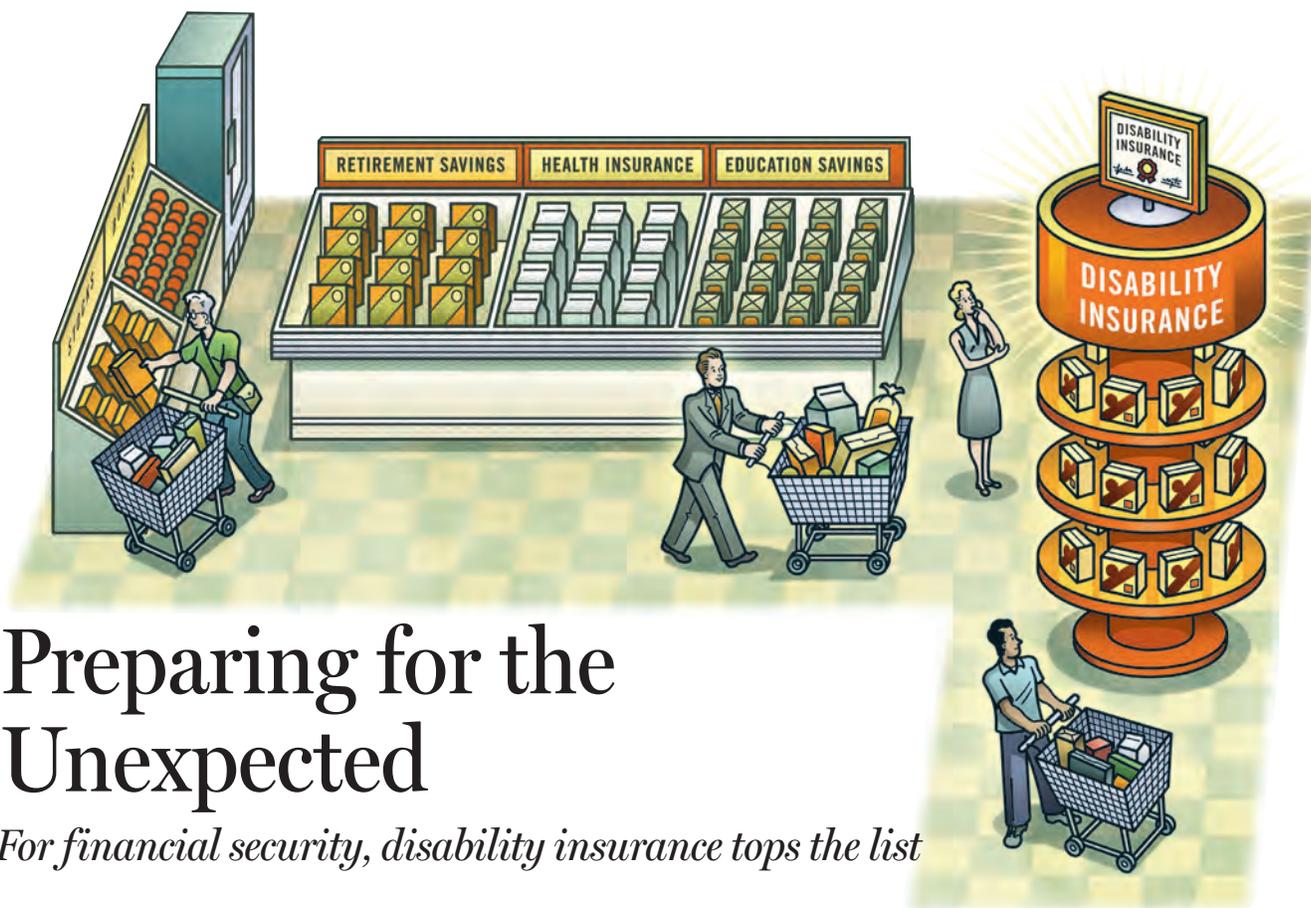
# DISABILITY INSURANCE

{ May is Disability Insurance Awareness Month }

Story By Russ Banham

*Illustrations by Peter Hoey*

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# Preparing for the Unexpected

*For financial security, disability insurance tops the list*

Everyone makes financial decisions important to leading a productive, fulfilling life, from buying life insurance and health insurance to putting aside money in a nest egg for the uncertain future. An equally significant but oft-overlooked component of financial planning is disability insurance, which financially offsets the impact of an illness or injury preventing the ability to earn an income.

Your income often is your largest asset. If you take what you earn today and multiply it by the number of years you expect to work, you have an idea of the financial security that would be compromised in the event of a disability. It's estimated that a lengthy disability will cost a 25-year-old worker who makes \$50,000 a year a potential loss of \$3.8 million in future earnings. For those in higher income brackets, a disability could mean a drastic change in lifestyle.

## Considerable Risk

Prior to the current recession, many people may have believed their savings and investments would take care of their financial needs in the event they could no longer work. Certainly, fewer people have this perception today. The economic crisis has left many Americans with less to fall back on financially, making them more vulnerable to serious financial hardship in the event they are disabled and unable to earn an income.

"People understand the point behind life insurance, the notion that if I die prematurely my death

will have a serious financial impact on my family's future, yet they often fail to perceive the financial risks of a disability," says former Oklahoma Governor Frank Keating, president of the American Council for Life Insurers (ACLI), a non-profit trade association.

Yet, these risks are quite real. The U.S. Commerce Department says one in seven workers can expect to be disabled for five years or more before they retire; one in five will suffer a disability lasting a year or more, maintains the National Association of Insurance Commissioners. Here are some more disturbing statistics: Three in 10 workers entering the work force today will become disabled before retiring. And of the more than 6.8 million workers who are receiving Social Security Disability benefits, almost half are under age 50.

"Most people naively think, 'Disability won't happen to me, it will happen to someone else,'" says Kimberly Mashburn, vice president of strategic part-

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nerships at insurer Prudential Group Insurance. “The lack of knowledge is troubling.”

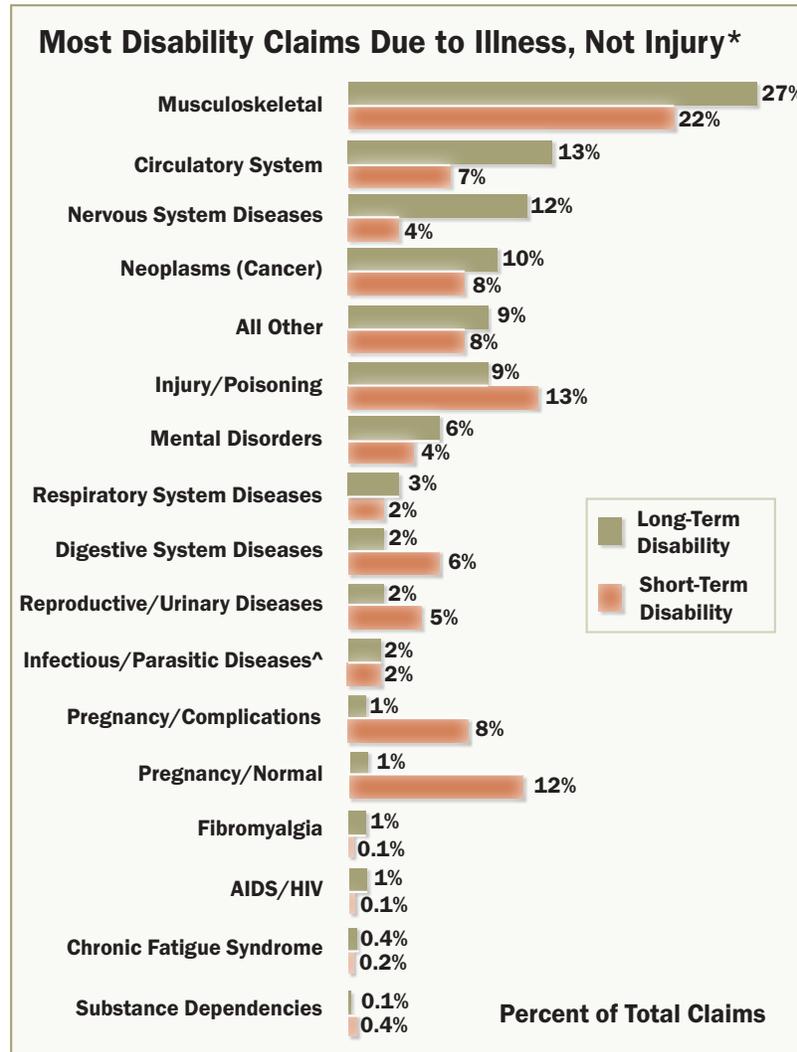
Barry Lundquist, interim president of the Council for Disability Awareness, concurs. “People are unaware or confused about the risk of disability, the impact on their income stream, and the premium for the insurance, which is pennies on the dollar,” he says.

## Government Benefits Meager

“Many employees believe Social Security Disability Insurance benefits will cover them, but these benefits are very hard to obtain and require total disability. However, employers’ disability offerings are more flexible and cover even partial disabilities,” says Robert Risk, vice president of sales for group protection at insurer Lincoln Financial Group.

To qualify for Social Security Insurance, a person must be disabled for five full calendar months, and the disability must be expected to last at least 12 months or otherwise end in death.

A disabled individual also must be unemployable at any occupation, not just his or her own line of work at the time of the disability. Consequently, 60 percent of those who apply for Social Security Insurance are initially denied it, and those who make the grade often have to wait months, sometimes longer, to receive the benefits. Once monies are received, it usually serves only as a supplementary income — averaging slightly more than \$1,000 a month, according to the non-profit Life and Health Insurance Foundation for Education (LIFE). “Government benefits should not be



Source: JHA Disability Fact Book, Fifth Edition, 2008; JHA, 2006 U.S. Group Disability Rate & Risk Management Survey (\*Percent of open claims as of 12/31/2005; represents average for participating companies) (^Excluding AIDS/HIV)

depended on for a comfortable disability income,” says Matthew Tassey, past chairman of LIFE and president of Burwell & Burwell, a Portland, Maine-based insurance and employee benefits brokerage.

Quick and easy recourse to government largesse is just one of many misconceptions about disability risks and cost. Many people mistakenly believe that workers compensation will absorb income lost to a disabling illness or injury, but the insurance only addresses work-related causes. The National Safety Council gauges that nearly 90 percent of disabling accidents and injuries are not work-related and, therefore, not covered by workers compensation.

Another fallacy is that most disabilities are caused by accidents and injuries. Actually, according to an evaluation of claims by JHA, a disability reinsurer, 90 percent of disabilities are caused by illnesses. Vascular problems, musculoskeletal conditions and cancer are among the medical causes of most disabilities, with pregnancy an additional factor for women.

## Withstanding Income Loss

The most pervasive misconception may be a flawed trust in one’s ability to financially withstand the

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loss of income in the event of a disability, especially a prolonged one.

A study of bankruptcy filings by Harvard University revealed that medical disability led to nearly half of the 1.458 million bankruptcy filings in 2001. This research parallels the findings of an earlier Housing and Home Finance Agency study that found 48 percent of home foreclosures were the result of disability while a mere 3 percent resulted from the homeowner's death.

These figures are made more alarming when considering the current economic climate, which has markedly reduced the value of homes and savings and investment accounts. "There is far less to fall back on if you become ill or hurt and can't work for an extended period of time," says Tassey.

Paying for the mortgage and kids' college educations, not to mention a worry-free retirement, will be out of reach for many people who become disabled, even those with significant savings and investments. "Without reliance on a regular paycheck people will watch their assets deplete," says Tassey. "Yet, they still have to pay their taxes, the energy bill and health insurance premiums."

### No Time to Skimp

There is concern that in the effort to economize, people might question whether disability insurance is really needed.

"During times of recession some may consider dropping or reducing their group insurance coverage to save money — and that could have serious consequences for them and their families. Group coverage offers an excellent value and easy way to secure

financial protection," says Lori High, president of group insurance at Prudential Group Insurance.

"Employers must educate employees regarding voluntary insurance value, to help them make informed decisions based on needs," says Risk. "While employers must be cost-conscious, voluntary offerings like disability insurance allow them to continue to offer vital coverage to protect their employees."

### Protective Measures

There are two types of disability income (DI) insurance policies: short-term and long-term. Short-term DI insurance typically pays a percentage of a disabled worker's salary for 13 to 52 weeks after a short waiting, or elimination, period has elapsed, such as one day for an accident and eight days for an illness. Long-term DI insurance

kicks in after the short-term policy has expired. The premium is relatively inexpensive considering the generous benefits provided, roughly \$30 to \$40 a month, on average.

Since both short-and long-term policies pay only a percentage of the employee's salary — usually somewhere in the neighborhood of 50 to 66.66 percent — many policyholders are opting to buy supplemental DI insurance, increasing the salary percentage covered while providing themselves with non-taxable income in the event they become disabled.

"When we conduct employee meetings at our client companies, employees are asking a lot more questions now about disability income protection, whereas in the past they were primarily concerned about their medical coverage," High says. "There's more heightened interest in what their employers are offering and how they can supplement this

coverage."

In cases where the employer pays for the benefit, the amount flowing to the employee post-disability is taxable, thereby reducing the ultimate payout.

For example, an employee making \$100,000 whose employer provides a DI benefit at 50 percent of his or her salary would receive \$50,000 annually. Assuming a 30 percent tax bracket, that overall amount would be reduced by \$15,000. A \$35,000 award for someone earning \$100,000 annually may not be enough to maintain his or her current standard of living.

Supplemental DI insurance augments employer-provided coverage. "It can bring the total amount covered closer to a person's take home pay," says Lundquist. "When an employee pays the disability insurance premium with his or her own after-tax dollars, then claim payments received are considered non-taxable income," he notes.

### Solid Investment

Several factors affect a supplemental premium calculation, including age and health, the benefit period and the benefit amount. Lundquist estimates that group disability insurance, on average, costs about a half-percent of a person's income, and individual insurance about two percent.

"Disability income protection is a wise investment of your resources, particularly when every family in America has an asset base that is roughly half what it was two years ago," says ACLI's Keating. "Now is not the time to absorb the risk of a disability on your income stream."

Lundquist agrees. "Given a one in seven chance of a disability lasting more than five years, the expense is certainly prudent."

*Russ Banham is a veteran business journalist. His articles have appeared in Forbes, The Economist, CFO and Time.*

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*"Most people naively think, 'Disability won't happen to me, it will happen to someone else.'"*

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— KIMBERLY MASHBURN



## Picking a Policy

This checklist from the American Council of Life Insurers (ACLI) can help you compare different policies and decide which features are most important to you.

### **How does the policy define “disability”?**

Some policies pay benefits if you are unable to complete the duties of *any* occupation while others pay benefits if you are unable to perform the major duties of your *own* occupation. Find out how long benefits can be collected under the policy.

### **How will the benefits be paid?**

Find out if the benefit is a percentage of your regular income or a flat amount.

### **Does the policy provide benefits for a partial disability?**

Some policies pay benefits when you can only do part of your job or are unable to work full time.

### **What is the elimination period for the policy?**

Most policies have a waiting period before you start to receive benefits.

### **Does the policy pay benefits if your disability results in less income?**

Some policies will make up income if you must take a lower-paying job because of your disability.

### **Does the policy have a return-to-work or rehabilitation provision?**

Some policies have provisions to help pay for training, modifications to your work environment, or other services that can help you return to work.

### **Is there a wait for benefits if you experience a recurring disability?**

If you return to work after recovering from a disability, and relapse within a specified period, most policies do not make you go through a second elimination period before receiving benefits.

### **Does the policy provide a cost-of-living adjustment (COLA)?**

A COLA provision ensures periodic increases in the amount paid to you that corresponds to cost-of-living increases.

### **How long does the policy pay benefits for disabilities from mental illness or substance abuse?**

Policies usually pay benefits for these conditions up to two years, although limits usually don't apply when institutionalization is required.

### **Is the policy noncancellable? Is the policy guaranteed renewable?**

Under a noncancellable policy, premiums can never be increased. With a guaranteed renewable policy, premiums cannot be raised based on an individual circumstance, but can be increased for an entire class of policyholders. Both can usually be renewed until age 65 and neither can be cancelled by the insurer as long as premiums are paid.

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