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# What you need to know about Disability Insurance

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# Disability Income Insurance

## What is disability income insurance?

Disability income insurance is insurance that pays benefits when you are unable to earn a living because you are sick or injured. Like all insurance, disability income insurance is designed to protect you against financial disaster. Most disability policies pay you a benefit that replaces part of your earned income (usually 50 percent to 70 percent) when you can't work.

***Example(s):*** *Lola, Lorraine, and Leslie were friends who never expected to become disabled. One day, however, Lola broke her leg in a car accident and wasn't able to work as a dance instructor for five months. Because she didn't have disability insurance, she fell behind on her mortgage payments, and the bank threatened to foreclose on her house. A few days later, Lorraine became ill and couldn't work for weeks. With no disability insurance, she was forced to rely on her family for support. Fortunately, Leslie was prepared. She had purchased a disability insurance policy. When she suffered a stress-related heart attack, her disability benefits allowed her to pay her expenses while she recovered.*

## Who needs disability insurance?

### The odds are ... you do

Your chances of being disabled for longer than three months are much greater than your chances of dying prematurely. One reason for this is that medicine has made treatable many illnesses and injuries that formerly would have killed you. Although this is good news, it increases your need to protect your income with disability insurance.

### Working individuals

What would happen if you suffered an injury or an illness and couldn't work for days, months, or even years? If you're single, you may have no other means of support. If you're married, you may be able to rely on your spouse for income, but you probably also have many financial obligations, such as supporting your children and paying your mortgage. Could your spouse really support both of you? In addition, remember that you don't have to be working in a hazardous position to need disability insurance; accidents happen not only on the job but also at home, and illness can strike anyone. Everyone who works and earns a living should consider purchasing disability income insurance.

***Example(s):*** *Bob worked as an accountant, a relatively nonhazardous occupation. However, on Christmas Day, he broke both wrists when he slipped and fell on a patch of ice. Since his injury was not work-related, he was not eligible to receive workers' compensation insurance. In addition, he was not covered by an individual or group disability policy. His wife was working full-time as a seamstress but was not able to support Bob and their children on her salary alone. Within a few weeks, they were in financial trouble.*

***Caution:*** *If you work part-time, work in a hazardous occupation, or are self-employed, you may have a hard time buying a private disability policy. If you can purchase one, it will likely be expensive. You may have to rely on your group employer or association issued disability policies. (See Questions & Answers.)*

### Nonworking individuals

If you don't work because you took an early retirement, or you live off your investments, you may still need disability income insurance. Although your income may remain constant after you get sick or hurt, your expenses may rise dramatically. You may need round-the-clock medical care or part-time help, and you may need special equipment. In addition, you may need to pay high medical insurance deductibles. If you don't have enough income or savings to meet those needs, you may financially burden your family. Many policies may not pay benefits, however, unless a disability results in a loss of income.

***Caution:*** *You may find it difficult or impossible to buy an individual disability policy that will pay benefits if you don't work because disability income insurance is designed to replace the income you lose as a result of not being able to work and maintain your current lifestyle. In addition, in the eyes of the insurance company, you have no financial reason to get better; after all, your income stream from investments won't change. Your only option may be to buy an association policy (if available) or to buy a policy before you retire (unless disability benefits end at retirement). Even if a disability income policy is available to you, you should read it carefully to determine whether it will pay benefits to an individual who is not working at the time the disability occurs.*

### *Business owners and employers*

If you own a business, disability insurance can protect you in several ways. First, you can purchase an individual disability policy that will protect your own income. Second, you can purchase key person insurance designed to protect you from the impact that losing an important employee will have on your business. Third, you can purchase insurance to fund a salary continuation program that will help you reduce your income taxes while protecting key employees at the same time. Fourth, you can purchase business overhead expense insurance to ensure that if you get sick, your business will stay healthy. Finally, you can purchase a disability insurance policy that will enable you to buy your partner's business interest in the event that he or she becomes disabled.

## Types of disability insurance

In general, disability insurance can be split into two types: private insurance (individual or group policies purchased from an insurance company) and government insurance (social insurance provided through state or federal governments).

### *Private disability insurance*

Private disability insurance refers to disability insurance that you purchase through an insurance company. Many types of private disability insurance exist, including individual policies, group policies, group association policies, specialized group policies, and riders attached to life insurance policies. Depending on the type of policy chosen, private disability policies usually offer more comprehensive benefits to insured individuals than social insurance. Individually owned policies may offer the most coverage, followed by group policies offered by an employer or association.

### *Government disability insurance*

Workers' compensation and Social Security are two well-known government disability insurance programs. In addition, some states, including California, Hawaii, New Jersey, New York, and Rhode Island, along with Puerto Rico, have mandatory disability insurance programs that provide disability benefits to resident employees. If you are a civil service worker, a military servicemember, or other federal, state, or local government employee, there are many disability programs set up to benefit you. In general, however, government disability insurance programs are designed to provide limited benefits under restrictive terms, and you should not rely upon them (as many people do) as your main source of income if you are disabled.

## How does disability income insurance work?

### *You become disabled*

What does being disabled mean? If you've ever seen an apparently healthy man or woman park in a handicapped spot at the mall, you know that a person can be disabled without using a wheelchair or showing any outward signs of illness. Any disease or injury that is severe enough can cause disability. For insurance purposes, being disabled means having a mental or physical condition that impairs (either permanently or temporarily) your ability to work. In general, to be considered disabled enough to receive insurance benefits, your condition must be medically certifiable, expected to last for a certain period of time, and (depending on the policy or type of insurance) impair your ability to do your own job, any other job, or both.

***Example(s):*** *Elise is an architect. She develops muscle spasms and is no longer able to write, draw, or use a computer. As a result, her insurance company covers her disability because her physician reports that she is unable to perform any duties of her occupation for at least six months while she undergoes therapy.*

***Caution:*** *Government disability insurance definitions may be much more restrictive than private insurance definitions of disability. For example, to receive benefits under workers' compensation, your sickness or injury must be work-related. When reviewing what coverage you may be entitled to if you become disabled, pay close attention to how the insurance policy or source defines disability.*

### *You apply for benefits, then wait*

Once you become disabled and apply for benefits, you have to wait for a certain amount of time after the onset of your disability before you receive them. If you are applying for benefits under a private insurance policy, this amount of time (called the elimination period) ranges from 30 to 720 days, although the most common period is 90 days. If you are applying for benefits under a type of social insurance, your waiting period may be over six months (for Social Security). After you satisfy the elimination period, you will begin receiving a monthly disability benefit that usually replaces 50 to 70 percent of your earned income.

### You receive benefits, but not usually forever

You can purchase private disability insurance policies that guarantee lifetime coverage, but they are very expensive. Most people buy either short-term policies (benefits are paid for up to two years) or long-term policies that pay benefits up for a few years or up until age 65. In fact, many injuries or illnesses do not disable you permanently; you may be able to go back to work full-time after a rehabilitation period or return to work part-time. Most private and social insurance programs encourage you to go back to work either by paying you partial or full benefits while you try to work or by continually reevaluating your disability. In addition, they usually pay for any training or rehabilitation you might need to help you get back to work.

***Example(s):*** *Clark is seriously hurt. He begins receiving Social Security disability benefits five months after his accident. One year later, he wants to go back to work, but isn't sure he can make a living as a carpenter anymore. According to work incentives established by the Social Security Administration, Clark is able to go back to work for a nine-month trial period without losing any of his benefits. At the end of that period, Clark found that he could resume his career as a carpenter, and his disability benefits ended.*

## Strengths of disability income insurance

### Can protect a disabled person from financial ruin

Typically, people buy property and casualty insurance to protect their possessions (houses, cars, and furniture) and life insurance to provide income for their survivors. However, many people don't think about protecting their income with disability insurance. But how well could you live without your income? Disability is an unpredictable event, and if you become disabled, your ability to make a living will be restricted, at least for the short-term. Although you may have enough money in the bank to meet your short-term needs, what would happen if you were unable to work for months, or even years? The real value of disability insurance lies in its ability to protect you over the long haul.

### Individual policies can be tailored to meet individual needs

Although government disability insurance programs are generally inflexible because they are designed to meet the needs of the masses, private individual policies can be tailored to meet your needs.

***Example(s):*** *Mr. Mason has adequate savings to meet his income needs for six months in the event he becomes disabled, so he buys a disability insurance policy with a 180-day elimination period that will pay him benefits for two years. However, his next-door neighbor Mr. Dixon wants his disability benefits to begin sooner and last longer, so he buys a policy with a 30-day elimination period that will pay him benefits until he is age 65, if necessary.*

## Tradeoffs of disability insurance

### Individual policies can be expensive

Ask anyone why he or she doesn't own an individual disability income insurance policy, and you're likely to hear this answer: "Because it's expensive!" Although you pay for government insurance through your taxes and your employer may pick up part of the cost of a group disability policy, quality individual disability policies cost a lot more money. You can try to lower the cost of an individual policy by reducing the benefit period, increasing the elimination period, or getting rid of features that you originally wanted. However, if you do this, you may end up with a policy that doesn't meet your needs.

### Disability claims can be hard to evaluate

If you get in a car accident, your insurance company will want a copy of the police report as proof of damage, and you'll receive a check in a few days or weeks. If you die, your insurance company will ask your beneficiary for a copy of your death certificate, and your claim likely will be paid quickly. If you become disabled, however, not only will you have to prove that you actually got hurt or got sick, but you'll have to prove that your injury or illness is expected to outlast your elimination period. This means that your disability will have to be certified by a physician, and you'll have to wait (sometimes for months) before you receive any money from the insurance company. In addition, while some claims are easy to evaluate, some are more difficult, especially mental illness claims.

## *Disability insurance is complex*

Both private and government disability insurance are complex because the needs of humans are complex. In addition, injury or illness is unpredictable. As a result, governments and insurance companies have designed insurance programs with many restrictions and--in the case of individual disability insurance, at least--many options. When you purchase a disability policy, you may have to spend a lot of time evaluating your future needs and weighing what coverage you can afford to buy against what coverage you'd like to have. Then, you'll have to compare individual policies and determine what coverage you are already entitled to through your employer or through the government.

# Questions & Answers

## *If you begin receiving Social Security disability benefits, why do you receive a reduced benefit from your individual disability income insurance policy?*

Disability insurance is designed to protect your earned income, not to pay you extra income in the event you become disabled. Because insurance companies know that you may (but often do not) collect other disability benefits, they usually give you the option of buying a rider (in your case, a Social Security offset rider) to your policy that will pay extra benefits to you before benefits begin or if Social Security denies your claim. However, if you do receive Social Security benefits, your policy benefit will be reduced proportionately.

## *If you are self-employed or work part-time, why is it difficult to purchase disability income insurance?*

If you are self-employed, you may have a hard time buying a disability income insurance policy if you haven't been working very long or if you have inconsistent earnings. This makes your risk of disability--and the amount of income you need to replace--difficult to determine, and you may pose a higher risk to the insurance company as a result. However, once you've been established for two to three years and can show earnings over a certain amount (usually $12,000 per year at the minimum), you should be able to qualify for disability insurance. If you work part-time, you may find it difficult to buy a policy because many insurance companies require that you work more than a certain number of hours to qualify for disability insurance, as well as earn more than a certain amount annually.

# Private Disability Income Insurance

## What is private disability income insurance?

Private disability income insurance is insurance purchased through an insurance company that pays you a predetermined benefit when you are too sick or too injured to work. Private disability income insurance policies come in many forms: individual policies; group insurance policies sponsored by employers, trade associations and organizations; business protection policies; and riders on life insurance policies. More and more private disability policies are being sold as people realize that coverage provided by government-sponsored social insurance programs is limited in scope and often difficult to qualify for.

## Types of private disability income insurance policies

### Individual policies

An individual disability policy is designed to replace income you will lose if you are too sick or too injured to work. While a group policy covers many people, an individual policy covers just one person: you. As a result, you may pay a higher price for coverage, but you often receive more for your money. You get a policy tailored to meet your needs, more liberal benefits, and guaranteed protection against disability.

***Example(s):*** *Maureen was paying $50 a month for a group policy at work that would provide disability benefits to her for two years, beginning after a 30-day waiting period. However, if she quit her job, she would no longer be insured for disability. Since she felt she needed more permanent long-term coverage, Maureen purchased a private disability policy that guaranteed to pay her benefits until age 65, after a 90-day waiting period. Although this coverage cost her twice as much as her group coverage, she felt it was worth the price.*

### Group disability coverage provided through an employer

Group disability insurance that you purchase through your employer is a low-cost alternative to individual coverage. Here's how it works: Your employer buys a group disability policy and then offers coverage to you and other eligible members of the group during certain periods of the year (called open enrollment periods). If you enroll at this time, you'll qualify for coverage even if you are older or have health problems. However, employer-sponsored group plans are not very flexible and may pay limited benefits. Many plans offer only short-term coverage and you may have to meet a stringent definition of disability to receive them.

### Group disability programs sponsored by a trade association

Trade or professional associations sometimes offer disability coverage to their members. Although called group disability because it is group-sponsored, association policies are issued to individual group members who must prove insurability. However, insurability standards for association members are sometimes relaxed, and you may qualify more easily for association disability insurance than for an individual policy. If you buy an association-sponsored policy, it will initially cost less than an individual policy. However, after a certain term (5 or 10 years), your premium may rise and eventually exceed an individual policy rate. In addition, the policy will be canceled if you leave the group or if the association withdraws its endorsement, leaving you without disability protection.

***Example(s):*** *Hans bought an inexpensive group disability policy through the Michigan Tulip Growers Association. However, when he was barred from membership in the group after importing illegal bulbs from Mexico, his disability policy was canceled, leaving him without coverage.*

### Specialized policies

You can purchase a group policy that provides limited coverage in specific circumstances. Credit disability insurance (a policy that will make payments to a specific creditor, should you become disabled), accident-only insurance, long-term care (LTC) insurance, and limited health insurance all pay disability benefits in specialized circumstances. Some of these policies (such as credit disability insurance) are group policies issued through organizations and institutions. Others (such as LTC insurance) are individual policies purchased through an insurance company.

***Example(s):*** *When Lenny took out a car loan, the bank manager sold him a credit disability insurance policy. The cost of the* *policy was added into his loan and increased his car payment by $2 per month. When Lenny was disabled in a skiing accident, his insurance company made his car payment for him until he was able to return to work.*

### Business protection policies

If you own a business, you can purchase disability insurance that will protect your business if you or one of your employees becomes disabled. You can purchase insurance to protect your business in one or more of the following areas: long-term disability (LTD) plans, salary continuation plans, key person disability insurance, business overhead expense policies, and disability buy-out plans.

Although some of the terminology explained in this document applies to business disability policies as well as individual and group policies, business protection policies contain terms and provisions unrelated to most individual and group policies.

### Disability income riders attached to life insurance policies

Some people purchase limited disability insurance by attaching a rider to their life insurance policy. This rider guarantees the insured a regular monthly benefit payment in the event he or she becomes permanently and totally disabled. The amount of benefit payment depends on the face value of the life insurance policy.

***Example(s):*** *Angie buys a life insurance policy with a face value of $50,000. She adds a disability income rider to it that guarantees that she will receive $10 per month per $1,000 in life insurance coverage. Thus, if she becomes disabled, she will receive a $500 per month disability benefit payment.*

## Who can purchase private disability insurance?

### In general, you must be a good risk

If you are buying a group insurance policy during an open enrollment period, you won't have to prove that you are insurable. However, if you are purchasing an individual disability policy, you will have to meet certain standards before you are issued a policy. On an application, you will answer questions regarding your age, income, occupation, health, and hobbies, and you may be turned down for coverage if you pose too great a risk to the insurance company or if you can't meet minimum age or income requirements.

***Example(s):*** *Captain Crook applied for disability insurance. On his application, he listed the following information:*

***Example(s):*** *Occupation: Pirate Income: $250,000 annually Current Health: Excellent Past Health: Arm severed 10 years ago, requiring prosthesis; had 40 stitches 3 years ago after sword fight; hospitalized six months ago after shark attack. Hobbies: Searching for buried treasure, making sailors walk the plank*

***Example(s):*** *Unfortunately, although Captain Crook met his insurance company's age and income requirements, he was denied disability coverage due to his dangerous occupation and lifestyle.*

### You can't be too young or too old

Most disability policies are issued to people between the ages of 18 and 60, although coverage may continue to age 65 (and sometimes for a lifetime). In addition, age is a factor in pricing the policy; since younger people are less likely to become disabled, they pay the least expensive premiums.

### You can't be too rich or too poor

You don't have to be rich to buy disability insurance, but most companies won't insure individuals who make less than $12,000 (sometimes $15,000) a year. This is because individuals with low income may not be able to afford the premiums and may not have a great need for insurance. Conversely, you may also have trouble buying disability insurance if you make a lot of money or if your net worth is too high. The insurance company may decide that you don't need disability insurance because you can afford to self-insure, or it may determine that you pose too great a risk to the company (because any benefit paid to you over a long period would cost the company a lot of money).

### You can't work in an extremely dangerous job

Statistically (and according to common sense), some jobs are more dangerous than others. For example, construction workers, firefighters, truck drivers, and mine workers are employed in dangerous occupations, whereas architects, schoolteachers, and lawyers are not. If you work in a dangerous occupation, you may be denied disability coverage outright, and if you are able to buy a disability policy, you will pay a higher premium. Unfortunately, it's not up to you to decide whether your occupation is dangerous; the insurance company decides that for you, grouping occupations in categories based on job duties and frequency of claims experience.

***Example(s):*** *Phil and his twin brother, Bill, applied for disability insurance coverage on the same day. Phil, a chemist, had no trouble buying a policy at a reasonable price, even though he worked with dangerous chemicals every day. On the other hand, Bill, an air traffic controller, was turned down for coverage. Even though Bill had never filed a disability claim, his insurance company considered him a poor risk due to the fact that many air traffic controllers had, in the past, filed a large number of claims because of the stressful nature of their jobs.*

### You can't be too sick

You won't be disqualified from buying disability coverage if you have a cold on the day you apply for it, but if you have a heart attack in the insurance agent's office, you might be out of luck. To get individual disability income insurance, you have to prove that you are currently healthy by disclosing any known physical or psychological problems on your insurance application and, in many cases, by taking a physical exam. In addition, your past medical history and any hereditary traits will be evaluated to determine what disability claims risk you pose to the insurance company. If you have had past medical problems, you won't necessarily be disqualified if the condition occurred long ago and you are now completely healthy. However, that specific condition may be excluded from coverage, or you may pay a higher premium.

### You must be an upstanding, careful citizen

Unfortunately, disability insurance companies have to guard against fraud. To prevent fraudulent claims, insurance companies may disqualify anyone who may have a criminal past or a history of substance abuse. In addition, the company will also try to determine your attitude toward risk. If you regularly engage in dangerous hobbies (such as cliff diving), you may pose a greater claims risk to the insurance company than someone who does not.

## Key provisions of individual and group disability policies

Although there is no such thing as a standard disability policy, you are likely to see most of the following terms, conditions, and benefits included and explained in the base portions of individual disability contracts and group association contracts. Employer-provided group disability contracts also share much of the same terminology and many of the same provisions; however, they differ from individual contracts in a few ways. In addition, this list is not all-inclusive; your disability policy may include other benefits or information.

### Definition of disability

If you want to make sure your disability claim will be paid when you are hurt or injured, it's extremely important to know how your policy defines disability. No single definition of disability exists; however, all policies define disability either according to how an illness or injury affects an individual's ability to do his or her job or any other job (total disability) or according to how an illness or injury affects an individual's ability to earn income (residual disability). Some policies combine both definitions. One type of disability may be covered in the base contract, and the other type may be added on as an optional benefit. Many wording variations exist that take into account many different situations, but the following examples illustrate common wording found in disability insurance contracts:

- A total disability definition that covers your ability to do your own job (own occupation coverage) might read, in part: "The inability to perform any and every duty of your own occupation"
- A total disability definition that covers your ability to do any job (any occupation coverage) might read, in part: "The inability to perform the duties of any occupation"
- A residual disability definition that covers a loss of earnings might read, in part: "As a result of injury or sickness, you have experienced a loss of earnings equal to at least 20 percent of your pre-disability earnings"
- A residual disability definition that covers loss of earnings and loss of ability to work might read: "As a result of injury or sickness, you are able to perform all of the duties of your occupation but for less than full time, and you have experienced a loss of earnings equal to at least 20 percent of your pre-disability earnings"

Some disabilities (called presumptive disabilities) automatically classify you as totally disabled. These disabilities include loss of two limbs; total, permanent blindness; and loss of speech and hearing.

## Benefit period

How long you receive benefits once you become disabled depends on the benefit period you choose when you purchase a disability policy. Common benefit periods are one year, two years, five years, or up to age 65. Some policies even offer lifetime benefits. Disability policies are classified as short-term or long-term, depending on the length of benefit period they offer. Short-term policies may pay benefits for as few as 13 weeks or as long as 104 weeks. Any policy that pays benefits for longer than 104 weeks (two years) is usually considered long-term. In general, the longer benefit period you choose, the higher the premium you pay.

## Elimination period

When you become disabled, you have to wait a certain number of days before you begin receiving benefits from your disability policy. This waiting period (called the elimination period) ranges from 30 to 720 days. This period helps to reduce the premium you pay for disability insurance, functioning much like a deductible. The longer elimination period you choose, the lower your premium. However, most people choose the elimination period based not only on cost but also on how long they could live off their savings or other income without receiving disability benefits. The most common elimination period chosen is 90 days.

***Example(s):*** *Alice wanted to buy a disability insurance policy with the shortest elimination period she was offered, 30 days. However, after comparing the price of a policy with a 30-day elimination period with a policy with a 90-day elimination period, she decided that the policy with the longer elimination period would suit her needs and save her a lot of money in premiums. When she fell down some stairs a few weeks later, she was able to live off her investments until the 90-day waiting period was over and her disability benefits began.*

## Monthly benefit amount

To ensure that you have incentive to return to work after a period of disability, disability insurance pays you only a portion of your normal earnings. In general, you will receive a disability benefit equal to 50 to 70 percent of your normal earnings, subject to a monthly maximum. Your benefit will be determined when you apply for your disability policy. The insurance company will consider what disability income you will need in order to support yourself and your family, your current earned and unearned income, and other disability coverage you might have (including Social Security and other government-sponsored insurance). This will determine the maximum benefit coverage you may purchase. You can, of course, purchase less.

***Example(s):*** *Randall made $3,000 a month as a photographer. When he applied for disability insurance coverage, the insurance company calculated his maximum monthly benefit to be 60 percent of his earnings or $1,800 a month. However, to reduce his premium, Randall elected to receive a lower monthly benefit of $1,000 in the event he became disabled.*

## Renewability provisions

Most disability policies are classified according to their renewability provisions. The most common type of policy is the guaranteed renewable policy. According to the provisions of this policy, the insurer guarantees to renew the disability contract but does not guarantee the premium. However, the premium may be increased only on the stated anniversary date (with prior notification) and only if the premium is increased for an entire underwriting class. Another type of policy issued is the noncancelable and guaranteed renewable policy. This policy guarantees not only that the disability contract will be renewed but also that the premium won't be increased. This provision, however, is becoming less common and is often available only to applicants at the lowest risk for disability who can afford to pay for it.

## Waiver of premium

Although many policies include this in their base coverage, some offer it as an optional rider. If you become disabled, the insurance company will pay your insurance premium for you, and your policy will remain in force until your disability period ends. In addition, it may refund any premiums you paid during the elimination period.

## Contestable period

If you make any false statements on your disability application, the insurance company has the right to contest or to rewrite your policy or to deny a disability claim within a certain period (usually two years) from the effective date of coverage. After that period, the company can still void the contract or deny a claim if it can prove that you gave incorrect information or if you intended to commit fraud when you made the statements. This should be stipulated in the disability insurance contract.

### Exclusions and limitations

Certain causes of illness or accident may not be covered under the disability policy. Some common exclusions are injuries caused by aircraft (except to passengers on scheduled airline flights), war or acts of war, suicide attempts, and normal pregnancy. In addition, if you have a pre-existing medical condition, your disability policy may exclude that condition from coverage, either forever or for a specified period of time.

***Example(s):*** *Petra fell and hurt her back. One year later, she wanted to buy disability insurance. Her back injury had healed, but because the insurance company felt that she was likely to experience back problems in the future, they approved her application for disability insurance provided that a rider was added to her policy that excluded coverage for any disability related to back problems.*

### Grace period

A disability policy usually states that if you pay your premium within 31 days of your due date, your policy won't be canceled for nonpayment.

### Rehabilitation provision

Both you and the insurance company benefit if you can return to work. For this reason, most disability insurance policies cover the cost of rehabilitation in an approved program up to a certain maximum.

## Optional benefits and riders

Optional benefits and riders are policy add-ons that enable you to customize an individual disability policy to fit your needs. Occasionally, some of these riders or optional benefits will be included as base coverage, but most of them often must be purchased separately and may substantially increase the cost of the policy. You may need to purchase some of the riders when you buy the policy; others may be added on to the contract after the policy is issued. The following section details some (but not all) of the optional benefits and riders that can be added on to a disability insurance policy.

### Automatic benefit increase rider

This rider (sometimes offered as part of the basic policy) stipulates that the monthly policy amount will be adjusted automatically every year to account for pay raises or increased income you may receive after you've purchased a disability policy. The rider provides annual increases for a certain term (often five years). During this time, you won't have to provide any proof that your income has gone up. However, upon renewal of the rider, you may have to show evidence that your income has increased; otherwise, you won't be able to renew the rider.

### Cost-of-living rider

If you are afraid that inflation will eat away at your disability benefit, you can purchase a cost-of-living adjustment rider that increases your monthly benefits if inflation rises. If inflation is low, a minimum percentage (4 or 5 percent) often applies. Although some companies cap the increase amount, others let you choose your own maximum at the time you purchase the rider. The cost-of-living rider is very expensive but may pay off on a long-term policy. If you suffer a short-term disability, however, inflation is unlikely to matter.

### Future benefits increase rider

Also called an option to increase coverage or a guarantee of insurability rider, this gives you the option to buy more disability coverage if you need it later, without being turned down for medical problems. This is a useful rider if you are young and expect your income to rise significantly over the years.

***Example(s):*** *Heloise purchases a disability income insurance policy when she is 30 that includes a future benefits increase rider. At the time she buys the policy, she earns $2,000 per month, and her policy pays her a $1,200 per month benefit. By the time she is 35, however, she is earning $3,000 per month and wants to increase her benefits. She does so under the terms of her rider, which allows her to purchase an additional $400 of monthly benefits every three years.*

## *Partial disability benefits rider*

Although the terms partial disability and residual disability are sometimes used interchangeably, partial disability is actually a simpler, short-term version of residual disability. Like a residual disability policy or rider, a partial disability benefits rider will pay you benefits in the event that you can perform some but not all of the duties of your occupation full-time or part-time. Unlike a residual disability policy or rider, however, a partial benefits rider doesn't pay benefits based on the percentage of earnings you've lost. Instead, it simply states that you must first be totally disabled and pays you benefits equal to 50 percent of your total monthly disability benefit once you return to work. However, the benefits will be paid only for a specified period (usually three to six months).

## *Return-of-premium rider*

The return-of-premium rider might appeal to you if, like most people, you don't believe that you will actually become disabled but you are buying a disability policy just in case. The return of premium rider entitles you to get back the premium money you pay in the event you don't need to use the policy benefits. Depending on the type of rider you choose, you will either get a percentage of the money back at certain ages or after a certain number of years, or you'll get all of your money back at age 65 when the rider expires. This rider will substantially add to the cost of your premium.

## *Social benefits rider*

This rider provides disability benefits in addition to your base monthly benefit. This benefit amount is payable to you as long as you are not receiving (or are eligible to receive) a social benefit (e.g., Social Security disability insurance). When you receive a social benefit, your social benefits rider may be reduced by the dollar amount you are receiving. This rider typically costs less than your base benefit because it takes some of the guesswork out of underwriting and protects the insurance company against some risk.

***Example(s):*** *Hillary purchased an $800 Social Security offset rider. She applied for Social Security disability benefits and began collecting $500 a month after the five-month waiting period elapsed. When she filed a claim for disability benefits with her insurance company, she began receiving a $300 per month disability benefit from her social benefits rider in addition to her base amount benefit. This amount was equal to the difference between her rider amount and what Social Security actually paid her.*

***Caution:*** *There are several versions of Social Security income riders that pay benefits in various ways. Check your policy for specific terms.*

# Questions & Answers

## *If you are already receiving disability benefits from an individual disability insurance contract you purchased, how will these benefits affect the disability payments you receive from the group disability coverage you have through your employer?*

Benefits you already receive from an individual disability policy shouldn't affect the benefits you will receive from your group policy. Ordinarily, only benefits received from social or government sources will offset private individual or group disability benefits.

# The Fundamentals of Disability Insurance

Disability insurance pays benefits when you are unable to earn a living because you are sick or injured. Most disability policies pay you a benefit that replaces a percentage of your earned income when you can't work.

## Why would you need disability insurance?

Your chances of being disabled for longer than three months are much greater than your chances of dying prematurely, due in part to medicine that has made many fatal illnesses treatable. (Source: 1985 Commissioner's Individual Disability Table A--most recent data available.) Although this is good news, it increases your need to protect your income with disability insurance.

Consider what might happen if you suffered an injury or illness and couldn't work for days, months, or even years. If you're single, do you have other means of support? If you're married, you may be able to rely on your spouse for income, but you probably also have many financial obligations, such as supporting your children and paying your mortgage. Could your spouse's income support your whole family? In addition, remember that you don't have to be working in a hazardous position to need disability insurance. Accidents happen not only on the job but also at home, and illness can strike anyone.

If you own a business, disability insurance can help protect you in several ways. First, you can purchase an individual policy that will protect your own income. You can also purchase key person insurance designed to protect you from the impact that losing an important employee would have on your business. Finally, you can purchase a disability insurance policy that will enable you to buy your partner's business interest in the event that he or she becomes disabled.

## What do you need to know about disability insurance?

Once you become disabled and apply for benefits, you have to wait for a certain amount of time after the onset of your disability before you receive benefits. If you are applying for benefits under a private insurance policy, this amount of time (known as the elimination period) ranges from 30 to 365 days, although the most common period is 90 days. Group insurance policies through your employer will generally have a waiting period of no more than 8 days for short-term policies that pay benefits for up to six months, and 90 days for long-term policies that pay benefits up to age 65.

You can purchase private disability income insurance policies that offer lifetime coverage, but they are very expensive. Most people buy policies that pay benefits up until age 65; however, two- and five-year benefit periods are also available. Because many injuries or illnesses do not totally disable you, many policies will offer a rider that will pay you a partial benefit if you can work part time and earn some income.

## Where can you get disability insurance?

In general, disability insurance can be split into two types: private insurance (individual or group policies purchased from an insurance company), and government insurance (social insurance provided through state or federal governments).

Private disability insurance refers to disability insurance that you purchase through an insurance company. Many types of private disability insurance exist, including individual disability income policies, group policies, group association policies, and riders attached to life insurance policies. Depending on the type of policy chosen, private disability policies usually offer more comprehensive benefits to insured individuals than social insurance. Individually owned disability income policies may offer the most coverage (at a greater cost), followed by group policies offered by an employer or association. Check with your employer or professional association to see if you are eligible to participate in a group plan. If not, contact your insurance broker to look into individual coverage.

Workers' compensation and Social Security are two well-known government disability insurance programs. In addition, five states (California, Hawaii, New Jersey, New York, and Rhode Island) have mandatory disability insurance programs that provide disability benefits to residents. If you are a civil service worker, a military servicemember, or other federal, state, or local government employee, many disability programs are set up to benefit you. In general, however, government disability insurance programs are designed to provide limited benefits under restrictive terms, and you should not rely on them (as many people mistakenly do) as your main source of income if you are disabled.

# Government-Sponsored Disability Insurance Programs

## What is government-sponsored disability insurance?

Government-sponsored disability insurance programs are programs designed or mandated by federal, state, and local governments to provide basic income protection, and sometimes medical benefits, to disabled individuals. While they may not offer the comprehensive protection you need, they can help protect you and your family from financial devastation when you can't work.

## What government-sponsored disability programs are available?

Numerous government-sponsored disability insurance programs may pay benefits to you if you meet certain eligibility requirements. The following is a synopsis of the major forms of government-sponsored disability benefit programs available.

### *Social Security disability benefits*

Two programs administered by the Social Security Administration pay disability benefits. The Social Security disability insurance program pays benefits to qualified individuals who are under age 65, regardless of income. The other program, Supplemental Security Income (SSI) , pays benefits to qualified individuals who are either over age 65, or who are blind or disabled, and who have limited income. Neither program covers partial disability, and both programs define disability strictly. The impairment must prevent you from earning a substantial income, must be medically determined, and has to last, or be expected to last, 12 months or more or result in your death. Like other Social Security benefits (though not SSI benefits), disability benefits are based on your Social Security earnings record.

***Tip:*** *If you are entitled to receive Social Security disability benefits, you may eventually be entitled to receive Medicare benefits if your disability is long-lasting. If you are eligible to receive benefits under SSI, you may be entitled to receive Medicaid benefits.*

***Example(s):*** *Carol became disabled and began collecting Social Security disability benefits. After two years had passed and she was still unable to work, she became eligible to enroll in Medicare due to the long-lasting nature of her disability.*

### *Workers' compensation*

All states (and the District of Columbia) have workers' compensation laws designed to protect employed individuals who get sick, injured, or killed on the job. Most workers are covered by these laws, although a few occupations are excluded and some states exempt small-business employers from the law. The key point about workers' compensation is that disability benefits are paid only to covered workers whose illnesses or injuries are work-related. How benefits are paid, and in what amount, is determined by state law and is based on how severe and permanent your injury or illness is. However, in most states, you will receive 66 2/3 percent of your wages (subject to a weekly maximum), although this percentage may be higher for permanent total disabilities.

### *Department of Veterans Administration (VA) benefits*

Military servicemembers and veterans are entitled to disability compensation for service-connected health problems. Several programs are available, with some sponsored by the Department of Defense (DOD) and others by the Department of Veterans Administration (VA). Military-sponsored programs include disability retirement, temporary disability retirement, and disability severance pay. VA benefits include disability compensation, vocational rehabilitation, and pensions. Since the rules surrounding these benefits can be complex and change often, it's best to check with your military personnel office or local VA office if you have questions about any of these benefits.

### *Federal Employees Retirement System (FERS)*

Federal employees covered under FERS are eligible for disability benefits if they have at least 18 months of creditable service. To receive benefits, you must be unable to perform your job because of injury or disease. During the first year of disability, you receive 60 percent of your average salary (your average salary is based on your three highest earnings years). After the first year of disability, you receive 40 percent of your average salary. However, in the first year, any Social Security benefit you receive will offset your FERS disability benefit dollar for dollar. In the second year of disability, your FERS benefit will be reduced by 60 percent of your Social Security disability benefit. At age 62, your benefit is further adjusted.

***Example(s):*** *Ken worked for the government for five years, earning $3,000 a month during his first three years of employment and $4,500 a month during the following two years. He became disabled and was unable to work for nine months. His disability payment under FERS was $2,400, calculated by figuring his average earnings based on his three highest earnings years, then taking 60 percent of that figure. His highest three years of earnings were averaged, and the resulting figure ($4,000) was used to calculate his disability payment (60 percent of $4,000 is $2,400).*

### *State-sponsored programs*

Five states--California, Hawaii, New Jersey, New York, Rhode Island--and Puerto Rico pay disability benefits to residents who are disabled due to nonwork-related injuries or illnesses. Benefits generally may be payable up to 26 weeks (52 weeks in California).

### *Other programs*

If you work for the federal government or for a state or local government, you are probably covered by a disability program designed to benefit government workers. Check with your employer for more information.

## Who is eligible for coverage?

To be eligible for disability benefits from government insurance programs, you must meet the requirements established by each program. For instance, your disability may need to be totally disabling (Social Security), work-related (workers' compensation), or nonwork-related (state assistance). You may have to work a certain length of time before becoming eligible for benefits (Social Security and FERS) or work in eligible positions (FERS and workers' compensation).

## Strengths

### *Premium-free disability coverage*

Unlike other types of disability coverage, you don't have to pay a premium for government-sponsored disability coverage. Not that it's a free benefit; you finance some types of government disability insurance by paying taxes. However, you don't have to pay the relatively high premiums you pay for private disability insurance, and you get basic protection against disability.

### *Family members may receive benefits too*

Government disability programs often have provisions for disabled and nondisabled family members of a disabled worker. For instance, if you suffer a job-related illness or injury and later die, your family may receive survivors benefits under workers' compensation. A private disability insurance policy, conversely, doesn't pay any benefits to your family members.

## Tradeoffs

### *Sometimes hard to qualify for benefits*

Qualifying for government disability benefits can be tricky, primarily because you usually have to meet a strict definition of disability. For instance, to be considered disabled under workers' compensation, your disability must be job-related. However, to qualify for state assistance (if you live in one of the five states that have disability programs), your disability must be nonwork-related. To qualify for benefits under Social Security, you must be unable to work at any job (not just your own job) and earn income, and your disability must be expected to last at least a year or end in your death. In fact, the Social Security Administration rejects over half of the disability benefit applications it receives.

### *Limited coverage*

If you buy private disability insurance, it's likely that your benefit check will be larger than a disability benefit check you receive from the government if your earnings are high. Like private disability insurance, government disability programs often aim to replace a portion of your earnings lost to disability. However, government benefits are often capped at legal maximums that may not reflect your true earnings level.

***Example(s):*** *Ken earned $4,500 a month selling big-screen televisions. One day he was struck and injured when one of the sets toppled over. He filed a workers' compensation claim in his state. Even though his state pays workers' compensation benefits equal to 70 percent of the disabled worker's wages, the maximum weekly payment someone can receive is $475 ($2,058 per* *month). Unfortunately for Ken, this limits his workers' compensation benefit to only 46 percent of his actual earnings.*

### *No flexibility*

When you buy a private disability insurance policy , you can determine, within certain limits, what base coverage you want and need, and you can purchase riders to help personalize your disability income insurance coverage. Government disability, however, is an impersonal product designed to protect the average worker. If you rely on government disability insurance to meet your individual needs, you may be disappointed when it doesn't.

***Example(s):*** *Pat thought about buying an individual disability income insurance policy with an elimination period (waiting period) of 60 days because she decided that she could afford to live off of her savings for no longer than two months if she became disabled. However, she decided not to buy disability insurance when she learned about Social Security disability benefits. When Pat became disabled, she found out that the waiting period for Social Security disability benefits was five months. She was forced to support herself for this period, even though she could hardly afford to.*

## Tax considerations

Some government disability benefits are taxable, while others are not. You may also qualify for a special tax credit if you are totally and permanently disabled.

# Group Disability Insurance

## What is group disability insurance?

Group disability insurance is a single disability policy that covers many people (a group). The insured group has a common interest or association, such as an employer, a trade, or a school affiliation. All eligible individuals may be covered by the policy, and the cost of group coverage is often less expensive than the cost of individual coverage. The plan may be contributory (you must sign up for coverage and contribute toward the premium payments) or noncontributory (funded by the employer or association, and you are automatically covered if you meet eligibility requirements).

## Who is eligible for coverage under a group disability policy?

To be eligible for coverage under a group disability plan, you must meet the following requirements:

### *You must be a member of the group*

To be eligible for group disability coverage, you must be affiliated with, or be a member of, the group offering coverage.

***Example(s):*** *Pat's boyfriend, Jamie, wanted to enroll her in the same disability insurance coverage that he purchased through the United Aviators, a trade association he belonged to. However, because Pat did not belong to the group herself and the contract allowed members to enroll only their spouses, Pat could not purchase the association's disability coverage.*

### *You must meet the eligibility requirements outlined in the group policy*

Not all members of the group may be eligible for group coverage. Although a group plan cannot bar an individual from coverage, it can bar a group of individuals from coverage until certain eligibility criteria, such as length of employment, are met.

***Example(s):*** *Fred got a job as a bus driver. On his first day at work, he found out that he would be eligible for enrollment under a group disability plan but only after he had worked for the company for 90 days. Since Fred wanted disability insurance, he waited 90 days and then applied for coverage during the 30-day enrollment period that followed.*

### *You must enroll in a contributory plan*

If you are offered the opportunity to enroll in a contributory group disability plan, you must fill out and sign paperwork pertaining to the insurance contract. If you enroll during an open enrollment period, you won't have to prove that you are insurable; in other words, you don't have to show proof that you are healthy or take a physical. However, if you don't enroll during an open enrollment period and later decide you want coverage, you may have to prove insurability at that point, or you may have to wait until the next open enrollment period.

## How does it work?

### *A group disability policy is held by the master policyholder*

When you apply for group disability insurance, you are not issued an individual policy, nor are you evaluated for coverage as an individual. Rather, the policy is issued to the organization or company that represents the group (the master policyholder). The individuals within the group that apply for disability insurance are issued certificates of coverage rather than individual policies. These certificates are proof that coverage exists, and they contain information about the amount and type of coverage provided.

### *You pay premiums directly to the master policyholder*

Instead of paying premiums to the disability insurance company, you pay your premiums directly to the master policyholder (if this is your employer, often through payroll deduction). If you pay either part or all of your premium cost, your group plan is said to be contributory. If the master policyholder (your employer, for example) pays the entire premium cost, then the plan is said to be noncontributory. For the plan to remain in effect, most or all of the group's members must want to be included and have coverage. If the plan is noncontributory, 100 percent of eligible group members must be covered by the plan. If the plan is contributory, then usually 75 percent or more of eligible members must be covered by the plan. When enrollment levels drop, then the group must find new participants from the eligible pool of members.

**Caution:** *The taxation of your disability benefits depends upon who pays the premium cost of your group disability policy.*

# What benefits does a group disability policy provide?

## *Short-term disability benefits*

If your employer offers disability insurance, it's likely a short-term policy. Short-term disability insurance contracts usually have short elimination periods (3-14 days) and are simple to apply for. Although some offer benefits for up to two years, many policies pay benefits for six months to one year.

## *Long-term disability benefits*

Long-term disability policies are offered less frequently by employers than short-term disability policies. You are more likely to find them offered at medium- to large-sized companies than at smaller ones. Most of these plans pay benefits up to age 65, although, in certain instances, they may pay lifetime benefits.

# Strengths of group disability insurance

## *Less strict underwriting standards*

Group disability policies often have fewer underwriting restrictions than individual disability policies. That's because the risk of disability is borne by the group rather than by an individual. A fairly large group will include mostly individuals who are good risks, as well as a few individuals who are poor risks. Even though individuals enrolling in a group disability plan will not have to pass a physical exam, they will only have a limited enrollment period to take advantage of this provision. This helps to prevent individuals with health problems from enrolling after they have discovered that they are sick.

***Example(s):*** *When Pat applied for an individual disability insurance policy, his insurance company asked him many questions about his health, his family medical history, and his habits. In addition, he was asked to take a physical before the insurance company could issue him coverage. When he applied for a group disability policy through his employer, however, Pat only had to fill out a simple application, and he was issued insurance without undergoing a physical.*

## *Low-cost coverage*

In general, group disability insurance premiums are much lower than premiums for individual disability insurance policies because it's more cost-effective to underwrite insurance for a group than for individuals.

# Tradeoffs of group disability insurance

## *Lack of portability*

"You can't take it with you" is a phrase that normally applies to group disability coverage. When you leave your job or otherwise terminate your relationship with a group, you can't take your coverage with you. In addition, you normally cannot convert it to an individual disability policy. This means that you may be left without disability coverage when you need it, and if you develop a medical problem, you may be unable to buy coverage for that preexisting condition in the future.

***Example(s):*** *Sue was fired from her job as a flight attendant. As a result, her disability policy coverage from her employer was terminated. Three weeks later while job hunting, she found out that she had a serious liver disease, and she was hospitalized for a month. She finally found a new job, but her new employer did not offer disability coverage, and she was unable to buy an individual disability policy that covered her disease. When it flared up again six months later, Sue had no disability insurance to pay her bills while she recovered.*

***Tip:*** *If you know you're leaving your job, consider applying for individual disability coverage before you quit. Assuming you are insurable, this will ensure that there will be no lapses in your disability coverage.*

## *Premiums can be raised*

You can buy an individual disability insurance policy that guarantees that the premium you pay will remain the same for as long as you own the policy. Group disability insurance, however, normally does not offer this guarantee. Association policies usually offer term coverage that guarantees that the premium will not rise for that term. However, at the end of the term, you may find that you have to pay much more for coverage if you want to renew it (if the premium has been raised for the entire group).

***Caution:*** *If your employer pays the premium for your group disability coverage, then some or all of your benefits will be taxable when you receive them.*

Note: Strict definition of disability--Unlike individual disability policies, most group policies sponsored by your employer only pay benefits if your injury or illness is not work-related (nonoccupational). This is because workers' compensation covers many work-related disabilities. In addition, your employer-sponsored group disability policy is likely to define disability as any occupation disability. This means that if you are able to work in any occupation (even one outside of your own area of expertise), you won't be eligible for disability benefits. Occasionally, however, group disability plans will incorporate the two definitions, paying benefits in the short term even if you are able to work in another occupation and paying long-term benefits only if you are completely disabled and unable to work in any occupation.

## *Benefit provisions*

Group plans are not designed to meet the specific need of the individual. They may offer many of the same features as individual disability plans but are less flexible. You may be able to personalize your policy somewhat by adding on a rider or two, but you won't end up with a policy that reflects your individual circumstances. Although both individual and group disability policies limit coverage to certain maximums based on income, group policies often do not consider deferred compensation, bonuses, and commissions when determining the maximum benefit payable. This might hurt you if your earnings are not truly reflected through your salary. In addition, long-term group disability benefits are usually offset by other government benefits, which is not necessarily the case with individual insurance.

# Questions & Answers

## *How does long-term care insurance cover you if you become disabled?*

Long-term care insurance is similar to long-term disability insurance but not the same. Long-term disability insurance pays benefits if you are unable to work and earn a living and your benefit is a certain percentage of your predisability income. Long-term care insurance pays benefits if you suffer a debilitating accident or injury and you can't care for yourself. The insurance is designed to pay for the high cost of at-home or nursing-home care. You choose your benefit level, based on the cost of care you anticipate. You may need both types of insurance to fully cover you in the event of a long-term disability.

# Disability Insurance as an Employee Benefit

## What is it?

### In general

The inability to work due to physical or mental incapacity is a major cause of concern for many employees. Providing your employees with the security of a sick-leave plan or disability insurance can help alleviate some of this concern. A sick leave plan can reimburse your employees for lost wages as a result of a sickness or accident that lasts for a short period of time (usually no longer than six months). Disability insurance provides your employees with benefits during the period when he or she has a disability and is unable to work. The type of disability insurance that you provide to your employees will depend on the types of disabilities you would like to cover under your disability insurance plan. There are three types of disability insurance plans: short-term disability, long-term disability, and permanent disability.

***Tip:*** *There is usually a waiting period before employees can begin receiving their disability income insurance benefits.*

### Internal Revenue Service (IRS) tax treatment of disability insurance plans

If you provide your employees with disability insurance, you may be eligible for tax deductions. Contributions that you make to a disability insurance plan may be deductible as ordinary and necessary business expenses as long as you self-insure or fund the plan with insurance. Whether or not you can exclude the amount that your employee receives under the plan from your employees' gross income depends on who pays the premium. If your employee pays the total premium using after-tax income, then his or her benefits will be tax free. Conversely, if you pay the total premium and do not include the cost of coverage in the employee's gross income, then the employee will be taxed on the benefits. If you pay part of the insurance premium and your employee pays the rest, then your employee's tax liability will be split as well. Any part of the benefit that your employee receives that is attributable to your share of the premium is taxable; any part of the benefit attributable to your employee's share of the premium is tax free.

***Example(s):*** *Bob was covered by a group disability insurance plan at work. His employer paid 60 percent of the monthly premium, and Bob paid 40 percent using after-tax dollars. When he became disabled, Bob received a $1,000 benefit monthly for six months ($6,000). When he filed his income taxes, he only had to pay taxes on $3,600 (60 percent of $6,000), the part attributable to his employer's contribution.*

## Sick-leave plans

Under a sick-leave plan, you either wholly or partially reimburse your employees for lost wages resulting from a sickness or accident that lasts for a short period of time (usually no longer than six months). Sick-leave plans usually provide benefits for a specific number of days each year. You can either allow your employees to accrue sick days on a monthly basis, or you can allocate your employees with a certain number of sick days each year. You do not have to purchase insurance to set up a sick-leave plan. Instead, you administer and fund the plan yourself. If you choose to implement a sick-leave plan, sick leave may be includable in your employee's gross income as wages. However, you may be able to deduct all or part of the cost you incur by providing your employees with a sick-leave plan.

***Tip:*** *Make sure the sick-leave plan that you offer to your employees is in writing.*

***Tip:*** *Under a sick-leave plan, you can allow your employees to carry over any sick days that they do not use to the following plan year.*

***Example(s):*** *Ken works for a factory that allows its employees to earn one day of paid sick leave for each month of full-time employment. After a year of full-time employment with the factory, Ken has used only 3 of his 12 earned sick days. The factory allows him to carry over the 9 remaining sick days to the following plan year.*

## Short-term disability

Short-term disability often bridges the gap between sick pay and long-term disability coverage by providing benefits that cover temporary disabilities for a limited time period (typically less than one year). The length of disability coverage under a short-term disability plan can last anywhere from a few months to one year. Under a short-term disability plan, an employee is considered to have a disability when the employee is unable to perform his or her regular duties.

***Tip:*** *If you provide your employees with short-term disability insurance, you must also provide your female employees with benefits during pregnancy and childbirth.*

***Tip:*** *Insurance companies will differ in their interpretation of the beginning of a new period of disability. Some companies require that your employee return to work for one day, while others require a few months of continuous active employment.*

***Example(s):*** *Ken works at a factory. The factory's short-term disability plan provides that employees can receive three weeks of benefits for each period of disability. Ken was out of work for three weeks due to a back injury he received while on the job. Three days after returning to work, he reinjures his back. Thankfully, the disability insurance company interprets his new period of disability as beginning the day after he returned to work.*

# Long-term disability

Long-term disability insurance usually provides benefits to employees who are disabled as a result of sickness or accident, and who are unable to work for a lengthy time period, usually longer than six months. The benefit an employee receives from long-term disability insurance is usually 50 percent to 70 percent of their predisability pay. Typically, the employee can receive long-term disability benefits up until he or she reaches age 65. The definition of disability will vary from policy to policy.

***Tip:*** *Since long-term disability plans (that are not self-insured plans) do not have to follow IRS nondiscrimination rules, you can reduce a plan's overall costs by offering it to only a select group of employees.*

***Tip:*** *Long-term disability benefits usually do not kick in until your employee uses up all of his or her short-term disability benefits.*

***Example(s):*** *Ken, who works at the local factory, injured his back while playing golf. Ken was entitled to one year of short-term disability benefits. Almost a year after he first injured his back, Ken was still out of work, and his short-term benefits were about to run out. Luckily, the factory offered its employees additional long-term disability benefits that will take effect once Ken's short-term benefits run out.*

# Permanent disability

If your employee becomes permanently disabled before reaching age 60, he or she may be able to receive permanent disability benefits through provisions that are contained in an employer-provided group life insurance policy. This is not a cash benefit but rather a bill that does not need to be paid. A permanent disability is a disability that prevents you from being able to work at any job. A typical life insurance provision that is used for permanent disabilities is a waiver of premium, which continues coverage of an employee who becomes disabled. The coverage lasts until the employee's death and is without the payment of any premium.

# How Disability Income Insurance Contracts Define Disability

## What is it?

When you purchase disability insurance, you should pay close attention as to how the policy defines disability. Not only will the disability definition determine, in part, how much the policy will cost, but it will also determine how you can qualify for disability benefits. In general, to be considered disabled, you must be unable to work and earn income; however, many policies narrow down this definition quite a bit. They may specify whether you must try working in another occupation if you can't do your own job, or they may pay benefits if you can do some but not all of the duties of your own occupation. Other policies aren't concerned with occupation at all; they consider you to be disabled when, because of illness or injury, you experience a loss of earnings.

## Total disability coverage

Disability policies that pay benefits according to an occupational definition of disability are called total disability policies. You qualify for benefits under these policies if you are totally unable to work and earn income. Several types of total disability coverage exist: own occupation coverage, any occupation coverage, split definition coverage, and presumptive disability coverage.

### *Own occupation coverage*

In general (see note below), an own occupation policy defines disability as the inability to perform the usual and customary duties of one's own occupation. This is a liberal definition of disability, because even if you can work in another occupation, you will still receive disability benefits. Because it is relatively easy to qualify for benefits under this definition of disability, insurance companies are limiting the availability of own occupation coverage, either by making it extremely expensive or by restricting coverage to individuals that are unlikely to file a claim.

***Example(s):*** *Cynthia was an artist who purchased own occupation disability coverage. When she developed carpal tunnel syndrome in her right hand (the one she used to sketch with), she began receiving disability benefits because she was unable to perform the duties of her own occupation. Even though she went to work selling real estate a few months after she began receiving benefits, her ability to work in another occupation did not affect her eligibility for disability benefits, and she continued to receive them for another year.*

***Tip:*** *The terminology used to define disability will vary from policy to policy.*

### *Any occupation coverage*

An any occupation policy defines disability as the inability to perform the duties of any occupation. This definition of disability is strict; to receive benefits according to this definition, you have to be unable to work in any gainful occupation, not just your own. Occasionally, however, the wording is modified to take into consideration your earnings level, education, training, and experience.

***Example(s):*** *Audra bought an insurance policy that defined disability as the inability to perform the duties of any occupation for which she was reasonably suited by reason of her education, training, or experience. A few weeks later, she suffered a heart attack and was unable to continue practicing law. Because she loved to teach, she began teaching at a local college. However, she no longer continued to receive disability benefits.*

### *Split definition coverage*

Many disability policies incorporate both an own occupation definition of disability and an any occupation definition. You purchase a policy that provides own occupation coverage for a limited period of time, then after this period ends, you must meet the any occupation definition of disability in order to continue receiving benefits. This is sometimes known as short-term own occupation coverage.

***Example(s):*** *Stephen bought an insurance policy that used a split definition of disability to determine when benefits would be paid. When he was hurt in a car accident and was unable to go back to his teaching job, he found a telemarketing job and continued to receive disability benefits. Two years later, when the own occupation disability coverage period ended, Steve's disability benefits ended because he was able to work as a telemarketer and didn't meet the stricter any occupation definition of disability that now covered him.*

### *Presumptive total disability coverage*

No matter how your insurance company defines total disability, most companies automatically consider certain catastrophic ailments to be totally disabling. If you are disabled by one of these ailments, you won't have to meet the conditions normally required in order to be considered totally disabled. In addition, not only will you receive immediate benefits, but you will continue to receive benefits even if you are able to return to work. These ailments (which may be caused by injury or illness) are the loss of sight in both eyes, of hearing in both ears, of speech, of the use of both hands, of the use of both feet, and of use of one hand and one foot.

## Residual disability coverage

Traditional total disability policies pay benefits in the event that you are totally disabled and can no longer work. However, a newer type of policy called a residual disability or income replacement policy pays benefits according to how much income you have lost due to disability. These policies pay benefits even if you are not totally disabled and can work part-time. Your benefit will be based on the percentage of income you earn working part-time in relation to what you used to earn working full-time. In general, to qualify for benefits, your earnings have to be at least 20 percent less than your predisability earnings. Residual disability is often long-term coverage, especially if your policy requires a period of total disability first.

***Example(s):*** *Craig suffered anxiety attacks and was unable to work as a full-time stockbroker. However, he was able to go back to work part-time. Under the terms of his residual disability contract, he was able to receive partial disability benefits because he was earning only 40 percent of his average earnings in the 12-month period that immediately preceded his disability.*

***Tip:*** *Some confusion surrounds residual disability coverage. In the past, it was primarily available as a rider to a total disability policy, and you were required to be totally disabled before you were eligible for residual disability benefits. Today, however, you can also purchase residual disability coverage as a stand-alone policy, and you can receive disability benefits even if you never suffer a total disability. Some policies combine both types of coverage in the base policy or offer one as base coverage and the other as add-on coverage.*

## Partial disability coverage

Partial disability coverage is usually offered as an optional rider to a total disability policy, although it may be included in base coverage. It is similar to, but not the same as, residual disability coverage. Both types of coverage provide benefits to you if you return to work after a period of total disability and pay benefits if you can perform some but not all of the duties of your occupation. However, unlike residual disability, a partial disability definition does not consider loss of income. Rather, you will be paid an amount equal to 50 percent (occasionally less) of the benefit that you would earn if you were totally disabled. In addition, the benefit period is much shorter than that for residual disability (a few months or a year at most).

***Example(s):*** *Alan bought a total disability insurance policy and purchased an optional rider that paid partial disability benefits. He suffered a disabling injury and for 18 months was unable to work at all. During this period, he received a monthly benefit of $1,000. Finally, he recovered enough to go back to work part-time, and he began to receive a reduced benefit of $500. He continued to receive this benefit until he fully recovered.*

## What types of disabilities does the policy cover?

Disability insurance contracts further limit disability definitions by narrowing down types of coverage. Most policies offer coverage for both injuries and illnesses and pay benefits no matter where you were disabled. Some policies, however, offer accident-only protection and don't cover work-related injuries or illnesses, because work-related disabilities are covered by workers' compensation.

### *Injury*

Most disability policies define injury as accidental bodily injury. The term accidental, however, doesn't necessarily mean that an accident caused the injury. It may simply mean that the injury was not sustained intentionally or while the insured was doing something that would knowingly cause the injury. You can buy a disability policy that only covers accidental injuries and not sickness.

### *Sickness*

Sickness is defined in disability policies as illness or disease that manifests itself while the policy is in force. This definition covers mental illness as well as physical illness. Knowledge is key here; you may have a preexisting condition, but you might not know it, or a medical exam might not reveal it. Most disability policies cover both sickness and accidental injury; policies that cover only illness are not widely available.

If you are interested in an insurance product that offers specific protection against major illnesses, consider critical illness insurance. This type of health insurance policy pays benefits when you are diagnosed with one of many serious illnesses, such as a heart attack, a stroke, and cancer. It can be purchased as a separate policy or as a rider to an existing policy.

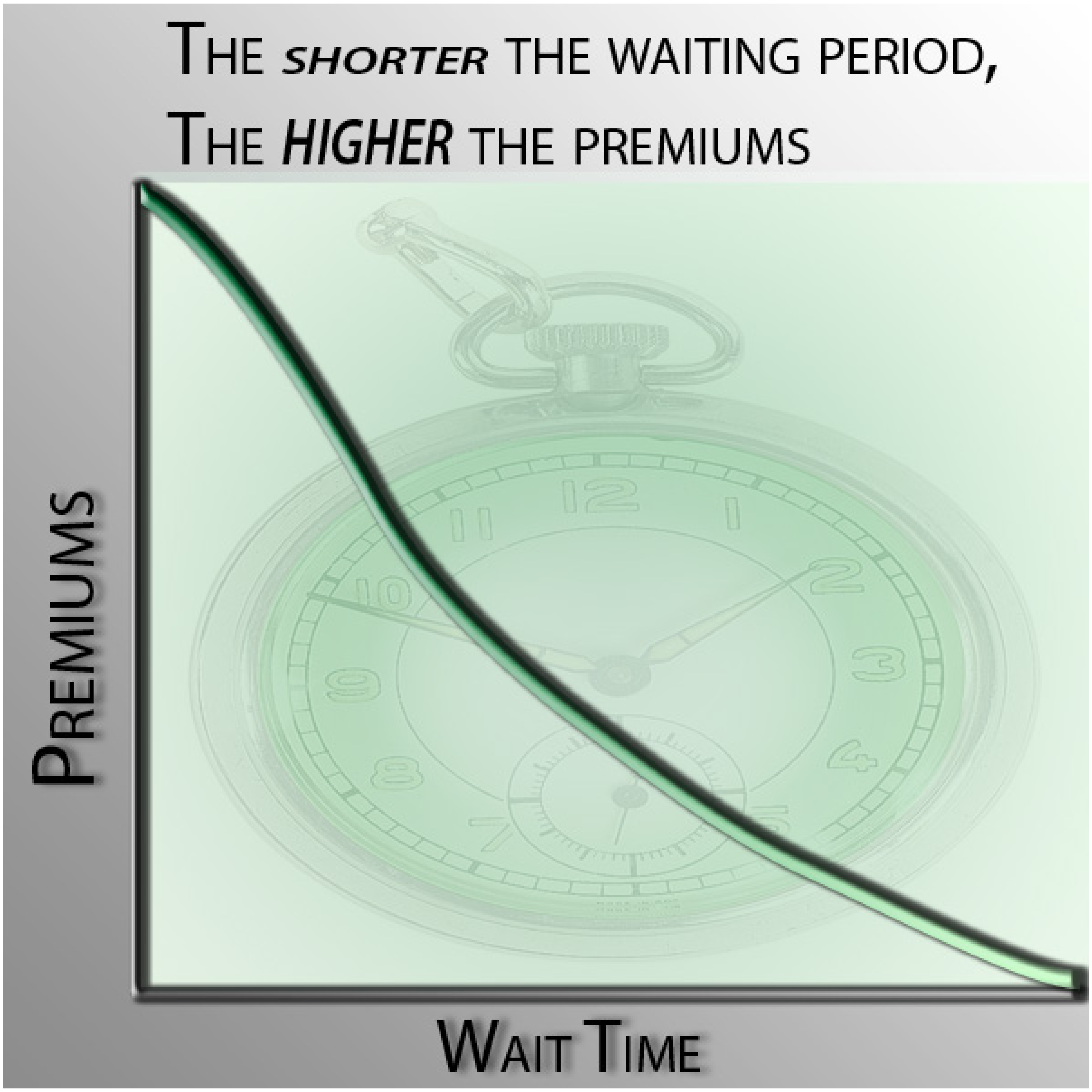
## *Occupational*

Injury or sickness can either be occupational or nonoccupational. An occupational injury or sickness is caused by one's job and is related to that job. To be eligible for benefits under this definition, your injury or sickness must be work-related. These types of disability are covered under workers' compensation, so sometimes they are excluded from group disability insurance contracts. Individual disability insurance contracts may pay you benefits, but these benefits may be offset according to the terms of a social insurance rider.

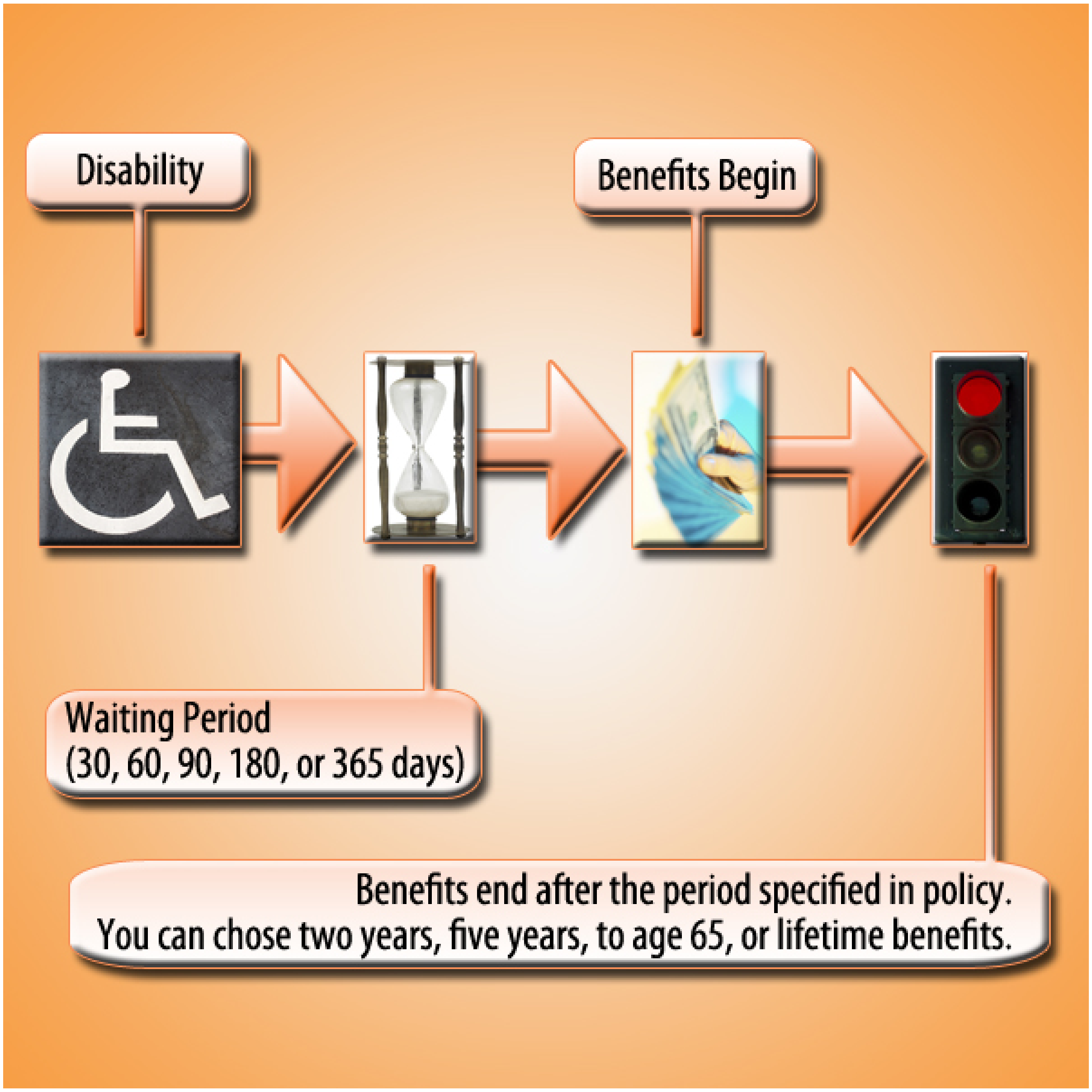
## *Nonoccupational*

A nonoccupational injury or sickness is unrelated to one's job and occurs away from one's place of business. Nonoccupational coverage is much more liberal than occupational coverage and often implies 24-hour benefits. This means that if you get injured, either away from home or on the job, your disability insurance will pay benefits.

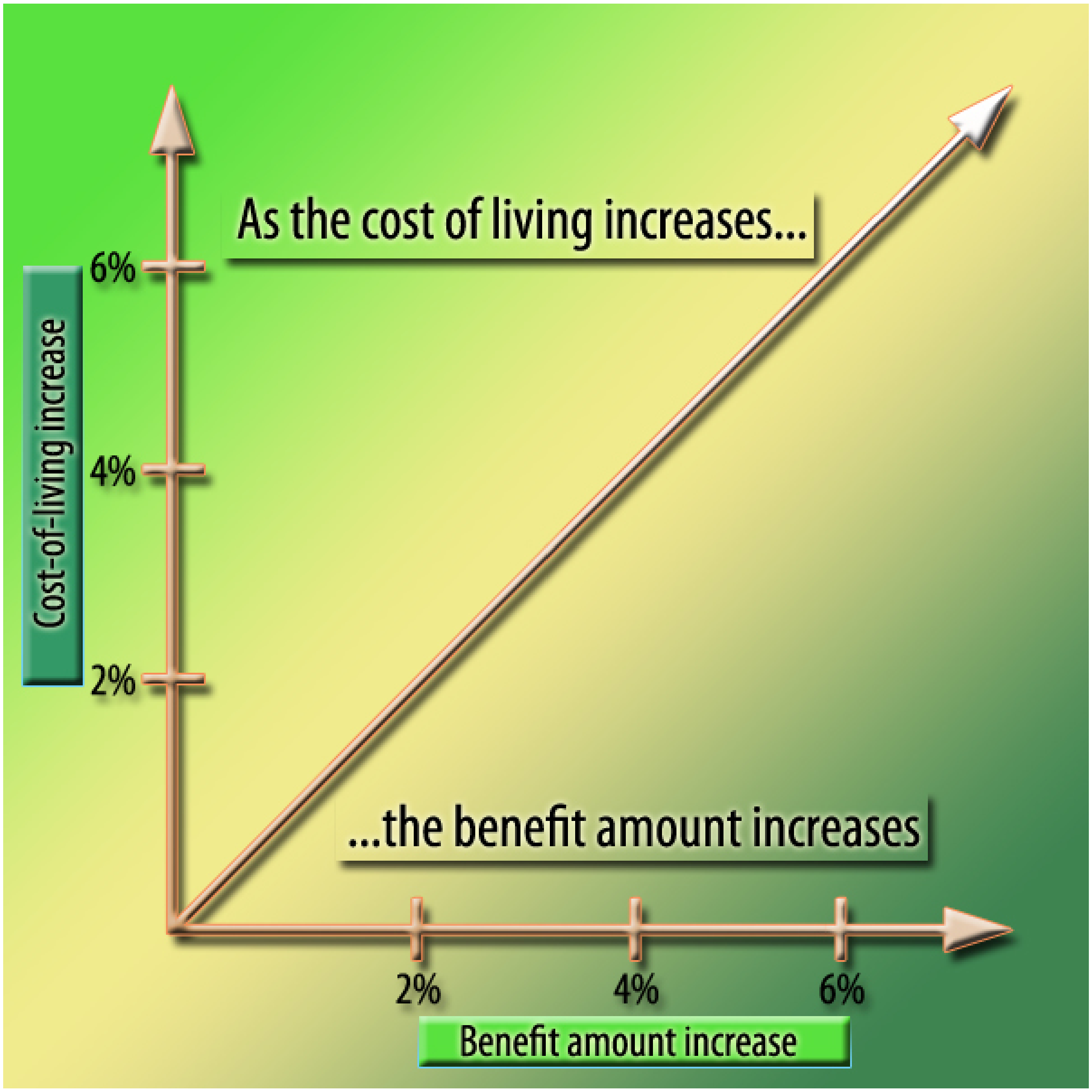
## Disability Insurance Waiting Period



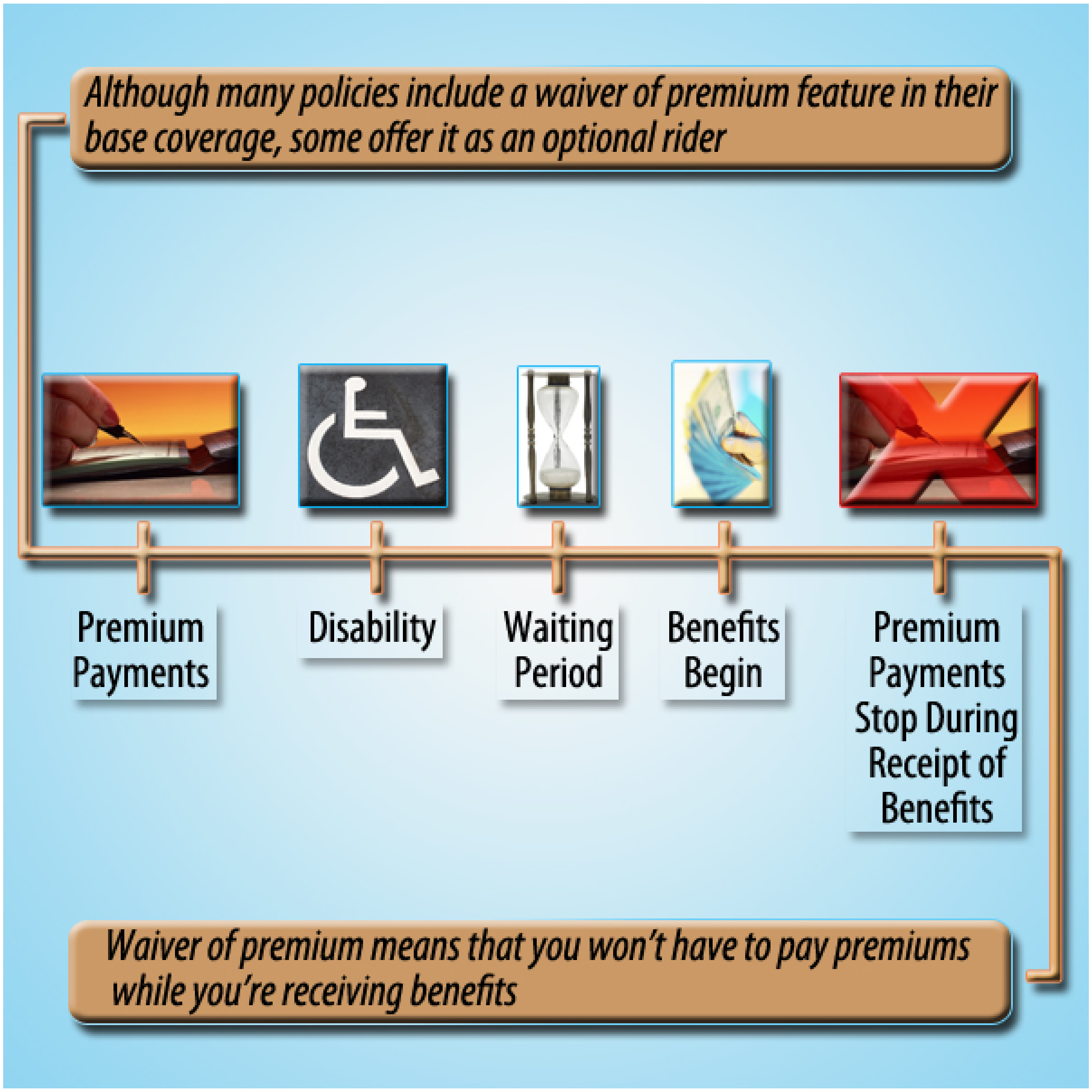
## Disability Insurance Benefit Period



## Disability Insurance Cost-of-Living Rider



### Disability Insurance Waiver of Premiums



# Comparing Individual Disability Income Insurance Policies

## What is it?

One great thing about individual disability insurance is that it's a very flexible product, allowing you to design and buy a policy to fit your needs and your budget. However, you'll have to do your homework. Although relatively few companies sell disability insurance policies, there are many types of policies available that come with an array of features and options. Comparing policies and benefits is crucial if you want to buy a good policy at an affordable price.

## How to do it

### *Contact a financial advisor or insurance professional*

Although you may be able to research disability policies independently, the easiest way to find out what's out there is to contact a financial advisor or insurance professional. Not only can he or she give you general advice regarding disability insurance, but he or she likely has access to a computer database and can give you information on specific products that might suit your needs.

### *Analyze your disability income insurance needs*

When you sit down with your financial advisor or insurance professional, he or she will help you evaluate your disability income insurance needs . Your aim when purchasing disability income insurance is to replace the income you will lose when you suffer a disability. However, you probably won't be able to replace 100 percent of your income; typical disability policies replace only 50 to 70 percent of your earned pretax income.

### *Decide what kind of disability policy you'd like to buy*

Before you can fairly compare policies, you have to determine what features and coverage you want. Would you prefer to buy a policy that will pay you benefits only if you are completely disabled and can't perform any of the duties of your own occupation, or do you want to buy a policy that will pay you benefits if you can go back to work part-time? Do you need short-term disability coverage or long-term coverage? These are only some of the many factors you should consider before you begin comparing disability insurance policies. Sit down with a professional who can review policy features with you. Also, read Private Disability Income Insurance for an explanation of what's included in a typical individual disability insurance contract.

***Example(s):*** *After researching disability income insurance, Pat decided to buy a policy that paid her a residual disability benefit for up to five years. She wanted the benefits to start as soon as possible after she was disabled, so she opted for a 60-day elimination period. She also wanted her benefits to increase with inflation, so she purchased a cost-of-living rider as well.*

### *Obtain literature and samples of two or more similar policies*

Once you have narrowed down the type of disability coverage you'd like to buy, compare two or more policies that have similar features. You don't have to do an exhaustive study of every disability product on the market, but you should evaluate more than one to see how coverage and cost compare. You can obtain literature directly from the insurance company or through your financial advisor or insurance agent. You can usually obtain both a brochure that describes a product as well as a sample (specimen) policy. Read any insurance literature you receive carefully, and ask questions if any provisions seem unclear so that you fully understand the coverage you are considering.

### *Analyze and compare four key points*

You should analyze and compare the disability policies according to four key points: (1) how each policy defines disability, (2) the base and optional features each policy offers, (3) the cost of each policy, and (4) the insurer's financial strength and claims practices.

### *Buy the policy that best suits your needs and your budget*

After you've compared disability insurance policies, you're ready to make a decision. In many cases, one policy will obviously be far superior to another, and your decision will be easy. In other cases, though, you'll have to spend some time weighing the strengths and tradeoffs of each policy before you can decide which policy is right for you. Of course, price will be a big consideration, but be careful not to buy a policy that's seriously lacking because it's cheaper. Quality of coverage is as important as price, something you'll find out if you ever need to file a disability claim.

***Tip:*** *Although you should make the final decision, give your financial advisor or insurance agent the chance to offer input. A professional can often help you see the hidden weaknesses of a policy that you think is adequate. However, don't let yourself be pressured into buying any policy that you can't really afford or don't really want.*

***Example(s):*** *Lucinda compared two disability policies, one from Company A and another from Company B. On the advice of her insurance agent, she decided to buy A's policy even though it cost $200 more per year than a similar policy from B. Her insurance agent had pointed out that not only did A's policy include partial disability benefits (B's policy did not), but A had also received a better rating from A. M. Best than had B. A few months later, Lucinda was glad she had chosen the better-quality policy when she suffered a heart attack but was able to work part-time. A paid her partial disability benefits, whereas B would not have.*

# How does each policy define disability?

One of the most overlooked--yet most important--aspects of disability insurance is how the policy defines disability. Some policies define disability according to how an illness or injury affects an individual's ability to do his or her own job or any other job, while others define disability according to how an illness or injury affects an individual's ability to earn income. For a comprehensive discussion of this topic, see How Disability Income Insurance Policies Define Disability .

## *Total disability*

Although the specific language may vary, each policy will define total disability either as the inability to perform the material and substantial duties of your own occupation (own occupation coverage) or the inability to perform the duties of any occupation for which you are reasonably suited by education, training, or experience (any occupation coverage). Some policies offer a split definition, providing own occupation coverage for short-term disabilities, then providing coverage only if you can't perform the duties of any occupation.

***Tip:*** *Choose a policy that provides own occupation coverage whenever possible. This is a much more liberal definition of disability than that of any occupation coverage.*

***Example(s):*** *Cleo became seriously ill after she fell into the Nile and contracted malaria. Because she couldn't fulfill her royal duties, she began receiving disability insurance benefits based on an own occupation definition of disability. Had she owned a disability policy that paid her benefits based on an any occupation definition of disability, however, she would have received benefits only if she couldn't be queen or do anything else, such as make papyrus in the royal mill.*

## *Residual and partial disability*

If a disability policy offers total disability coverage, it often offers you the chance to purchase residual or partial coverage as well. Residual and partial coverage are similar concepts, but they are applied differently. Both pay benefits in the event that you can go back to work part-time after suffering a disability. Residual disability, however, considers what percentage of earnings you've lost due to disability, whereas partial disability pays you benefits equal (usually) to 50 percent of the disability benefit you were receiving before you returned to work. In addition, residual disability benefits are payable up to the maximum benefit period stated in the contract; partial disability benefits are usually payable for only 3 to 6 months (occasionally 12 months).

Here is an example of residual disability benefit:

***Example(s):*** *Craig suffered from anxiety attacks and was unable to work as a full-time stockbroker. However, he was able to go back to work part-time. Under the terms of his residual disability contract, he was able to receive partial disability benefits because he was earning only 40 percent of his average earnings in the 12-month period that immediately preceded his disability. Before Craig was disabled, he was earning $5,000 per month. After he returned to work part-time, he earned $2,000 per month. His residual benefit was calculated by multiplying the amount his total monthly disability benefit might be receiving ($3,000) by the percentage of income he was losing by not working full-time (60 percent). Thus, his residual monthly disability benefit was calculated to be $1,800.*

Here is an example of partial disability benefit:

***Example(s):*** *Craig suffered from anxiety attacks and received a $3,000 a month disability benefit for 24 months until he was able to return to work part-time. Under the terms of his partial disability rider, Craig continued to receive a benefit of $1,500 per month*

*(50 percent of the disability benefit he received prior to returning to work part-time) for an additional 6 months.*

***Tip:*** *A partial disability or residual disability provision is important because it will allow you to ease back into the workforce after suffering a disability. Some policies offer residual or partial disability benefits as part of the base coverage, while others offer one or both types of coverage as a rider you can purchase. Carefully review the terms of each policy.*

### Presumptive disability

Most insurers consider you to be totally disabled when you suffer a catastrophic illness or injury that results in the loss of sight in both eyes, the use of both hands or both feet, the loss of the ability to speak, or a total loss of hearing. When you compare policies, check to see if each one contains a presumptive disability provision.

***Tip:*** *Although a presumptive disability provision is common and useful, you shouldn't be overly concerned if a policy omits this provision.*

### Recurrent disability

Many policies define how disability benefits will be paid if your disability recurs after a previous period of disability ends. If your total or residual disability recurs within several months from the date the previous disability ended, this second period of disability will be considered a continuation of the previous period of disability. The advantage is that you can begin receiving benefits immediately. The disadvantage is that you may quickly reach the end of your benefit period.

***Example(s):*** *Arthur dislocated his shoulder and applied for disability insurance benefits. After satisfying the 90-day elimination period, he began receiving disability benefit checks and received them for 14 months until he was able to go back to work. Then, 6 months later, he hurt his shoulder again and had to have surgery to repair it. Since his disability recurred within 6 months of the end of his previous period of disability, he began receiving benefits right away. However, since the second disability was seen as a continuation of the first, he was entitled to receive benefits for only 10 more months, up to the limits of his two-year benefit period.*

***Tip:*** *Look for a policy that has a relatively long recurrent disability period, no shorter than 12 months. However, a few states limit the recurrent disability period to 6 months.*

## Compare coverage: what's included in the base policy?

### Policy basics

All disability contracts share some common coverage provisions. These provisions are found in the base policy, usually on the first page (the face of the policy or policy schedule). These provisions form the backbone of the disability policy, and you should carefully consider how the terms of these provisions differ from policy to policy.

### Type of contract: renewability

The type of contract section will state whether the policy is noncancelable or guaranteed renewable. This is vital information. Noncancelable means that the policy can't be canceled and the premium can't be raised for the life of the policy as long as you continue to pay your premiums. Guaranteed renewable means that the policy can't be canceled as long as you pay your premiums, but the premium can be raised under certain circumstances (with permission of the state and for a whole class of insured individuals).

***Tip:*** *A noncancelable contract is preferable to a guaranteed renewable contract. However, because insurance companies are experiencing losses from noncancelable policies, they are becoming rarer, and most policies issued are guaranteed renewable. Noncancelable policies are often offered only to low-risk occupational groups at high premiums. If you're offered only a guaranteed renewable policy, don't despair. It's not easy for the insurance company to raise your premium, and you may see your premium raised only every few years.*

### Elimination period

An automobile insurance policy passes on some of the cost of a claim to you by requiring that you pay a deductible. Similarly, a disability insurance policy passes on some costs to you by requiring you to wait a certain period of time after you become disabled before you can begin receiving benefits. This time period is known as the elimination period (waiting period). Some policies even offer two elimination periods--a shorter one for accidents, a longer one for sickness. When you buy a disability policy, you choose the elimination period that bests suits your needs. You have to balance two variables: how long you could afford to support yourself after a disability and how much you can afford to pay for disability insurance.

***Tip:*** *You can choose a period as short as 30 days or as long as 720 days, depending on the policy. However, the shorter the elimination period, the higher the premium. Many people compromise and choose a moderate elimination period of 90 days because it's usually the most economical choice.*

### Benefit period

When you buy disability insurance, you choose how long you want to receive benefits in the event you become disabled. You can usually choose to receive benefits for periods of one year, two years, five years, or up to age 65. Some policies even offer lifetime benefits, particularly if your disability was caused by an accident. A few policies offer lifetime benefits for sickness as well, but they are usually very expensive and may cover only low-risk occupations.

***Tip:*** *People often buy what they can afford; the longer the benefit period, the higher the premium. If you can afford to buy coverage that lasts at least until age 65, this is the best option because you'll be guaranteed coverage for disability even if your health changes. However, if this is too expensive, buy the longest term coverage you can afford. Don't panic if you can only afford a short benefit period (two years or less). Even short-term coverage may be enough, because many disabilities end within two years, although the average period of disability is about four years. In addition, because the benefit period offered to you is based on your occupation, you may only be able to buy two-year or five-year coverage. In this case, the best option would be to opt for the longest benefit period you can.*

### Monthly benefit

The maximum amount of disability insurance you can purchase will be determined by the insurance company based on certain underwriting factors such as your income, sex, health, age, and other disability benefits to which you may be entitled. Each company may have a stated maximum, as well as a maximum percentage of your income that it will replace. Most companies aim to replace 50 to 70 percent of your earned income. However, as long as you don't exceed the maximum allowable monthly benefit, you can choose the benefit amount you want or can afford. You might want to do this to keep down the policy cost.

***Tip:*** *When you compare policies, make sure that you compare them on equal terms; don't, for instance, give equal weight to a policy that promises to pay you a benefit of $1,000 and a policy that promises to pay you a $2,000 benefit.*

## Compare coverage: What optional benefits can be added?

Adding riders to your base disability policy is how you personalize your coverage. However, riders also increase the policy's cost. You can choose among many different riders, but the following is a list of a few popular options that you should consider buying. Again, read the policy or brochure carefully. Some companies include one or more of these options in their base coverage and raise the price accordingly.

***Example(s):*** *Lisa compared two disability insurance policies. One policy offered comprehensive base coverage, guaranteeing both that benefits would automatically be adjusted 4 percent per year to counteract inflation and that Lisa would have the chance to buy additional coverage in the future without a medical exam. The premium for this policy was $985 per year. The other policy's base coverage provisions were sparse; however, Lisa could buy an array of add-on riders. The premium for this policy was $850 per year. Which policy was better? Lisa finally decided that even though the second policy cost less, the first policy suited her needs better when she compared the coverage offered.*

### Automatic benefit increase rider

This rider (sometimes offered as part of the base policy) stipulates that the monthly policy amount will be adjusted automatically every year to account for pay raises or increased income you receive after you've purchased a disability policy. The rider provides annual increases for a certain term (often five years). During this time, you won't have to provide proof your income has gone up or evidence of medical insurability. However, upon renewal of the rider, you may have to show evidence that your income has increased; otherwise, you won't be able to renew the rider.

### Cost-of-living rider

If you are afraid that inflation will eat away at your disability benefit, you can purchase a cost-of-living adjustment rider that increases your monthly benefits (after you have been receiving disability benefits for a year) if inflation rises. If inflation is low, a minimum percentage (usually 4 or 5 percent) often applies. When comparing policies, be aware that some companies cap the increase, while others let you choose your own maximum.

***Tip:*** *Price is certainly a factor here; while important, a cost-of-living rider can be quite expensive. Choose a policy that offers this as base coverage (unless the policy premium has been raised accordingly), or compare the cost of this rider in each policy.*

### Social benefits rider

This rider provides disability benefits in addition to your base monthly benefit. This benefit amount is payable to you as long as you are not receiving (or are eligible to receive) a social benefit (e.g., Social Security disability insurance). When you receive a social benefit, your social benefits rider may be reduced by the dollar amount you are receiving. This rider typically costs less than your base benefit because it takes some of the guesswork out of underwriting and protects the insurance company against some risk.

***Tip:*** *Occasionally a Social Security income rider is included with base coverage, and sometimes the insurance company requires it. In addition, there are several versions of Social Security income riders that pay benefits in various ways. When you compare policies, determine how each policy handles the Social Security rider.*

***Tip:*** *Some insurance companies offer social insurance riders, which are similar to Social Security income riders but which also cover other forms of social insurance, such as workers' compensation.*

### Future benefits increase rider

Also called an option to increase coverage or a guarantee of insurability rider, this rider gives you the option to buy more disability coverage if you need it later without being turned down for medical reasons. You'll be able to purchase a specified amount of coverage on certain option dates, often every two to three years. This is a useful rider if you are young and anticipate needing more disability coverage later because you expect your income to rise significantly over the years.

***Example(s):*** *Heloise purchases a disability income insurance policy when she is 30 that includes a future benefits increase rider. At the time she buys the policy, she earns $2,000 per month, and her policy pays her a $1,200 per month benefit. By the time she is 35, however, she is earning $3,000 per month and wants to increase her benefits. She does so under the terms of her rider, which allows her to purchase an additional $400 of monthly benefit every three years.*

While you can increase disability coverage under this rider, you usually cannot exceed twice the monthly indemnity that you have in force from all insurance companies that cover you against disability.

## Compare coverage: special provisions and exclusions

The following provisions and exclusions are found in most disability insurance. They should be used as points of comparison but should not be weighed as heavily as other factors.

### Rehabilitation provision

Look for a rehabilitation provision in each disability insurance policy. This provision promises to pay for certain expenses you incur if you enter a rehabilitation program, such as books, the cost of a training program, or living expenses.

### Waiver of premium provision

Most disability policies include a waiver of premium provision that states that your premium will be waived after you've been disabled 90 days. In addition, any premium you paid in the first 90 days that you were disabled will be refunded to you.

### Normal exclusions

Typically, disability policies have a general exclusion provision that excludes loss for unpredictable or uncontrollable events. Many don't cover injuries or illnesses resulting from aircraft accidents (pilot or crew), war or acts of war, suicide attempts or self-inflicted causes, and normal pregnancy (although some states require that pregnancy be covered as an illness).

### Special exclusions

Special exclusions may apply if you have a pre-existing condition at the time you apply for disability insurance benefits. In addition, some policies also exclude (or limit the duration of benefits paid for) mental and nervous disorders and drug and alcohol abuse. Check the language of each policy carefully.

# Compare cost: make sure that the price is right

## *Evaluate equivalent products*

You can't fairly compare the cost of two disability insurance policies unless they have similar terms and provisions. For instance, it would be unfair to compare a noncancelable loss of income policy that has a 60-day elimination period to a guaranteed renewable any occupation policy with a 90-day elimination period. Before you begin comparing policies, figure out what terms and conditions best suit your needs. Then compare policies that offer the features you are looking for.

## *Find explanations for price disparities*

If one policy costs much more than another equivalent policy, try to figure out why. Perhaps the more expensive policy has some extra coverage hidden in the base policy, or maybe the cost of each additional rider is higher. Maybe the company can afford to charge less because it pays claims less frequently due to strict underwriting standards. Maybe you've overlooked an important provision. This is where a financial advisor or insurance professional can be an invaluable source of information, because he or she has knowledge of other companies' products as well as his or her own.

***Example(s):*** *Jake wanted to buy disability coverage and started comparing policies. Company A offered him a policy that cost $300 a year more than a policy from Company B. His financial advisor told him, however, that Company A's policy included coverage in the base policy that Company B's policy did not. Company B offered the additional coverage as two add-on riders, each costing $200 a year. Thus, all things considered, purchasing coverage from Company B that was equivalent to Company A's coverage would actually cost Jake more.*

## *Find ways to reduce premiums*

If you prefer the coverage one policy offers over another policy but you can't afford it, look for ways to reduce the cost of the premium. For more information on some ways to do this, see Ten Ways to Lower the Cost of Disability Insurance .

# Compare companies: three questions to ask

## *What's your company's industry ranking?*

Although it's unlikely that an insurance company will become insolvent, it has happened. To protect yourself, find out where the companies you are comparing stand within the insurance industry. Several companies rate insurance companies based on financial strength, profitability, and claims-paying ability. These companies (such as, A. M. Best, Standard & Poor's, Fitch (formerly Duff & Phelps), and Moody's) assign insurance companies letter grades as a way to compare and evaluate their performance. However, each evaluator uses a slightly different ranking system, so it's important to know what grading scale and standards are being used. You should specifically ask about the company's past ratings, because one indicator that a company might be in trouble is that its rating has been declining.

***Example(s):*** *Veronica purchased a disability insurance policy from Insurance Company One, a company that was rated B+ by A. M. Best. One year later, Insurance Company One became insolvent. Veronica found out that prior to her purchasing her disability insurance contract, One had been steadily decreasing in the ratings. At one point, it had received an A+ (excellent) rating, then slid to B+ (very good) within two years. Although a B+ rating was acceptable, the ratings downturn indicated that the company was experiencing financial difficulties.*

## *When will you receive your first benefit check?*

Find out when you will begin receiving benefits after the elimination period ends. Many companies issue checks at the end of the month, so you may have to wait an extra 30 days from the time your elimination period expires before you receive your first check. So if you have a 90-day elimination period, you won't receive your check for at least 120 days after your disability began. Some companies, however, process checks more quickly. You may be able to call the company's claims department to find out how quickly claims are processed.

### What's your company's lapse ratio?

Your insurance agent should be able to tell you what your company's lapse ratio is. The lapse ratio shows the percentage of policyowners who terminate their policies after the first year. A low lapse ratio may indicate that policy owners are generally satisfied with the company.

## What happens next?

### Submitting an application

After you've selected the disability policy that best suits your needs, you'll fill out an application to purchase the insurance. Your financial advisor or insurance agent will likely have already begun the underwriting process by doing a preliminary evaluation. If you haven't already filled out an application for disability insurance, you'll do this now. It will ask you questions about your age, income, medical history, and lifestyle. You may be required to submit proof of income, take a physical exam, and submit to blood testing. Your application will be submitted to an underwriter, who will evaluate your answers and determine what coverage you can purchase and at what price. For a more comprehensive discussion of the application process, see Surviving the Underwriting Process When Buying Disability Income Insurance .

### Know your rights

Some states require that you receive a printed buyer's guide when you're comparing and purchasing disability insurance. Some states also require that the company give you an outline showing your benefit entitlement and provisions. In addition, you may also have the right to review the policy, returning it to the insurance agent or company within 10 days if you wish to cancel. You will then receive a full refund of any premiums you have already paid.

## Questions & Answers

### You already have a group disability insurance policy through your employer. Should you depend on this coverage or purchase an additional individual policy?

Insurance companies want you to have adequate disability coverage, but they don't want to overinsure you. Most companies will take into account what other disability benefits you may be entitled to before issuing you coverage. This means that you may be able to purchase a supplemental individual policy that works with the insurance you already have. Remember, though, that one of the primary differences between group disability and individual disability insurance is that a group policy can be canceled; if you lose your group affiliation, you lose your disability insurance coverage. On the other hand, an individual policy is yours to keep unless you choose to cancel it. For more information on this topic, see Replacing and Conserving Disability Income Insurance Policies .

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