Disability Coverage – Common Questions and Answers

Note: With a little education and common sense, you'll find that Disability coverage is very important for most of us, that it is inexpensive, and that your choice of policy and agent do make a difference. Since premiums are age-dependent and can be "locked-in", procrastination can be very costly.

I already have Disability coverage. Does this pertain to me? Do you have sufficient coverage? Would it be better to increase benefits through a new policy? Will your existing coverage pay when you need it to? Do you have appropriate riders? Do you have the right insurance agent?

Why should I have Disability coverage? When you become independently wealthy, you don't need Disability coverage. Until then, your most valuable asset (<u>your ability to work and earn an income</u>) is obviously far more important to your financial future than what any financial investment can do for you. Would it be prudent to spend a very small portion of your income to protect that earning power?

<u>The chances are greater than 1 in 6</u>, that you will experience a long term disability before you retire. Are you willing to play Russian Roulette? (1985 Commissioners Individual Disability A Table) There are <u>over 700 illnesses and other conditions</u> that can keep you out of work.

The median length of a disability that lasts one year or more is five years and a high percentage of these last more than 15 years (Social Security Administration). The median length for profession specific disabilities is undoubtedly much longer and very likely to be permanent. About 1 in 15 Americans between the ages of 16 and 64 have a severe disability (12/97 Census Brief, U.S. Dept of Commerce.) About 1 in 20 non-institutionalized Americans between the ages of 25 and 64 who have a bachelors degree, have a work disability (CPS 1998, U.S. Census Bureau.); nearly half of those have a severe work disability. See also "Are Disability policies expensive?"

Why should I get it now? 1) You can <u>lock in a quality contract now</u>. While your choices are more limited than in the past, there are still several good choices and options available. Future policies are likely to be more limited if recent trends continue. If they get better, you can always switch (assuming you qualify for the new coverage) 2) You will <u>save money</u> by locking in rates at your current age. 3) You are probably as <u>healthy right now</u> as you will ever be. Little aches and pains can be major issues to a Disability underwriter.

"I'm young and healthy and not likely to become disabled" Maybe now, but time and statistics are not on your side. Because you have more time, the <u>odds of becoming disabled during your career are greater when you are younger than when you are older!</u> In a group of six men age 30, there is a 99% chance that one of them will become disabled for 180 days or more before age 65. By age 50, the chances drop to 95% and the odds are worse for women (1984 Commissioner's Disability Table.) In any one year, however, an older person is more likely than a younger person to become disabled. About 1 in 20 Americans between the ages of 25 and 34 have a work disability (CPS 1998, U.S. Census Bureau.) See also "Are Disability policies expensive?"

Wouldn't it be better to invest the money in the Stock Market? If you were diligent enough to invest an extra $2,000 a year entirely in the stock market, and generated the average long term returns of roughly 11% annually, you would end up with a little over $400,000 after 30 years, assuming you didn't have to pay any taxes. A quality Disability policy with a similar cash outlay protects your ability to earn and make those investments throughout your career, and would **generate roughly $2,000,000 tax free** if you became disabled! Figures vary depending upon when you become disabled.

What conditions cause someone to be disabled? Illness rather than accidents are responsible for the majority of claims. There are <u>over 700 illnesses and other conditions</u> that can keep you out of work. The leading causes of disability in the U.S. are heart disease and back problems (each accounting for about 13% of the cases), arthritis (9%), orthopedic impairments (7%), eye and visual impairments (5%), asthma and diabetes (4% each), mental disorders (3%), learning disabilities (3%), cancer, hearing impairments, and cerebrovascular disease (2%

each). Hypertension accounts for about 1/3 of the heart disease statistics (1992 National Health Interview Survey.)

Is my choice of insurance agent important? Not if you are knowledgeable, draw on experience, and are willing to work at it. What are the guarantees, definitions, and riders? What are the exclusions? Is the company strong financially? You also need to revisit these issues when you review your coverage. Otherwise, pick a good agent or agency. Prices are the same either way assuming the same product is picked; it's just the advice and help over time that make huge financial and time-saving differences!

How much Disability coverage can I get? You can get roughly 50% of your net income (gross income minus business expenses, but before income taxes are deducted) covered by a quality individual Disability policy. The actual percentage varies significantly (roughly 20% to 80%) depending upon your income. For example, at net income of $20,000 you can get 75% (benefits of $1,250 per month). At $100,000 of net income, you can get 56% (benefits of $4,700 per month.) At $300,000 of net income, you can get 40% (benefits of $10,000 per month.) The percentage keeps dropping as your income increases.

What features should I look for in a Disability product? In general, you should get a policy backed by a very financially strong company, and a policy with strong guarantees (non-cancelable, guaranteed renewable, neither), definitions (true owner occupation, modified owner occupation, any occupation, other), and riders. Make sure benefits last to age 65 or for life even if you are partially disabled. The waiting period (the initial time period where no benefits are paid) is a matter of choice, but is typically issued at 90 days. The cost of living rider will help you keep benefits up with inflation and the option to increase in the future will protect your ability to get increases later even if your health deteriorates. Other riders may be good, but usually don't add much in the way of basic protection. Premiums usually do not need to be paid when you are disabled. Any of these features may have limitations, so it is important to get policies with good features.

Are Disability policies expensive? No, premiums are very inexpensive. When you consider the "bigger" picture (costs, benefits, and odds), this coverage makes more sense than most other insurance. It costs almost as much to insure a home worth $500,000 as it does to insure yourself for $2,000,000, and the odds of a major homeowners claim are only about 1 in 300, compared to 1 in 6 for a disability. Losing a house would be a severe financial loss, but if you still had the ability to earn an income, you could rebuild it. If you lost your earning power, you would probably lose your house as well.

Sample costs for a $3,000 per month quality Disability policy are shown below. Premiums do not increase. Costs are typical of those for a very financially strong company with good rates, and which provides strong guarantees, definitions, and riders. Benefits are generally tax-free, premiums are waived when disabled, and generally only war and crime are excluded. There are a number of ways to reduce these costs further. Ask us about options for getting unisex rates, which lie somewhere between male and female rates.

	Monthly Cost		Potential	% Disabled for 90 Days	% Still Disabled
Age	Male	Female	Benefits	or Longer Before Age 65	After 5 yrs
30	$140	$200	$2,642,480	42%	50%
40	$200	$290	$1,490,253	39%	55%
50	$250	$320	$711,849	33%	59%

(Policy features include: Noncan/Guar Ren for A30 & A40, Guar Ren for A50, benefits to age 65 after 90 day wait, own occ, residual, 4% COLA, $6,000 increase option. Disability data is from the 1985 Society of Actuaries study.)

Two strategies:	Do Nothing	Protect Income
Earnings	100%	100%
Cost of Policy	0	2%
Net earnings	100%	98%
Income Protection	None	Full

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