

Why You Need Disability Insurance

By Ric Edelman

From [The Truth About Money](#).

Your largest asset is not your house, your health, or your company pension.

For almost everyone who is still working, your largest asset is *your ability to produce an income*.

Thus, the most important type of insurance is *disability income insurance* (DI). You need it more than any other kind of insurance — more than life, health, homeowners, or auto insurance. In fact, in my firm's planning practice, we typically are far more concerned that our clients own disability coverage than life coverage.

Although everybody who earns a living needs disability insurance, less than 15% of all workers in the U.S. have it. There are two reasons why:

Reason #1: "It won't happen to me"

I bet you think "bad stuff" only happens to the other guy. Well, to the other guy, you're the other guy. Consider this: 48% of all mortgage foreclosures in this country are caused by disability. When somebody gets injured or ill, they can't work. They then lose their job and thus their income. With no income, they can't make their mortgage payment and the bank forecloses. If you thought people lose their homes because they're deadbeats, alcohol or drug abusers, criminals, or compulsive gamblers, think again. They're good, honest people who merely suffer a disability.

Although only 15% of workers have DI coverage, virtually all home-owners have insurance on their homes. I'll bet you do, too. Yet has any house on your street ever burned down? Unlikely, because the odds of that happening are only one in 1,200.

Yet your odds of suffering a disability before age 65, one that lasts 90 days or more, is an incredible 1 in 8. So if you think it won't happen to you, maybe — just maybe — it might.

In fact, as Figure 10-1 shows, actuaries can predict with remarkable accuracy the probability that a disability will occur. For example, take any five people who are age 45. Statistically, it is 95% certain that at least one of those five people will suffer a long-term disability prior to age 65. Those are pretty awesome odds, and I certainly would not want to bet against them — yet that's exactly what you're doing if you do not have disability insurance.

The Air Bag Phenomenon

Interestingly, the reason you are so likely to suffer a disability is exactly because you are so *unlikely* to die. Since 1960, the frequency of death from the four leading causes have sharply *decreased*, while the frequency of disability has sharply *increased*. I call this the Air Bag Phenomenon.

If you live in a major metropolitan area, you'd agree that there are 10 rush hours every week, one each weekday morning and evening. How often do you hear of a traffic accident in those rush hours?

Every time, of course.

But in how many do you hear that a driver was killed in a rush hour accident? That's much less common. Since fatalities are unusual, most of us don't give those accidents a second thought, other than to complain that someone made us late. But the truth is that someone is getting hurt in those accidents. After all, you're not likely to avoid injury after sustaining a collision at 55 mph.

And that's my point: Due to the advent of airbags, many people now survive auto accidents who 10 years ago would have been killed. But this does not mean accident victims just walk away from the scene. Rather, it simply means they go to the emergency room instead of the morgue.

Indeed, a study by the University of Pittsburgh showed that people protected by an airbag who are involved in a high-speed, head-on collision often suffer a variety of injuries caused not by the collision, but by the airbag itself — including burns to the chest and face, loss of hearing and vision, and broken forearms. Airbags also fail to prevent legs from being broken. And research from the University of Florida revealed that many drivers whose lives were saved by airbags suffer injuries that are not readily apparent to rescue workers, such as lacerations to the liver. Thus,

airbags do not assure that you will survive injury-free if you are in an accident.

So while airbags have been very good news for the life insurance industry (as the number of highway fatalities has dropped), it has been bad news for the health and auto insurance industries (which pay the medical expenses of accident survivors).

Indeed, medical advances can be felt far beyond the highway. A generation or two ago, a worker who suffered a heart attack on the factory floor would have died. Today, paramedics and emergency medical technicians arrive in minutes, ready to stabilize and transport the patient to the hospital — by helicopter, if necessary. Throughout much of the country, EMTs are able to install pacemakers *right at the scene*.

And there's more. Has your liver gone bad? No problem. We'll give you a new one. Clogged arteries? We'll predict the stroke before it occurs, give you a quadruple bypass, and you'll be back on the tennis court in six weeks. Failed kidneys? We'll hook you up to a machine that will take over the job.

Modern medicine can do many things. Above all else, it can *keep you alive*. But that doesn't mean you'll never miss a day of work.

Quite the contrary. In a study of more than 2,000 severely ill patients from five medical centers around the country, the *Journal of the American Medical Association* reported that nearly a third of the families lost most of their life savings as a result of the patient's illness. The study found that although 96% of patients had some form of medical insurance, 31% still lost their savings.

"Home care and disability costs may now be more devastating to patients and their families than the costs incurred in the hospital," said the study. These expenses include the unreimbursed costs of home care, health aides, special transportation, and related medical costs. In addition, 29% of the families studied lost a major source of income, either because the patient no longer could work, or because another family member had to quit a job in order to care for the patient.

So if you think a disability won't happen to you, or if you think it won't result in a financial burden, think again.

Reason #2: "It's Too Expensive"

Without question, DI coverage is expensive. Annual premiums can be 1% to 3% of your annual salary. And that's why many people ultimately reject DI insurance. "I can't afford it," they say. Turn this argument around. The reason you need to buy disability insurance is exactly why you don't want to buy it.

Have you ever seen one of those insurance commercials on late-night TV? "For just two dollars a week... you cannot be turned down... veterans only..." and other nonsense. These policies are only two bucks a week because the insurance companies know they're not going to pay a claim!

If you look at the fine print, you'll see that the benefits for the first several years often are limited to a return of the premiums you've paid, minus administrative costs. Since most buyers of this awful coverage are a gizzardillion years old, the carriers know the buyers will die before they qualify for a claim. Thus, the carriers collect \$2 a month, for which they do nothing in return. That's why coverage is so cheap. For the carrier, that \$2 premium is virtually pure profit!

This is the main thesis of the insurance world. A policy is cheap when the insurance company knows it is unlikely to pay a claim. But policies are expensive when there is higher probability that you will file a claim. Therefore, the more expensive the policy, the more you need the protection.

Think Like the Seller

It might help if you examine the situation from the insurance company's point of view. If only one house in 1,200 is likely to burn down and each house is valued at \$250,000, then how much does an insurer need to charge each of the 1,200 homeowners to be able to pay the claim for the one house that burns down? The answer is:

1 Claim of \$250,000

= \$208/Per Home

1,200 Homes

Toss in administrative expenses, profits, and payouts for other forms of damage, such as lightning, theft, and flood, and the typical homeowner's insurance bill is about \$350. Thus, from the insurer's perspective, the cost of a policy is directly related to the likelihood and cost of a claim. This explains why homeowner's insurance is cheap, and why DI coverage is expensive.

The Cost of Disability vs. The Cost of Death

Look at Figure 11-3. Mike, a 35-year-old male nonsmoker in good health, buys a \$250,000 life insurance policy. If Mike were to die, the insurance company would owe his survivors \$250,000. On the other hand, if Mike bought a \$2,000 disability income policy and suffered a disability, the insurance company would owe him \$2,000 per month — for as many as 30 years. That would be as much as \$720,000 in claims!

That's why disability insurance is expensive — and why you need it.



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Don't Ignore This Insurance

You've probably heard the mantra: The likelihood of suffering from a long-term disability is significantly greater than the likelihood of dying before age 65, especially when you're young.

Despite these grim odds, the life insurance industry has done a lot better job selling policies than its disability counterpart. According to one statistic lurking on the Internet, 70% of Americans have life insurance policies, while only 40% have disability coverage.

And don't assume you're out of the woods if your boss offers group coverage. Group policies typically pay a maximum of only 60% of base salary -- not including such extras as bonuses, commissions and stock options. Payments are usually capped at a monthly maximum, too. And when your employer pays the premiums, you pay the taxes.

Things are tougher now

What this means is, there's a good chance you and your spouse need this insurance, or need more of it in the form of a supplemental policy. Unfortunately, it's not as easy to get as it used to be.

Ten or 15 years ago, disability insurance policies were more generous and premiums were lower. Then, after a deluge of claims and resulting floods of red ink, companies left the business or merged, leaving only a handful in the market.

Although premiums haven't increased much in the last few years, overall they are from 50% to 70% higher than they were before the bloodletting. Currently, Guardian Life, which sells top-of-the-line disability insurance, offers a policy with benefits to age 65 and a three-month waiting period for a healthy, 45-year-old male non-smoker with a job such as computer analyst, CPA, architect, or financial planner and earning \$50,000 a year for \$1,275 annually. For a woman of the same age, health and job, the annual premium would be \$1,813. The benefit in each case would be 60% of salary per year, or \$2,500 per month.

If it's hard to pin down a cause for your ailment, as it is for, say, chronic fatigue syndrome, "some insurance companies will start hassling you" about paying claims, says Bill Barrett of [The Plus Group](#), a disability insurance brokerage marketing organization. And companies have toughened up financial underwriting.

Disability insurers have been even more reluctant to insure home-based businesses because of the difficulty of verifying a disability as well as income.

Fortunately, insurance companies are beginning to join the 21st century. Some, such as [Assurity Insurance](#), [Mutual of Omaha](#) and the [Principal Insurance Group](#) have begun easing requirements for home-based businesses.

In fact, new coverage announced in early May by [Guardian Life](#) no longer requires owners to spend 50% of their time working outside the home or to receive clients at the house in order to qualify.

Shopping for policies

If you need more insurance and you can buy *individual* coverage through your employer, take advantage of the offer. The premiums will be lower than buying on your own, and you will be able to take the policy with you if you leave your job. (You normally can't take group coverage with you.)

Look for a future insurance option (cost: about 10% of the premium) that guarantees you the right to buy more insurance without a medical exam as your income grows.

Pay special attention to these provisions in any policy:

The definition of disability. This is the key to determining under what circumstances you will get your benefits. *Own-occupation* policies pay benefits if you can't practice your profession any more. With this coverage, you can work in a related field and still get the benefits.

Any-occupation coverage pays only if you cannot work in any occupation that fits your training and education. For example, if you can't litigate in the courtroom any more but can teach law, you won't get benefits. Some policies offer two years of own-occupation coverage then switch to any-occupation coverage. Own-occupation policies run about 10% to 15% more than any-occupation policies.

Residual benefits. To encourage employees to come back to work, some policies offer residual or loss-of-income benefits. If, say, you can go back to work only part time, earning 80% or less of your former earnings, this provision pays you the difference between current and former earnings. Without it, your part-time work might cause you to lose benefits.

Proving a claim under residual benefit provisions can be complicated these days as well. Jeff Sadler, author of *Disability Income* (published by The National Underwriter), says that some claimants have had to hire accountants to submit forms to prove their claims.

His recommendation: when you apply for insurance with residual benefits, "find out then what kind of records are necessary to prove a claim. It's so much easier for you if you have the right records up front."

Non-cancelable vs. guaranteed renewable. Under either of these policies the insurer can't change the provisions or cancel the policy. But under a guaranteed renewable policy the company can raise premiums -- as long as it's for a whole class of policyholders, such as all of those living in your state. Non-cancelable insurance is better but it is more expensive than guaranteed renewable insurance.

Waiting period. The waiting period (also called the elimination period) is the length of time between the onset of a qualifying disability and when you start receiving benefits. Three to six months is common.

Sometimes you can get a policy with a one- or two-month waiting period, but most people have enough sick leave and savings to get by for three months, so they're often not worth the higher price.

Benefit period. Some policies provide coverage only for two or five years, which many experts believe is inadequate. It's more expensive, but safer, to get a policy that provides benefits to age 65, when the income you are protecting might end with retirement anyway.

Disability insurance less popular than life but can be more important

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By Deborah Mendenhall, Post-Gazette Staff Writer

Families often consider life insurance as necessary as a sound roof when it comes to protecting them from the harsh winds of fate, especially when children are small. Primary bread earners want assurance that if the worst happens, the house will be paid for and the youngsters can go to college.

But they often forget the second worst thing: a disability that could knock the family provider out of the workplace. While industry studies show that workers are three to five times more likely to be disabled than die early, disability insurance is often neglected.

 Stacy Innerst, Post-Gazette)

"Much less disability insurance is sold in this country than life insurance," said John Grogan, director of disability benefits for Northwestern Mutual in Milwaukee. "But anyone who relies on income to support his family needs it."

While premature death tends to have a bigger emotional impact, disability can be equally, if not more, devastating to a family's financial stability, said Tom Wildsmith, policy research actuary for Health Insurance Association of America, a trade association in Washington, D.C.

"The largest financial asset most of us have is our ability to earn a living," Wildsmith said. "Twenty years of income is a awful lot of money to lose."

Income loss could be accompanied by unexpected expenses such as rehabilitation, education or training for a new job, modifications to the home or car to accommodate a handicap, and round-the-clock medical care, he said.

Many national firms sell disability insurance, and policies vary in coverage, benefits and cost.

In general, a policy that would protect 60 percent of the worker's yearly income would cost between 1 percent and 3 percent of the annual salary. The waiting period before benefits kick in ranges from three months to two years, depending on the policy.

If the worker pays for the policy, benefits would be tax-free. If his employer pays for the policy, payments are taxed. Companies will insure up to 60 percent of an annual salary, but workers can buy any number of policies or supplement a company-provided policy to guarantee that amount.

Some companies sell a "top hat" plan that would replace the taxes a worker would have to pay under his employer's disability policy, and bring the amount he receives up to 60 percent of his pay.

Consumers can buy policies that offer disability payments for two years, five years or until the age of 65, when Social Security would be available. Some companies charge an additional fee for policies that guarantee lifetime payments.

A good comprehensive policy would cost a worker with an annual \$80,000 salary \$1,300 a year, with lifetime payment coverage costing him about \$1,500 a year, said Steve Crawford, director of Guardian Disability Insurance Brokerage.

Most companies offer "income replacement" insurance, which would protect the amount of salary a worker loses if a disability forces him into another field.

Guardian and Northwestern Mutual are among a smaller number of firms that also offer noncancelable, own-occupation disability policies.

A noncancelable policy protects the income a worker earns in his chosen field, even if he is disabled after he leaves that job for another profession.

Own-occupation coverage pays benefits to disabled workers who can't perform their old jobs, even if they are able to work in another field.

If a policy is "guarantee renewable," but not "noncancelable," that means a company can raise the rates or modify coverage, Crawford said. "As a consumer, I would think twice about buying that kind of policy," he said.

The benefits of some private policies would be reduced if the disabled worker receives disability payments through Social Security or state plans, such as Pennsylvania workers' compensation.

Some speculate that workers don't buy private policies because they think they will be well protected by government plans.

But while they offer a hedge against disaster, government benefits are perceived as difficult to qualify for, and Pennsylvania's workers' compensation covers only on-the-job injuries.

To be eligible for Social Security disability payments, a person must be unable to work in any field, and the disability must "be expected to last a year or to result in death." There is no provision for partial or short-term disabilities.

Initially, 37 percent of the 2.03 million workers who applied were approved for Social Security benefits last year. After appeals, that number jumped to 55 percent.

A 45-year-old worker with a spouse and child who was making an annual \$80,000 before the injury could receive about \$2,500 a month from Social Security. Benefits would stop if his medical condition improved or if he earned \$700 a month.

Pennsylvania companies are required to provide worker's compensation coverage. Under the provisions, disabled workers are eligible to receive two-thirds of their salary up to maximum payments of \$588 a week, said John Currie, spokesman for the Pennsylvania Department of Labor and Industry. Benefits would continue until the worker could go back to his job or other work, he said.

If you decide to buy a private disability insurance policy, remember that policies are legal contracts. Read and compare the policies and understand the provisions before you sign. In comparing policies, you might want to

consider:

Is disability defined as your inability to perform your own job or any job?

Does the policy cover accidents and illness?

Are benefits paid for partial or recurring disabilities?

Are full benefits paid after loss of sight, speech, hearing or use of limbs?

Is the policy noncancelable, guaranteed renewable or conditionally renewable?

How long must the worker be disabled before premiums are waived?

Is there an option to buy additional coverage, without evidence of medical insurability, at a later date?

Does the policy offer an inflation adjustment feature?

Disability insurance underwriting has been known to upset many people who apply for disability insurance. People go into the process with unrealistic expectations, this is a result of agents not properly preparing their clients for what to expect during the disability insurance underwriting process. My goal here is to let people know what they can expect during the disability insurance underwriting process.

One important thought should be in the head of everybody who applies for disability insurance, **do not expect to receive an issued policy exactly as applied for**. A DI underwriter can reduce the amount of coverage applied for, place exclusion riders on the policy, increase the rate, decrease the benefit period, offer an entirely different policy series than the one applied for, or decline the coverage outright. As a consumer you need to understand that very few contracts get issued exactly as applied for. Let's dive into the process step by step.

Do not simply sign an application and expect the agent to fill it out correctly for you, this could do a lot of damage to your MIB file, and scar your insurability for life. It is important to answer all questions in detail, and leave nothing to question. As a consumer you have several goals here; to obtain the highest occupational class possible, eliminate the need for follow-up questions during underwriting, and eliminate the need for physicians medical records during underwriting.

There is a section of a disability application devoted to describing your occupation, try to put yourself in the best possible light for the underwriter. The higher the occupational class he gives you, the lower your rate will be. As an example, one may be tempted to describe your occupation as computer consultant. This is a class 4 with one insurance company, but computer engineer or analyst is a class 5, and hence a higher rate. Some occupations are straight forward, but if your occupation is somewhat vague, or open for interpretation give the underwriter a full and complete picture of what you are doing. Include a breakdown of your time including travel, client meetings, etc.

Another section of the application has to do with financial history, most insurance carriers will want to know your current earnings structure, and what you earned for the past two years. This will always have to be supported with financial documentation in the form of a W-2, tax return, or paystub. A hard and fast rule of disability insurance underwriting is you will always get an offer based on exactly what you verify through financial documentation. If you are making \$150,000 this year, made \$100,000 last year, and can only show the \$100,000 via financial documentation only expect to get an offer based on the 100K. There really is no way around this, only expect coverage based on what you can prove.

The third major section of the application causes most of the problems, and this is your medical history. Understand that life insurance policies are much easier to underwrite, the underwriter only needs to see if you have a life threatening pre-existing condition. A DI underwriter has to deal with the millions of [possible conditions](#) that could disable you. The most common disability insurance underwriting problems are spinal, mental and nervous, or labwork related. To come out of underwriting at all is a success with an issued policy, to come out of underwriting with one or two pre-existing condition riders is a great job, and to come out with coverage exactly as applied for is a miracle. There are just so many ways to receive a rider, reduced benefit, or some other policy modification that to expect a perfect policy is unrealistic. Disability insurance applications take into account your medical history for the past ten years, the more details you provide the underwriter up front, the less discovery the underwriter will have to do, and the more comfortable the underwriter will feel issuing your coverage. It is vital that you list every physician you have seen for the past ten years, their locations, and exactly what the visit regarded. The goal of disability insurance underwriting is to put the warm and fuzzt feelings into the underwriter handling your case, so take all the guess work out of it.

Disability insurance underwriting is quite a simple process when you break it down to the basic components.

Fill out the application in detail

Provide detailed financial verification of your income
Complete your labwork quickly
Keep a realistic goal for the result