

## Article – How To Select The Ideal Disability Policy



By Larry Schneider

Protecting your income, financial planners say, is the cornerstone of all financial planning. A 40-year-old has a 45% probability of becoming disabled for a substantial time during his or her lifetime (Society of Actuaries, 1995). Your income and ability to work are your most valuable assets. Protecting your earnings (which could be more than \$1 million for a 45-year-old earning \$50,000 a year projected to age 65) should be high on your list of priorities. The following article will help you sift through the maze of different disability contracts that are offered.

### **What to look for in an *ideal* disability policy**

If every company offering a disability insurance policy had the same wording, terms, and conditions, then the consumer's or agent's job would be easy; all he or she would have to think about would be simple things, like whether or not they liked the company's logo, and the like.

Unfortunately, evaluating, selecting, or recommending the right contract is not so easy. There could be 30 or more considerations, terms, definitions, etc. that make up a contract (analogous to the thousands of parts that make up an

automobile), each affecting benefits, how much, how long, and under what conditions and circumstances a claim will be paid. Most companies offer enough similarities in about 15 or 20 of these components, however, there are differences in many others, which have been described below.

**Let's look at 9 of the most important differences, roughly in the same order in which they appear in most contracts:**

**1. GUARANTEES:** One of the changes the industry has made in the past several years, is the introduction of guaranteed renewable only policies for some occupations- blue collar in particular. This change enables carriers to raise rates on certain occupation classes and thus remain profitable. The agent should try, however, to get his prospect a non-cancelable (non-can) and guaranteed renewable policy. Enough companies still offer non-can policies, which guarantee the insured's rates to the age of 65.

## **2. DEFINITIONS:**

**SICKNESS:** The definition for sickness should say "when first manifested itself" rather than "when first contracted." The difference between the two is significant, especially if the disability is caused by cancer, for example. Under the first definition, if cancer existed when the policy was issued, but it had not yet produced symptoms nor caused a prudent person to seek medical attention, it *would* be covered. Under the second definition, it *would not* be covered if it could be proven to have existed *prior* to the policy's effective date.

**TOTAL DISABILITY:** The best definition for total disability is an "own occupation" or "own occ" definition. Although this definition is available for many occupations (but not all), it is not always necessary, nor is it always available for the full benefit period.

This definition might be necessary for someone whose skill could be transferred to another occupation, for example, a surgeon. Without this kind of definition, he or she could be expected to teach or become involved in a related field of medicine. As a result, the surgeon might not be considered totally disabled and instead might be paid under the residual benefits provision. The other reason is that own-occ is easier to prove vs. loss of income and by comparison is relatively “hassle-free” at claim time.

There are basically three “own-occ” definitions and one other disability definition. These definitions reflect a particular carrier’s claims experience for a particular occupation. They are as follows and listed from the most liberal to the least liberal.

- Own occupation/ *full* benefit period – This definition pays *even* if the insured is working elsewhere (in another occupation). Some carriers even offer an own-occ specialty definition. Especially important to the medical profession.
  
- Own occupation/ *not* gainfully employed elsewhere – A policy with this definition pays if the insured can’t do the duties of his or her occupation and is *not* working elsewhere. Working or not then becomes the *claimant’s* choice.
- With a modified definition, it could be own-occ for five years and then change to not gainfully employed.
  
- Own occupation/ for a period of time, thereafter *unable to work/not working* elsewhere – This is a split definition that gives true own-occ (see the first definition above) for a

period of time (for example, five years), then changes to *unable to work/not working* elsewhere by reason of education, training, and experience (and in some instances prior economic status).

- Transitional-This is a new definition for some grey collar workers and basically allows one to work in another occupation and still be paid the full benefit amount.... so long as the new income doesn't exceed the previous income. If it does, the benefit amount gets reduced.
- Loss of earnings – This definition has been around for a long time, but more carriers have recently chosen to stipulate this in lieu of the own-occ definition. Loss of earnings is the same as residual (proportionate) benefit. If during a disability the insured has a 30% loss in income while disabled and under the care of a physician, they'll receive 30% of the monthly benefit. While this policy does pay proportionately, please note that the insured starts off with an initial 40-50% shortfall – since participation tables only allow approximately 50-60% of pre-disability income to be covered (depending on the income of the insured, their occupation, and where the policy was issued). Higher issue limits are available if the premium is employer paid. However, these benefits are taxable!

**3. BENEFIT PERIOD:** This represents how long the policy holder will be paid in the event of a covered disability (when there isn't an exclusion due to a pre-existing condition). The longer the benefit period is, the higher the premium. Lifetime benefit periods are available, but they are graded, meaning when the onset age is past a certain age, then rather than the full amount being paid,

a percentage will be paid instead. Note: In any event, when part of the benefit amount is a social security rider/option, that amount drops off the coverage usually at age 65.

#### **4. RESIDUAL/PROPORTIONATE DISABILITY OPTIONAL**

**BENEFIT:** Most contracts read almost alike for this benefit except for some of the following terms and conditions, which can make a difference in so far as how much of the claim will be paid:

- Pre-disability earnings period: Typical contracts state that, as a benchmark, the company will consider the previous 12 months or any two consecutive years within the last five, whichever is more favorable to the insured. There are also other combinations.
  
- Triggers – In order to collect from this optional benefit the claimant must have a loss of income of at least 20% (some cases 15%) and when the loss is 75% or more then the amount to be paid will be 100%.
  
- Pre-disability income included *or* excluded for the calculation of loss/earnings: This can be a significant factor if the claimant is in the service industry business (e.g. accountant, attorney, etc.) and has some accounts receivable (pre-disability earnings) received *during* a period of disability. If the contract does not allow these to be *excluded*, then the calculation will generate a *lower* loss of income percentage and as a result the payment will be *smaller*.

- Qualification period: This is the number of days the insured must be *totally* disabled before the residual benefits can be paid. Companies that have this restriction usually require 30 days. Most companies do not impose this qualification period and also allow periods of residual disability to count toward the elimination period.

#### **5. RECOVERY/EXTENDED TRANSITION OPTIONAL BENEFIT (usually part of residual):**

Basically, this recovery benefit means when a person who no longer is under claim (under a physician's care) will be paid as if he/she still were (even though they have returned to work full time and is in the process of rebuilding their practice). An example would be a Certified Public Accountant (CPA) who broke a wrist during tax season (when he/she earns 80% of his/her annual income) and recovered perfectly *after* April 15 for the remainder of the year. Benefits under this provision would *continue* to be paid *even* though the accountant was fully recovered until their income reached 80% of pre-disability earnings. Again, some companies offer this benefit, but for different time periods: for either 12 or 24 months, or for the full benefit period.

#### **6. FUTURE PURCHASE INCREASE OPTIONAL**

**BENEFIT:** Most companies offer this option; however, once again there are these differences to watch out for:

- Cut-off age for having this option *issued* as part of the policy. Most companies will not offer this option after the insured's age of 50, although a few companies will issue it up to 55. In any event if issued, it drops off at certain ages with a corresponding reduction in premium.

- Cut-off age for *exercising* the option and whether or not the option can be exercised and paid *during* a period of disability (older policies). Normally companies will not allow it to be exercised past 55. Most, if not all, use a formula as to what percentage can be exercised at any given time, participation tables notwithstanding.

## **7. COST OF LIVING ADJUSTMENT (COLA) OPTIONAL**

**BENEFIT:** Some differences that exist between companies fall into the following categories:

- Basis for increase, that is, indexed to some standard such as the Consumer Price Index (CPI) or guaranteed.
- Conversion of these benefits to the base benefit after returning to work, prior to what age and at what cost, if any. This is especially important if the insured got disabled again and there was no future increase option and insured wanted the new claim to *begin* with the last benefit amount. An article on this subject is yours for the asking upon completing the [request for quote](#).

8. **ELIMINATION PERIOD:** The better contracts, allow the elimination period to be satisfied by non-consecutive (stop/go) days of disability.

**9. MISCELLANEOUS:** There are a couple of other related contract components that should be considered when analyzing a contract, but because they are less significant, I will not elaborate. These are:

- Conditionally renewable — most policies are, after age 65, renewable to 75, while others are renewable for the insured's lifetime (if the insured is gainfully employed for a

minimum of 30 hours week). Some carriers use additional qualifications as well.

- Loss of income necessary to be deemed totally disabled (most contracts say 75%, while a few use 80%) — the *lower* the percentage, the better the contract.
- Recurrent disability — some contracts state six months must have elapsed, while others say twelve. Which is better depends on the length of the benefit period. If the benefit period has expired, then six months is better for the following reasons: If the insured can return to work for six months and has a relapse, then the benefit period starts all over again.

**CONCLUSION:** The insured should have their policy reviewed by a specialist in view of the fact that the disability insurance industry has experienced some major changes. Recently issued policies, or even some older ones might contain provisions that will make it more difficult to have a claim paid, especially employer group LTD plans.

Females in particular have been hard hit with the introduction of sex distinct rates which have replaced unisex rates, resulting in premiums that are approximately 30% higher than males. However, in some instances it is possible to still get unisex rates.