

Disability Income Insurance

Hello!

In this month's newsletter, disability income (DI) insurance is highlighted. This type of insurance coverage provides an income benefit in the event an individual becomes disabled due to an accident or illness. According to the Council for Disability Awareness, of those individuals entering the workforce today, 3 in 10 will become disabled before retiring. In addition, it is estimated that 1 in 7 can expect to become disabled for five years or more before retirement.

In my professional experience, I have seen how potentially devastating becoming disabled can be to an individual's financial picture. By having disability income (DI) insurance coverage, it provides a monthly stream of income so as to lessen the adverse impact of one not being able to work and subsequently, on achieving one's financial goals.

Short-Term vs. Long-Term Disability

Disability benefits include paid sick leave, short-term disability benefits, and long-term disability benefits.

- **Short-Term** – Coverage usually begins anywhere between 0 to 14 days after the disability occurs and usually lasts three to six months, but some policies can provide coverage for up to two years. According to the Life and Health Insurance Foundation for Education, most short-term DI insurance policies provide benefits of 40-65% of one's base salary. For injuries that occur while on the job, these are covered by workers compensation insurance.
- **Long-Term** – This type of coverage starts after a certain time frame is met, and benefits

are then paid for a specified period which can be anywhere from two years to age 67. Monthly benefits range from 50- 75% of one's base salary. The average long-term disability lasts 2.5 years, according to the Council for Disability Awareness (CDA).

Components of Disability Income Insurance

Definition of Disability

This determines under what circumstances an individual will qualify to receive benefits.

- **Any Occupation** – The insured is unable to perform the duties pertaining to any gainful occupation. This is the strictest definition of disability.
- **Modified Any Occupation** – The insured is unable to engage in any occupation for which he or she is reasonably suited by education, training, experience, etc.
- **Own occupation** – The insured is considered totally disabled if he or she is unable to engage in the principal duties of his or her own occupation. This is considered to be the most liberal definition of disability.

Benefit Period

This is the period of time an individual is eligible to collect benefits while on a disability insurance claim. Once the elimination period has been satisfied, benefit payments begin. The maximum amount of time one can

receive these payments is the benefit period. Benefits stop when an individual is able to return to work depending on the definition of disability used.

Elimination Period

This is the time period between when a disability occurs and when benefit payments begin and is sometimes referred to as a waiting period. It acts like a deductible, as the insured must cover any expenses on their own before benefits begin. Elimination periods typically are between 30 to 180 days and the longer the waiting period, the lower the premium payments.

Probation Period

This refers to the amount of time during which the individual policy must be in force before the insured is covered for specified perils or illnesses.

Inflation Protection

This is an optional rider offered in DI insurance policies and is often referred to as a Cost of Living Adjustment (COLA) rider. If this rider is selected, the benefit will increase by a certain percent in accordance with the Consumer Price Index (CPI). Many insurance companies restrict the increase to a maximum percentage per year, and a company may also put an upper limit to the maximum benefit paid.

Renewal Provisions

This is one of the most important parts of a DI insurance policy as it provides the insured how long they can expect coverage to continue, assuming the premiums are paid.

- **Non-cancelable** – This guarantees the same coverage year after year. Not only can the insured renew the policy for the full term

specified, but the company cannot change the premium amount.

- **Guaranteed renewable** – The insured has the right to renew the policy for the full term specified but the company can change the premium amount if they change it for an entire policy class.
- **Conditionally renewable** – The insurer can add extra conditions or restrictions anytime as well as increase premiums.

Taxation of Benefits

Disability insurance benefits may be taxable depending on how the premiums were paid. For individuals covered under group employer plans, where premiums are paid by the employer, benefits received are counted as taxable income to the employee. In situations where premium payments are paid by both parties, benefits will be taxable in relation to the percentage of premiums paid by the employer. For those that have a personal DI insurance policy, i.e. not part of a group plan and where premiums are paid for by an individual with after-tax dollars, the benefits are usually not taxed.

Conclusion

When one becomes disabled, it can potentially have adverse financial consequences so it is important to have sufficient resources (emergency fund of between 4-6 months of living expenses) and to have appropriate disability income insurance coverage. For those that are employed, review the short- and long-term coverage you are eligible for and determine if this is adequate. It may make financial sense to purchase supplemental coverage through an individual DI insurance policy that is not tied to the employer. For self-employed individuals, it is especially important to look at purchasing an individual policy since they are not covered by group benefits. Please consult with your financial advisor for further information on this.