Disability Insurance: Are Your Clients Truly Prepared?

by Nancy Opiela

Let's face it: there's no way you believe that you will become sick or disabled and unable to work. And your clients feel the same way. "We all think we're Superman," says Patrick Hehir, CFP®, of Innovative Planning Services Inc. in Woodbury, New York, "but all we have to do to understand the mistake we're making is look at what happened to Superman, Christopher Reeve. I also point to a recent tragedy here in New York, the Staten Island Ferry accident, where many people died and many others were maimed. If you asked any of those commuters if anything was going to happen to them that morning, you know what their response would be: 'I'm taking a nice, safe ferry ride to New York."

The protection clients need, says Hehir, is disability insurance. "The risk-management book I used to study for my CFP certification states that disability insurance is by far the most important and that some authorities argue that loss-of-income protection should come even before life insurance," he explains. "Disability insurance protects the largest asset people own: their ability to earn an income. Without that protection, most financial plans will fail should a disability occur. But I'm willing to bet most planners spend more time on the life insurance sale than on disability insurance. That's clearly a mistake as statistics prove the risk of becoming disabled before age 65 is significantly greater than the chance of dying before age 65."

Norman Politziner, CFP®, of NJP Associates in Highland Park, New Jersey, who has been working with disability insurance since 1978, says it is probably the most overlooked and least understood form of insurance—and that the lack of understanding extends to the planning community. "Most planners didn't start in the insurance business and have a misperception that disability is too expensive and too hard to get," he says. "Because most planners are not trained in the nuances of disability coverage, they leave their clients unprotected."

Here, planners active in the field of disability insurance discuss what type of coverage clients need and, most importantly, how to convince them that it's in their best interests.

Review Current Coverage

Recent research by The Hartford has found that more than 40 percent of full-time employees do not have coverage in the event of a short- or long-term disability. Of those with coverage, 27 percent don't know what losses their benefits would cover. That's especially troubling when, according to The Hartford, one-third of Americans will find themselves disabled for at least 90 days during their working years.

The first lesson for planners in these statistics is that when you ask a client if he or she has disability insurance and they say they are covered at work, that should not be the end of the conversation. It's important to ascertain what the policy would cover because chances are the client's group insurance is not enough. They need the extra protection an individual policy affords.

"Group insurance is a different animal; these policies don't have the same quality as individual contracts," says Politziner. "You might get 60 percent of your salary, to a maximum of $5,000 a month. Of course, that's not enough if the client is making $200,000 a year. What's more, if the company paid for the coverage, that 60 percent is taxable to the client."

In addition, group policies tend to be more restrictive and they are not portable. In effect, your client is simply renting inferior coverage.

In the experience of Cory Chmelka, CFP®, of Capstone Wealth Management in New York, New York, 99 percent of clients have inadequate coverage under a group policy. "Many clients assume that their incomes are covered fully through their group plans because few invest the time to understand the potential gaps in their coverage," he says. "Consumers should beware because disability insurance plans have become more restrictive and it's often hard to qualify for benefits. Over the last decade, we have seen a substantial change in the definitions in both group and individual disability income contracts. For example, many plans now have mental/nervous disorder limitations and have reduced or eliminated own-occupation coverage. Other plans discriminate against high-income earners by capping benefits at a relatively low amount."

Chmelka says it's his responsibility, as a trusted advisor, to educate clients and to help them understand that if they become disabled, their current group coverage may not be adequate. "Once clients understand their current coverage and the importance of proper protection, it makes it easier for them to accept the additional cost of increased protection," he notes.

So if the traditional 60 percent isn't enough, how much coverage do clients need? Jonathan Sard, CFP®, of Financial Alternatives in Atlanta, Georgia, says there's no need to run any kind of complex analysis. His advice is simple: Buy as much as the insurance company will sell you. "There is no insurance company that will insure you for more than 100 percent of your compensation," he says. "You need to ask the client, 'If you are making $100,000, can you live off of $60,000, less the taxes you'd owe on that?' If a client is covered for 60 percent at work, a supplemental policy might cover them for up to 80 percent because the individual insurer knows the group benefit will be taxable."

The Pitch for Disability Insurance

Across the board, planners who are experienced with disability insurance and those just beginning to sell it say cost is always the stumbling block. Planners often begin the discussion of disability insurance by noting that they, too, have the coverage. Says Chmelka, "For most Americans, the heart of their financial plan is the safeguarding of their income-earning ability. Despite this, we often see clients spending more money on car insurance premiums than they do on disability insurance premiums."

Adds Politziner, "The real answer to a client's complaint that they can't afford the disability premium is, if you can't afford the insurance premium, you sure couldn't afford a disability. We insure our cars, homes and the contents of our homes. People insure their underwear, but they have to understand that the thing that makes it possible for them to buy new underwear when they put a hole in it is their ability to work and earn. If they can't work and earn, where are they going to get the money to support themselves?"

In fact, Politziner poses that very question to clients: If you couldn't work, how could you support yourself and your family? "At times, people say, 'My father-in-law is rich,'" he says. "My response to that is, 'Do you want to be in a position where you have to ask your father-in-law for money?' At that point, people often realize they are blowing smoke and that they want to take care of themselves."

Politziner also has had success selling a disability policy when he presents the following scenario: "Let's say you have the opportunity to choose between two jobs. One job will pay you $60,000 a year, but if you become disabled you get nothing. The other job will pay you $58,000 a year and if you become disabled they will pay you a tax-free benefit equal to your net after-tax income. Which job would you take?"

Adds Sard, "*Expensive* is a relative word. When you are buying insurance with a potentially high liability for the insurance company, the premium will look high. But when you look at the total dollars at risk, it starts to look reasonable. If you're talking about an insurance company possibly paying out more than $1 million, then a premium of $2,000 a year doesn't look unreasonable."

Hehir, too, has a simple question for clients: What good would your financial plan be if the income stops coming? "If the client isn't ready to buy disability insurance, I'll suggest that maybe they aren't really ready to do a comprehensive financial plan because income protection is really the foundation of any financial plan," he says. "Of course, rather than simply turning away clients who refuse the coverage, we ask that they sign a disclosure letter if we are going to work together saying that we recommended disability insurance and they didn't want the coverage."

Hehir has some statistics, too, that often drive home the need for disability coverage, particularly to young families. "Disability is the cause of 48 percent of all mortgage foreclosures. Only two percent due to the death of the breadwinner," he notes. "I'll also point out they are insuring their $300,000 home for roughly the same amount of money they could insure their income for."

Statistics aside, Catherine Wade, CFP®, of Wade Financial Services in Chico, California, finds that personal experience or the stories of neighbors' misfortune is often powerful persuasion. Recently, in her small community, there have been two cases where physicians became disabled and, without disability insurance, lost their practices and their homes. "We have many small-business owners in town and I find that perhaps 1 in 12 has disability insurance," she says. "But since those two incidents with the physicians, I have not had a physician decline disability coverage."

Wade also stresses to clients how their disability could harm their entire family. "The oldest son of a physician's neighbor had been accepted to Stanford, his dream. But his father contracted leukemia and in his seven-year successful fight against the disease, spent their entire savings account and exhausted his pension. The family ultimately sold their home and the son went to the local state college so he could care for his father, who was still very weak. This family's entire life was completely turned around, something that would not have happened if the father had had disability insurance. The father is starting all over again, at a time in his life when he had planned to retire."

Wealth Accumulation Sexier

Michael Wells, CFP®, CLU, ChFC, CEBS, LTCP, of Northeast Planning Corporation in Cranford, New Jersey, says a mistake planners make when presenting disability insurance is that they quickly state the need and go right to the annual premium number. He explains, "In their minds they know they would never allow their own income to be so fully exposed and they assume that their clients think the same way—that they are rational and fully understand the need for coverage. But that's not the case. Planners are shocked when clients say they want to focus on growing assets rather than income protection. But let's face it, wealth accumulation products have more appeal."

Wells approaches a potential disability insurance sale with a one-page handout that provides statistics on mortgage foreclosures and business failures as the result of disability, as well as information on Social Security's narrow definition of disability and the limitations of many group policies. He then asks clients to go through an exercise of what they would be willing to live without if they were forced to live on less than 60 percent of their current income. Finally, he says, it's not essential that a client buy the maximum amount of disability insurance he or she qualifies for. "Disability insurance is a risk management tool," he says. "You don't need to fully insure, unless you couldn't live without anything."

Chmelka has an approach that's "a little outside the box" for overcoming the cost complaint. "Clients always come up with excuses, but cost is the only thing holding them back, no matter what they say," he says. "If they could pick up coverage for free, they'd take it. So, let's say the policy costs $2,000. We show them that. Now, if the client is 45 and they keep the coverage to age to 65, that's $40,000. We'll show them that, too, noting that their real cost is potentially even more than that because they could have invested the money and earned a return. Our message is, disability insurance costs you more than you think but, as your financial advisor, it's our job to show you how you might be more efficient somewhere else and find a way to pay for this important coverage. Perhaps they are paying too much for other types of insurance or could save by refinancing their home."

Marguerita Cheng, CRPC, of American Express Financial Advisors in Bethesda, Maryland, says she avoids using the term "disability insurance." She explains, "I talk about 'income protection' as something clients can't go without. It's hard for people to deal with the term 'disability.' So, I talk about the possibility of being sick, hurt or unable to work. If I say, 'You need disability insurance,' the client is walking right out the door. Talking about 'asset protection,' however, changes the whole dynamic. I tell clients I'm not trying to take money away from them—I'm just trying to make sure that no matter what happens, they have the money they need to fund all their goals."

Trends and New Features

In some cases, planners try to help clients overcome their resistance to the cost by tapping into the trends and newer features of disability policies. Cheng, for example, notes that an interesting option is the "step-up premium," which is low for the first several years before increasing.

Joan Zaleski, CFP®, a planner with Sagemark Consulting/LFA in Westhampton Beach, New York, sometimes works with young professionals who have a need for both life and income protection insurance, but have limited budgets. For them, she likes to use "convertible term insurance combined with disability insurance with future increase options, inflation protection and in some cases residual income. This puts a client in the driver's seat and in control of their family's financial future. With changing trends in disability product design and underwriting, I encourage clients to lock the guarantees in sooner rather than later."

Chmelka says that for clients who are more cost conscious or who are enrolled in an employer-sponsored plan, it is also possible to "wrap" an individual policy around an existing group policy. "Fortunately, employers can provide some premium relief and help their employees purchase individual policies at a discount of 25 percent to 45 percent from retail prices," he explains. "Some insurance companies will offer pricing discounts on their individually owned disability contracts if an employer endorses the insurer and gives everyone in their company the option to buy coverage. We often work with human resources managers to set up these programs."

Phil Snyder, CLU, of the Warner Companies in Timonium, Maryland, believes these multi-life disability plans sponsored by an employer are the "wave of the future" for how individual disability policies will be sold. He explains, "These multi-life disability plans may be employer-paid or offered by the employer on a voluntary basis. Typically, most employers provide some form of long-term disability benefits, though all too often on a very modest basis. We normally offer programs designed to increase the maximum available benefits and enhance the range of benefits offered to eligible employees...Our plans are generally offered on a guarantee-issue basis, so no underwriting or medical approval is required in order to obtain the coverage. Premiums are discounted anywhere from 20 percent to 35 percent below individual policy rates, and policies are employee-owned and fully portable."

Continues Snyder, "The typical products we employ in these situations provide significant 'return-to-work' financial incentives. Here, benefits are higher for a period of time and then the employee returns to work part-time. This provides substantial financial benefits to both employees and their employers. Further, we often can include catastrophic disability benefits, often allowing for 100 percent salary reimbursement under the most difficult of disability circumstances. These policies are more like long-term care policies and appeal to the consumer. In fact, often they can, at some point, convert the policy into a long-term care policy."

More Conservative Policies

Beyond the challenge of convincing clients of the basic value of disability insurance, planners say the task is being exacerbated as insurance companies continue to consolidate, ever-increasing claims cause the products to become more conservative and to adopt narrower definitions of disability, and underwriting becomes more stringent, making certain types of coverage difficult to get. Jonathan Sard notes, for example, that 13 percent of all disability claims are due to emotional or psychiatric disorders, which has prompted many insurance companies to limit mental disability coverage to two years.

Stephen Powell, ChFC, RFC, RFP, with Capital Financial Group in Norfolk, Virginia, says that "normally we will go to the market and spreadsheet the top companies for a comparison of definitions, provisions, premiums, and so on." But when trying to insure his primary group of clients—physicians and dentists—Powell "oftentimes find the industry's monthly benefit limitations to be challenging. Within the past few years, we have used high limit DI, long-term care insurance and critical care insurance as ways to fill some of the gaps in coverage for these types of clients. Although we have seen a little loosening up of underwriting with some companies, it is for occupations other than physicians and dentists."

In the midst of the negatives, however, there are some positives in the marketplace. Sard notes that disability coverage is getting easier to obtain for the self-employed who work at home. "Historically, the problem that the insurance carriers have had is that there is no real way to know what the person is doing in their home and what might cause an accident or injury in the home. So it's difficult for the company to get a handle on costs. They need to collect data for claims for a number of years and then pricing will become more consistent. But it's better now than it was five years ago."

He also notes that coverage for "catastrophic" disabilities is always worth talking about with clients. In addition, clients are often interested in a relatively new offering: riders to fund retirement accounts while on disability. Sard asks, "If you are on disability and not collecting your full salary, what happens to your retirement? Where will you be if your disability coverage stops at age 65?"

Finally, there's a new feature, jet issue, that Sard is excited about, particularly for younger clients. "Here, the monthly benefit amount cannot be more than $2,500 a month, but the underwriting process is very simple, no blood or urine, and you can purchase insurance within a few days. If you're a young person making under $80,000, this makes a lot of sense," he explains.

Planners Need to Commit Time

Politziner notes that planners just getting into the field should expect to commit significant time to establish relationships with the underwriters and, of course, to review clients' current policies. "Disability insurance is a complex product," he says.

Questions planners might ask in a policy review include:

- Is the coverage for your clientÕs occupation, or any occupation?
- Must your client return to work in any capacity available?
- How is disability defined?
- Is the benefit taxable?
- Is there an inflation provision?
- Can the client get additional coverage without new proof of insurability?
- How long will benefits be paid?
- Will benefits be reduced if your client receives benefits from other sources, such as Social Security or other policies?
- Does the policy have limitations on preexisting conditions, mental health issues or substance abuse?
- How strong is the insurance company?

The bottom line, say those active in the field, is that planners who are not interested in investing the time required to stay current in the field should look for an expert to partner with. As Wells, who has worked with planners within varied practice models on joint client calls, says, "You can't call yourself a planner and pay lip service to risk management. It's a key part of the financial plan."

In conclusion, Cheng says attention to asset protection benefits her clients and strengthens her practice at the same time. "In the bull market, many planners focused on rate of return. Now we've learned it's not wise to focus only on investment management, that we need some way to connect with our clients and add value in a market downturn. More importantly, that rate of return is worth nothing if you've lost your income," she says.

"That's where asset protection comes in," Cheng continues. "By recommending disability insurance, you are addressing something that may not be as exciting from a planning standpoint as growing the portfolio, but the bottom line is that it's good for the client. And, as their advisor, it's good for you, too. Taking a comprehensive approach and acting in your clients' best interests helps solidify your relationships. And no attorney would ever debate the need for disability insurance, so you will never be sued. Disability insurance protects your clients and your practice."

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