SmartMoney

Insurance by Stacey L. Bradford Published April 19, 2005

Do You Need Disability Insurance?

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FORTY-FIVE-YEAR-OLD ROBERT SCHENKER of Woodbury, N.Y., is the breadwinner of his family. He's also a Type I diabetic and understands that this gives him a higher-than-average chance of becoming disabled and unable to work. That's why after recently meeting with his financial planner, he decided to supplement his employer's disability coverage with an additional long-term disability insurance policy. "I have two young children, a wife to support and a house to maintain," says Schenker. "I wanted to make sure if there is an incident that there is ample financial protection for them and myself."

Let's face it: Nobody likes to think about what life would look like should disability strike. But the reality is one third of all Americans between the ages 35 and 65 will become disabled for more than 90 days, according to the American Council of Life Insurers. One in seven workers will be disabled for more than five years. And while many people think that disabilities are typically caused by freak accidents, the majority of long-term absences are actually due to illnesses, such as cancer and heart disease. The loss of income can be so devastating that it forces some people to foreclose on their home or even declare bankruptcy.

Disability insurance replaces a portion of your income if you become disabled and are no longer able to work. A typical group plan offered by an employer will replace up to 60% of your salary. Supplemental plans and individual policies will often cover up to 70% or 80%. (No plan will cover all of your salary for fear you will have little or no incentive to get back to work.) Benefits typically last for a set number of years (say five years) or until you reach retirement age. (Benefits typically stop around retirement age since once you retire, you would no longer be dependent on the income you generated by working, anyway.) If you pay the premium out-of-pocket — meaning your employer doesn't cover the tab — benefits are tax free.

Long term disability policies vary greatly. While some are iron-clad and pay benefits when you need them, others have more holes than a pasta strainer. Folks trying to save some money with a leaner plan may find it ultimately worthless. Typically, the cheaper plans have very strict definitions of disability, making it difficult to claim benefits over many years, warns Frank Darras, a disability insurance attorney with Claremont, Calif.-based law firm Shernoff Bidart & Darras. Sadly, this is also true of some group plans.

Below we'll discuss the difference between group and individual policies. Think you can stop reading because you've got a solid policy through work? Wrong. You may still want to purchase additional insurance on your own. Here's what you need to know.

Group Plans
Unless you're self employed, the first thing you should do is figure out if your employer provides long-term disability insurance in the first place. About half of mid- to large-sized firms offer benefits that last for at least five years, according to America's Health Insurance Plans, an industry lobbyist. But even if you're lucky enough to have coverage, the plan may not meet all of your needs, warns Cara Lovenson, president of New York City-based insurance brokerage firm *Plan Professionals* [1]. So be prepared to take a good, hard look at what you've got.

As mentioned above, the typical group plan covers up to 60% of one's income. (This is offset by any other benefits you may receive from social security or worker's comp.) But the amount may actually be far less than that. That's because most group plans have a benefit cap of, say, $5,000 a month or $60,000 a year, says Todd Katz, vice resident of group disability for MetLife. Another surprise for many is that bonuses don't usually make it into the equation. A group plan will only insure your regular salary.

Another shortcoming: Most group policies limit the amount of time it will pay benefits if you can't perform your job duties to just two years. After that, you'll need to prove you can't hold down *any* job. Not only does this keep costs down for your employer, but the idea is that you can get new job training during those initial two years that you receive benefits, says Katz.

Short-Term vs. Long-Term Disability

What's the difference? Short-term disability insurance — also known as sick leave — kicks in as soon as you're unable to work due to an illness, injury or the birth of a child. Most employers provide some type of coverage, ranging from just a few days to as much as one year. In some cases, the number of weeks you're eligible for this benefit is based upon how many years you worked at a company. The longer your service, the more paid sick leave you'll get.
Five states require employers to provide short-term disability. Hawaii, New Jersey, New York, and Rhode Island mandate most employers provide 26 weeks of coverage. In California, employers are obligated to offer 52 weeks.

Long-term disability insurance kicks in once your short-term disability benefits run out. Unfortunately, there are no state laws that require employers to provide long-term disability, but it's estimated that half of all midsized to large firms do provide at least some insurance.

If you do decide to buy an individual long-term disability plan or to supplement your employer-based insurance, be sure to find out how much short-term disability coverage you have. There's no reason to pay a premium for a long-term disability policy with a short elimination period of, say, 60 days when you have short-term coverage for six months.

Individual Plans

If you are self-employed or not covered by your employer, it clearly makes sense to consider purchasing an individual plan. But even if you are covered at work you may want to consider supplementing what you've got: After all, you probably can't afford to live on just 60% of your salary. An individual plan will allow you to insure another 10% to 20% of your income. And in some cases, you may even be able to get individual coverage for a six-figure salary and a bonus — something you'll never get with a group plan, says Plan Professional's Lovenson.

For financial analyst Stephanie Rubenstein, getting that extra 10% of coverage brought peace of mind. Last year, the 30-year-old Brooklyn, N.Y., resident decided to supplement her company coverage with an additional policy. Her motivation? She wanted to start a family. Just in case there were any complications with a pregnancy, she wanted to make sure she would take home as large a chunk of her paycheck as possible while she was out of work.

If you can afford it, Shernoff Bidart & Darras' Darras even recommends people consider opting out of their employer plan and purchasing a more comprehensive individual policy on their own. Why spend the extra money? An individual policy stays with you when you switch jobs and you can sue if the insurance company denies or delays benefits, he says. (With a group plan you'll have to go through a lengthy arbitration process.) And unlike group policies, the amount that you receive is also not offset by any other benefits, such as Social Security, that you may receive.

Some of the larger providers (based on the number of policies underwritten) that offer individual policies include companies such as *MetLife* [2], *Northwestern Mutual* [3], and *UnumProvident* [4].

Buying a Policy

Unfortunately, buying an individual plan can be tricky and expensive. Just like life insurance, prices will vary based on a host of factors including one's age, gender, amount of coverage and health status. Even one's occupation can raise your premiums — and we aren't talking about people who jump out of airplanes for a living. Doctors and lawyers can expect to pay a premium since their job skills are so specific versus, say, a general business manager, says Mike Simonds, president of market development for insurer UnumProvident.

How much does coverage cost? Here's one example from MetLife: A 40-year-old male non-smoking business executive would pay $1,150 in annual premiums for $3,500 per month in benefits delivered up to age 65 with a 90-day waiting period.

Also See

- *How Much Disability Insurance Do You Need?* [5]
- *Riders That Make Sense for You* [6]

Given the hefty price tag, you obviously want to make sure you buy the right type of policy. Here are some tips to help you get started. First, decide how much coverage you need. Do you spring for the maximum benefit? Or can you afford to live on a bit less? (To help figure this out, try running your numbers through our *calculator* [7].) Then determine how long you can go without benefits. This is known as the "elimination period" or "waiting period." To save money on premiums, Darras recommends people wait as long as they can — say, 120 days. Expect to pay a substantial premium for benefits that kick in within 30 or 60 days.

Next, you'll have to wade your way through a series of bells and whistles. Some of these riders aren't cheap, but experts agree they're crucial. (For more on riders, read our *story* [8].) For example, you don't want to go without "own occupation" coverage, which will pay benefits if you can't perform the exact job you held before you became disabled. While prices will vary, don't be surprised if a carrier charges an extra 40% for it, says Scott Simmonds, president of *Insurance Consultants of Maine* [9], which helps consumers analyze different insurance policies. Also, make sure that the policy is non-cancelable (the insurer can never cancel that policy) and guaranteed renewable (at the same price) as long as you pay your premiums on time. In many cases, these provisions will be automatically included in your policy, but you should still check.

If you can afford it, there are several other riders Simmonds recommends consumers seriously consider. In an ideal world, he says, everyone would spring for coverage until retirement age, although this could add another 15% to the premium. The most comprehensive policies also include "a cost-of-living adjustment," which will add at least 20% to the premium, says Simmonds, and a "future purchase option" for another 25%, which allows consumers to increase their coverage as they earn more money without having to take another physical.

Unlike term life insurance, which you can easily buy online, you'll probably want to sit down with a professional when you buy long-term disability. It might not be the most enjoyable conversation you've ever had. But it could be one of the most important.

[1]http://www.planprofessionals.com/
[2]http://www.metlife.com
[3]http://www.nmfn.com/
[4]http://unumprovident.com
[5]http://www.smartmoney.com/insurance/disability/index.cfm?story=worksheet
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