# Fundamentals of

# Disability Income Insurance

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# Introduction

As a financial professional, you are often engaged to assist clients in planning for their financial security. A major component of the planning process is to evaluate risk factors and identify potential strategies to minimize the risks that threaten the attainment of financial goals. In pursuing goals that focus on the realization of financial independence, a significant risk that confronts almost all clients is the possibility of an accident or sickness that eliminates or limits the client's ability to earn an income. When measured against other financial risks in terms of potential size and likelihood, the risk of long-term disability commands well-deserved attention.

In this course, we will address this risk management issue by investigating the following factors:

1. Define the risks of long-term disability.
2. Discuss the options to alleviate the risks.
3. Review and analyze the insurance options that are available to alleviate the risks.
4. Use a 4-step process to determine the need for disability income insurance.
5. Break the marketplace into three strategic segments based on the varied nature of risk characteristics and possible solutions.
6. Discuss the appropriate application of disability insurance coverages by reviewing case studies.
7. Helping clients to take actions to resolve their exposure to a substantial financial risk.

We begin our study of this opportunity on the next page by evaluating the risks of long-term disability.

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| Why Sell Disability Income Insurance? Presented by **J. W. Burriss**   |  |  | | --- | --- | | A graduate of Emory University, Woody Burriss is a CFP® Professional with more than 35 years of experience in the Financial Services industry. Additionally, he has earned the Chartered Life Underwriter, Chartered Financial Consultant, and Chartered Advisor for Senior Living designations from The American College. |  | | |
| Disability income insurance sales are often overlooked because the financial professional assumes the product is rather complex and is not a particularly lucrative sale. Hopefully, this course will not only make it clear that this risk should not be overlooked, but you will also realize the following advantages of addressing this substantial and ubiquitous need. |  |
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| Advantage 1: Commissions from the sale of disability products are at least as lucrative as life insurance – renewals are typically better. |  |
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| Advantage 2: Persistence of disability products and thus, renewal commissions, is very high. |  |
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| Advantage 3: Attention to the sales opportunity often leads to other sales and actually, since it mitigates a substantial risk, should precede most other sales. |  |
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| Advantage 4: Disability income insurance requires minimal service work, although the opportunity to periodically to review coverage is appreciated by clients and can lead to discussion of other financial planning opportunities. |  |
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| Advantage 5: Your client will not go elsewhere to resolve this substantial financial risk. Some financial professionals will consider the discussion of possible long-term disability a prudent service of risk management for any client. |  |
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# Defining the Financial Risk of Disability

As financial professionals, our clients look to us to advise them about wealth accumulation and to help them manage risks that can sabotage their goal of financial independence. These risks come in four forms:

1. Loss of asset value, such as that of a home, car, jewelry, etc.
2. Liability, resulting from professional malpractice or a multitude of personal acts.
3. The risk of illness or physical impairment, which can result in substantial medical costs.
4. Due to death or disability, the loss of the ability to earn an income for the benefit and well being of ourselves and our dependents.

Mortgage lenders require homeowner's coverage. State laws require auto insurance. Life insurance, which has been readily available since the mid 18th century and is relatively inexpensive, is sometimes required by lenders. However, the potential loss of our most substantial asset, our ability to earn an income, is too often overlooked. Think for a moment about the relative loss of a car vs. a lifetime of income: an orthopedic surgeon has his car stolen. At what cost? Maybe $50,000 to $75,000. An orthopedic surgeon loses his ability to perform surgery. At what cost? The present value of future earnings for a 40-year-old orthopedic surgeon could easily exceed $12,000,000. But that's not all; when measured against most other risks that we routinely insure, the risk of long-term disability is actually greater. Note the following statistics:

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| **Risk of Home Fire** | 1 out of every 88 homes |
| **Risk of** **Serious Auto Accident** | 1 out of every 70 autos |
| **Risk of Disability** | 1 out of every 8 people (at least 8 days) |

*[According to the Society of Actuaries and the Commissioners Disability Table]*

As medical technology improves, our chances of surviving an illness or accident increase. Diseases that used to result in short-term death now often result in a period of long-term disability, after which a patient may or may not fully recover from treatment.

Note in the table below the probability of disability before age 65 compared to the probability of death before age 65:

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| **Age** | **Probability of Disability vs. Death\*** |
| 30 | 4 to 1 |
| 35 | 3.5 to 1 |
| 40 | 2.7 to 1 |
| 45 | 2.1 to 1 |
| 50 | 1.8 to 1 |
| 55 | 1.5 to 1 |

***\**** *Statistical information derived from the Society of Actuaries, the National Safety Council, the Million Dollar Round Table, the National Underwriter-May 2002, The JHA Disability Fact Book -2003/2004 Edition - Need For Disability Insurance*

A 30-year-old individual is 400% more likely to be disabled for at least 90 days before age 65 than to die before age 65.

The probability of disability vs. death over the last generation has increased dramatically. Why? Advances in medical science result in fewer people dying of heart attack, cancer, and other diseases. That is the good news. The other side to that coin is that the heart attack that would have killed someone a generation ago now may result in disability instead of death.

The essence of a potential long-term disability emphasizes the reality of the following:

1. The financial risk is real and substantial.
2. The need for the basic necessities of life would continue while disabled.
3. Plans for retirement, children's education, etc., would have to be put off, if not eliminated altogether.
4. Costs would increase with inflation and may also increase due to ongoing required assisted living services or uninsured medical care costs.

In the next section, we will review the potential resources to replace earned income in the event of a long-term disability.

*"Insure the goose that lays the golden eggs." -* ***unknown***

# Income Replacement Options Due to Disability - Public Assistance

Most options to replace lost income due to disability are contingent or limited. In order to make credible suggestions to a client regarding a disability income insurance need, you must be able to identify all potential resources available to the client that will mitigate the risk of long-term disability. We have summarized below the typically available public assistance resources that are available to the affluent client. On the next page, we discuss private resources that may also be available.

Most applicants for Social Security disability benefits are denied. Fewer than four in ten are approved, even after all stages of appeal.

*Finance Committee, U.S. Senate, July 24, 2014, Hearing on A Fresh Look at Worker’s Disability Insurance.*

*Senate Finance Committee, 1998*

**Click each potential resource to learn more.**

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| **Social Security Disability Payments (SSDI)** |
| SSDI benefits are intended to provide a basic income benefit (possibly taxable) to lower and middle income workers with "severe" long-term disabilities.   * At a minimum, for a state agency that administers the system to consider a disability claim, the claimant's *"medical condition must significantly limit your ability to do basic work activities - such as walking, sitting and remembering - for at least one year." Benefits could begin after five months of disability.* * *If you cannot do the work you did in the past, the state agency looks to see if you would be able to do other work. It evaluates your medical condition, your age, education, past work experience and any skills you may have that could be used to do other work.* * *If you cannot do other work, the state agency will decide that you are disabled.* ***If you can do other work, the state agency will decide that you are not disabled****."* (Source: www.socialsecurity.gov)   The average SSDI benefit for a disabled worker in 2015 was approximately $1,146. The disabled worker with a spouse and at least one dependent child received an average monthly disability benefit of approximately $1,943.  As you can see, the potential SSDI benefits are at best modest and would not be available to a typical affluent client who may be unable to perform the normal duties of his or her profession or occupation and has lost his or her livelihood.  Here is the bottom line: If you can perform ANY gainful occupation, you are highly unlikely to be approved for Social Security disability benefits. |
| Workers' Compensation |
| Worker's Compensation benefits are also designed primarily to cover the needs of lower and middle-income workers. Benefits vary by state and coordinate with Social Security benefits. Eligibility starts with only job-related accidents or sickness. Relatively low maximum benefits apply. This is a very unlikely benefit resource for an affluent client and may not even replace sufficient lost income for middle-income workers. |
| **State Disability Insurance** |
| Five states (CA, NY, NJ, TX and HI) provide disability benefits when Workers' Compensation does not apply. Benefits vary by state but normally coordinate with Social Security benefits, which essentially negate SSDI benefits after five months. This potential benefit is, at best, very limited for an affluent client with a long-term disability if the client happens to live in one of the five states providing the insurance. |

# Income Replacement Options Due to Disability - Private Resources

The affluent client often assumes at least some of the resources listed below will resolve, or substantially resolve, the long-term loss of earning power. You can offer substantive assistance to help the client determine the extent of the qualitative and quantitative value of these resources.

**Click each resource to learn more.**

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| **No-Fault Auto Insurance or legal Recourse** |
| Benefits from auto or other accidents are unpredictable and subject to circumstances and decisions without predictable guidelines. In addition, a very small percentage of long-term disabilities are a result of accidents (statistics vary at between 7 and 13%). |
| Employer Sick Pay Plan Benefits |
| An employer may provide "Sick Pay" or "Salary Continuation" benefits to employees in the event of short and/or long-term disabilities. The conditions and potential benefits from these plans can vary dramatically. Beware of the "plans" that are informal and unfunded. Self-insured plans will naturally be dependent on the financial stability of the employer company. Informal/unwritten plans provide only "subjective" guarantees.  Many plans may allow accrual of paid sick leave days based on the employee's length of service and are subtracted from accumulated days when used. Some employers will provide group short-term and/or long-term disability insurance that is either paid for, or partially paid for, by the employer. Benefits may or may not be taxable (we will discuss taxation of disability benefits later in the course).  Short-term group disability will typically pay benefits for 13 to 26 weeks. These plans may not cover executives and higher-paid employees.  Group long-term disability insurance (Group LTD) usually offers income benefits for as long as the disability lasts, or until age 65, whichever is sooner. The coverage usually begins accruing income benefits after a Waiting Period of 90 or 180 days. This coverage can provide relatively good protection for executives and should not be ignored as a viable risk management tool in the financial planning of a client.  However, when compared to a quality individual disability income contract, the group LTD has certain limitations and the opportunity to supplement the group LTD should be addressed.   |  | | --- | | **Limitations of group LTD include:**   * + - The group coverage usually provides monthly benefits up to about 60% of *salary* only (not bonuses, deferred compensation, stock options, qualified plan contributions, etc.). This often results in a very low-income replacement ratio of pre-disability earnings.     - Benefits may be reduced by Social Security, state disability plans, and other employer-provided disability benefits, including pension benefits paid in the event of disability. **Note that if pension assets are used to pay for "early retirement" due to disability, the ultimate pension retirement benefit has been sacrificed.**     - Group LTD may or may not be payable for non-occupational disabilities, or benefits may be reduced by workmen's compensation payments.     - Premiums are not guaranteed and the carrier can cancel the coverage. The employer may terminate the coverage.     - Group LTD is typically not portable. If an employee changes employers, the coverage cannot be continued.     - This coverage may also be terminated after recovery from an extended disability and if the employee does not return to the same employer that retains the same coverage.     - A group LTD plan may contain a pre-existing condition clause that lasts from 12 to 24 months after enrollment.     - The definitions and provisions of group LTD are generally more restrictive when compared to a quality individual disability income contract. |   It is possible to replace the group coverage with an individual contract. However, if the premiums are paid by the employer and the quality of the group coverage is good, most clients will resist and it is difficult to replace free coverage unless it is of a poor quality. |
| **Spouse Income** |
| This may represent a substantial "asset" for a couple that both earn substantive incomes and should be taken into consideration. However, note the potential problems with relying too heavily on this "solution."   * + - Few couples live on only one income.     - If one spouse was investing all net income, what was the savings for? What will be lost without the continued savings?     - How will the household and family responsibilities of the disabled spouse be replaced?     - It *is* possible that both spouses could become disabled. It is also possible that the disabled spouse might need care provided by the healthy spouse. |
| **Personal Savings/Capital Assets** |
| Accumulating enough financial resources to render earned income optional is a goal of virtually every client. Realistically, only a tiny segment of affluent clients are in a position to rely on their investment capital to replace their earned income during a long-term disability, especially after inflation. All financial professionals will encourage clients to first establish an "emergency fund" which would weather the blow of a short-term disability, as well as maintaining a plan to accumulate long-term retirement capital. |
| **Personally Owned Disability Income Insurance** |
| In the next section, we will review the options and benefits of personally owned Disability Income Insurance as a reliable tool to alleviate the financial risk of long-term disability. We will also review case studies that illustrate the process of evaluating and implementing insurance solutions tailored to the unique characteristics of each client. |

Primary Structure and Policy Provisions of an Individual Disability Income Policy

Almost one-third of Americans entering the work force today (3 in 10) will become disabled before they retire.

*Social Security Administration, Fact Sheet Jan 2009*

On this page, we will discuss the primary structure and primary contract provisions of an individual disability income policy.

Click each heading to learn more.

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| **Guaranteed Renewable** |
| Can the policy be cancelled by the insurer for any reason other than fraud or non-payment of premiums? Most individual policies are "***guaranteed renewable***." This means, with very few exceptions, the policy can be renewed to the "Expiration Date" as long as premiums are paid in a timely manner. Note that this also means the policy can remain in force after a claim has been paid. |
| Noncancellable |
| In spite of the oddly selected terminology, "***noncancellable***" means the premiums for the policy cannot be increased for the life of the contact (to the Expiration Date).  Policies are invariably issued either as "Guaranteed Renewable" or "Noncancellable and Guaranteed Renewable." If a policy is issued as "Guaranteed Renewable" only, the policy cannot be canceled, but the premiums can be increased for a class of insureds. The vast majority of policies issued to affluent clients are "Noncancellable and Guaranteed Renewable." |
| **Expiration Date** |
| Most disability income policies are renewable to age 65 or 67. Many are conditionally renewable thereafter for a then current premium based on the non-disability of the insured at the time of renewal, and continued employment of the insured. |
| **Indemnity Amount** |
| The “***indemnity amount***” is the monthly benefit that the policy will pay in the event of disability. Note that disability income insurance will typically provide a maximum indemnity amount from all sources that will not exceed 50% to 70% of earned income. Unearned income cannot be insured. In addition, unearned income plus substantial financial assets may actually decrease the amount of coverage that can be issued. |
| **Elimination Period (also called the “Waiting Period”)** |
| The “***elimination period***” is the period of time from an initial disability of the insured until he is able to collect benefits. It is similar to the deductible for auto insurance. The elimination period is selected in the application (or can be amended later). The most common elimination period for disability policies is 90 days, although it can range from 30 days to two years. Policy premiums decrease as the elimination period selected increases.  http://www.greeneconsults.com/topclass/greene/insurance_planning/elimination_period.gif |
| **Maximum Benefit Period** |
| The “***maximum benefit period***” (MBP) limits the period of time that the policy benefits can be paid per claim. Typical MBPs range from two years to age 65 and sometimes are issued with a "lifetime" MBP, which generally scales down post-age 65 benefits once the insured passes a certain age at the time of disability (typically 45 or 50). The MBP is selected in the application (or can be amended later). Policy premiums increase as the MBP selected is increased. |
| **Definition of Disability** |
| The “*definition of disability*” is a major factor in determining the value and suitability of a disability income contract, which we will discuss in some detail on the next page. |

# Policy Definitions of Disability

The definition of disability is the key ingredient in the value of a disability income contract. A *life insurance* claim is typically not debatable. However, a disability claim's "validity" can be much more subjective. The difference between substantial benefits paid and no benefits paid at all on a submitted disability claim can be determined solely by the contract's *definition* of disability. A neurosurgeon who develops a tremor in his hands can no longer perform surgery and may suffer a substantial loss of income. On the other hand, the same tremor in the hands of a CEO may be an annoyance, but will not threaten her abilities to perform all of the material and substantial duties of her occupation.

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| **Overview** | We classify common disability definitions in disability income policies as one of four types, which are summarized below.  **Click each heading on the left learn more.** |
| **Occupational** | An occupational definition is usually worded to state that benefits are provided "if you cannot perform the duties or ‘material and substantial duties’ of your occupation." This definition is frequently referred to as an “Own Occupation” standard and represents the most favorable definition for the insured. Such policies generally require relatively high premiums as well.  Sometimes the definition may also note that "occupation" can mean a professional's unique specialty such as neurosurgeon, or orthodontist, etc. This may mean that the claim will be payable even if the insured changes careers and earns a substantial income in a new occupation.  In other cases, the occupational definition may only apply for a limited period such as 24 to 60 months of disability. After the duration of the occupational definition ends, the definition may change to one of the three below.  Some occupations do not qualify for an occupational definition and some insureds would not consider an occupational definition worth the extra premium. |
| **Gainfully Employed - A** | This definition typically states that the insured is disabled "…if due to an accident or sickness you are unable to perform the duties of your occupation for which you are reasonably fit by education, training, and experience," and possibly might add "with due regard to prior economic status." This definition may also be referred to as the “Reasonably Suited” standard. Premium costs are generally considered moderate.  This is a good definition from the standpoint of the insured, but is not as liberal as the "Own Occupation” definition. |
| **Gainfully Employed - B** | This is a simpler and considerably less liberal definition than the two above. In this case, disability is defined as something like "…unable to perform the duties of any gainful employment."  This definition is not common and would be used in policies that apply to higher risk classifications. This type of coverage would not typically be applied to affluent clients.  This definition is frequently described as the “Any Occupation” standard and closely mirrors the Social Security definition of disability - it is the least favorable to the insured. Premiums tend to be the least expensive among the definitions of disability. |
| **Loss of Income/Residual** | This type of definition can used to apply to a policy itself as the primary disability definition or as a supplemental rider to a policy with a total disability definition.  A residual definition states that the policy will pay benefits in proportion to loss of income attributable to an accident or sickness. If used as a primary definition of disability, this type of disability will provide coverage at a lower premium than a policy with an occupational or gainfully employed definition, and may appeal to certain affluent clients.  As a rider, it supplements a total disability definition with a provision for a partial loss of income. |

What if your client desires the most favorable definition of disability but lacks the cash flow to fund the relatively high premiums? A “split-definition” policy may be the solution. For example, a policy may cover “own occupation” for five years after the onset of disability and then convert (or split) to a “reasonably suited” definition. The advantages of such an approach are to reduce premiums and provide the insured with enough time to find suitable employment.

# Additional Contract Provisions of an Individual Disability Income Policy

We have summarized below the most common additional contract provisions of high-quality individual disability income policies in today's marketplace.

**Click each provision to learn more.**

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| **Recurrent Disability** |
| This provision defines how the insurance company will treat disabilities that recur for the same accident or sickness, i.e., how much time must elapse and under what conditions the impairment can be considered an entirely separate disability. This distinction affects limitations on certain benefits such as the Maximum Benefit Period, and determines whether a new Waiting Period is needed. |
| **Waiver of Premium** |
| Most policies offer the ability to waive premium payments if you become disabled. |
| **Preexisting Conditions** |
| Physical or mental conditions that were misrepresented or undisclosed in the application are generally excluded within the first two years of the policy's effective date. |
| **Exclusions** |
| Exclusions will vary by company and may include disabilities that:   * + - Are caused by military service (suspension of a policy is often allowed during military service)     - No payments are payable while incarcerated     - Are caused during act of criminal offense or engaged in illegal activity     - Are caused related to suspension of professional license     - Are caused by self-inflicted injury     - Are caused by *normal* pregnancy or childbirth during first three months of disability or Elimination Period, whichever is longer. |
| **Rehabilitation Benefit** |
| Rehabilitation costs not covered by medical insurance or programs that assist in return to gainful employment may be covered by this benefit. |

# There are also optional contract provisions that allow additional tailoring of a disability income policy to the unique characteristics of each client. We have summarized six of the most common optional provisions on the next page. Possible or Optional Provisions of an Individual Disability Income Policy

Below we have summarized the more popular *optional* contract provisions of high-quality individual disability income policies in today's marketplace. These provisions typically require extra premium payments.

**Click each provision to learn more.**

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| **Residual Disability Benefit Rider** |
| This rider provides for benefit payments if a sickness or accident causes at least a partial loss of income but the insured does not qualify for total disability. This rider may also be applicable to incent or allow an insured to return to work on a gradual basis after a period of total disability and still receive benefits. On the other hand, an insured may have an illness that is progressive and allows an insured to slow down his or her working time and thus begin to receive benefits prior to a total disability. |
| **Cost of Living Adjustments (COLA)** |
| This optional benefit will increase benefit payments after one year of disability in accordance with a predetermined formula by tying the increases to an inflation index. The annual changes may be scheduled (e.g., 5% per year), or have a maximum annual increase as well as a cumulative maximum increase. Increases may be simple or compounded. Note that the benefit increases from this rider are applied only after a claim is incurred; the age of the policy has no bearing on the annual "COLA" increases. |
| **Catastrophic Disability Benefit** |
| This optional benefit can provide extra payments beyond income replacement benefits if it is determined that the disabled insured cannot perform at least two activities of daily living (ADLs) without assistance as a result of an accident or sickness. ADLs typically include bathing, toileting, transferring, maintaining continence, and eating. This additional benefit reflects the fact that in some cases a long-term disability may actually *increase* an insured's monthly expenses. |
| **Retirement Protection Benefit Rider** |
| In the event of total disability, this rider makes monthly contributions into a self-directed trust that are intended to replace contributions that would have been made by the insured and/or employer to retirement plans. This rider invariably has an Elimination Period of a minimum of 180 days and typically would be issued with a Maximum Benefit Period of no longer than age 65. |
| **Additional Monthly Benefit Rider (AMBR)** |
| In some cases, a client may purchase an additional amount of monthly indemnity in the early months of disability. For example, John wants coverage that provides him with a monthly benefit of $10,000 to age 65 after a 60-day Elimination Period. His group LTD provides a monthly benefit until age 65 of $6,000 after a 180-day Elimination Period. John could purchase a policy with a long-term benefit of $4,000, but with an additional AMBR or $6,000 from the 60th to the 180th day. Thus, John would have a level benefit amount of $10,000 per month by "tailoring" the individual policy around his group LTD coverage. |

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| **Social Insurance Offset Rider** |
| This optional benefit coordinates benefit payments with various government disability programs; that is, if Workmen's Compensation, state disability programs, or Social Security programs do not provide benefits within the limits of the government disability program, the rider will pay. This rider can assure equivalent payments of government programs at a premium that is discounted from non-offset coverage. |
| **Guaranteed Insurability Options** |
| This policy provision provides the opportunity to purchase additional insurance at specified future dates (usually until about age 45 or 50) without evidence of insurability. This can be an effective policy provision for someone who is potentially going to see increases in his or her overall compensation and also wants protection against future potential uninsurability. |

# When considering disability coverage, the tax impact of benefits must be considered because if benefits are taxed, it reduces the spending value of benefit payments and should thus be considered in determining amount of benefit needed. Note that insurance companies will typically underwrite more coverage for a particular individual if the benefits will be taxable than if the benefits would be received tax-free. On the next page, we will discuss the taxation of disability income benefits.

# Taxation of Disability Benefits

The primary tenet of the taxation of disability benefits can be summarized as follows:

***If an individual or entity pays disability insurance premiums on an after-tax basis, any disability benefits received will be tax-exempt.***

***If a premium is paid by an employer and deducted as a business expense, any disability payments received by the employer or by the employee will be income taxable to the recipient.\****

Disability premiums are not deductible by individuals, thus benefits would be received income tax-free. As previously mentioned, when underwriters of a Disability Income policy are considering the maximum limits of coverage, the issue limits are increased for benefits that will be taxable (e.g., corporate/employer paid) versus benefits that are paid for on an after-tax basis.

Social Security Disability Income benefits are not taxable until the client meets certain thresholds of income. Most affluent clients will typically have up to 85% of their SSDI treated as taxable income.

*\*It is beyond the scope of this course to provide a detailed discussion of corporate Qualified Sick-Pay and Salary Continuation Plans (two commonly used names for the same plan) that provide disability benefits to employees. However, if a plan of some type is not in place for a specified class of employees, communicated to employees, and enforceable by employees, any disability payments to employees or owner-employees of the business are not deductible to the business and taxable income to the employee.*

# Disability Income Underwriting

# It is important to manage client expectations in regard to the outcome of underwriting; that is, what coverage is issued versus what is applied for. A greater understanding of the underwriting process enhances confidence and improves operational efficiency.

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| **Overview** | Since most of us are probably more familiar with life insurance and possibly the life insurance underwriting process, we will compare salient characteristics of each product.  **Click each heading to learn more.** |
| **Life Insurance Underwriting** | Life insurance underwriting is based on substantial statistics accumulated over many decades, or even centuries. Life insurance underwriting is almost a pure science. Life insurance insures a risk that is certain to happen; it's just a question of when.  The claim department rarely must make subjective decisions regarding whether or not an insured is deceased. |
| **Disability Insurance Underwriting** | In contrast, Disability is only a statistical probability and more subjectively evaluated both at the time of underwriting and in the event of a claim. Disability insurance underwriting is, therefore, more complex. For example, the insurance companies typically want verification of income, probably by reviewing copies of IRS Tax Form 1040. In addition, relatively minor health or lifestyle issues may have little or no increased mortality risk but may affect morbidity (disability) risk.  Note the following statistics regarding historical disability insurance versus life insurance underwriting results:   * Disability income insurance applications have a 5 - 10% rejection rate (vs. 3% for life insurance). * 15 - 25% of disability income insurance applications require extra premiums and/or exclusions (vs. 3 - 5% for life insurance). Underwriting also results in additional modifications in 15% of disability applications. * Net Result Comparison: 8% of life applications are rejected or modified; 40% of disability income insurance applications are rejected or modified.   Source: *Disability Insurance; The Unique Risk*; 5th ed., Charles E. Soule; The American College; p. 23 |

# What Determines the Cost of a Disability Policy?

The variety of contract provisions and riders available allow for tailoring of an individual disability income policy to the objectives and circumstances of a particular client. In addition to factors such as age, gender, occupation, avocations, and health status, the various provisions and riders also affect the premium. The Elimination Period and the Maximum Benefit Period (MBP) are two variable factors that significantly impact the premium charged.

In the table, we have illustrated the hypothetical cost of coverage for a healthy, non-smoker, 40-year-old, male orthopedic surgeon who is purchasing a $10,000 monthly benefit. The table below illustrates the monthly premium charges for the basic coverage of a guaranteed renewable, noncancellable policy with a specialized definition of occupational disability. These numbers are for illustrative purposes only and can vary by applicant, location, policy provisions and insurance company.**\***

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Elimination Period** | | | |
| **Maximum**  **Benefit**  **Period** | **60 Days** | **90 Days** | **180 Days** | **360 Days** |
| **2 Years** | **$287.17** | **$174.33** | **$153.75** | **$134.08** |
| **5 Years** | **$524.58** | **$317.67** | **$279.92** | **$243.83** |
| **10 Years** | **$592.67** | **$358.83** | **$316.08** | **$275.42** |
| **Age 65** | **$710.67** | **$430.00** | **$378.75** | **$329.92** |
| **Lifetime** | **$933.00** | **$564.25** | **$496.92** | **$432.75** |

Note that a longer Elimination Period decreases the premium and a longer Maximum Benefit Period increases the premium. Popular riders such as COLA, a Residual Benefit, a Catastrophic Benefit, and a Retirement Protection Benefit would increase the premium. For example a policy with a 90-day Elimination Period and an Age 65 MBP, with a $3,840 monthly Retirement Protection Rider, 3% compounded COLA, Residual Benefit and an $8,000 monthly Catastrophic Benefit would increase the basic monthly premium of $430.00 to $780.44. The potential benefits of this particular policy paid to the surgeon could exceed $8,000,000.

**\*** *(2008 Premium quotes provided by Peachtree Planning Corporation; Atlanta, GA; Guardian Life Disability Income Brokerage).*

# Roadmap

Let's now stop and review what we have discussed in this course so far and where we are going in the sections ahead. In the introduction, we stated the seven primary objectives and general outline of the course. So far, we have covered the first three objectives, which deal with the risks of long-term disability, the possible options to alleviate the risks of disability, and a broad discussion of the individual disability income insurance contract provisions available in the marketplace.

We now turn our attention to the practical aspects of applying our understanding of disability risks, possible options to resolve the risk, and disability income insurance to eliminate the risk and to help clients take actions to resolve their exposure. The last four objectives are listed below and serve as an outline for the balance of the course. We will begin on the next page by discussing the use of a 4-step process to determine the need for disability income insurance.

1. Define the risks of long-term disability.
2. Discuss the possible options to alleviate the risks.
3. Review and analyze the insurance options that are available to alleviate the risks.
4. Use a 4-step process to determine the need for disability income insurance.
5. Break the marketplace into three strategic segments based on the varied nature of risk characteristics and possible solutions.
6. Discuss the appropriate application of Disability Insurance coverages by reviewing case studies.
7. Help clients take actions to resolve their exposure to a substantial financial risk.

# The 4-Step Process to Determine the Need for Disability Income Insurance - Step 1

Calculating the amount of disability insurance needed is a process similar to the calculation performed in determining life insurance need. There are four steps:

Step 1: Determine the need for post-disability income

Determine the amount of income that is required for family support and any potential post-disability expenses. Help your client to realistically address the complete financial impact of a long-term disability, including the loss of current earned income, inflation's impact on future expenses, potential of increased medical care, and loss or decrease of retirement benefits. A table, such as the one below, can assist you and your client to determine their post-disability income needs.

|  |  |
| --- | --- |
| **Post-Disability Required Family**  **Monthly Expenses** | **Average Monthly Disbursement Amount** |
| Household mortgage, utilities, supplies, M&R, insurance, RE taxes, etc. |  |
| Food/outside meals |  |
| Clothing & personal care |  |
| Transportation |  |
| Routine family medical/dental |  |
| Recreation |  |
| 529 contributions |  |
| Children's school costs |  |
| Other/Misc. |  |
| **Subtotal of Required Monthly Expenses:** |  |
| **Variable/Potential Monthly Expenses:** |  |
| Retirement plan contributions |  |
| Other/Misc. |  |
| **Subtotal of Variable/Potential expenses:** |  |
| ***TOTAL:*** |  |

# The 4-Step Process to Determine the Need for Disability Income Insurance - Step 2

Step 2: Determine current post-disability sources of income

The need for post-disability income can be offset with any income available from sources such as Social Security, existing insurance, and investment income. By subtracting these resources from the needs established in Step 1, the design and amount of disability insurance required can be determined. The table below provides a simple checklist to consider and discuss post-disability sources of income.

|  |  |  |
| --- | --- | --- |
| **Potential Post-Disability**  **Income Resources** | **Monthly**  **Gross Income** | **Nature, Timing & Restrictions**  **of Payments** |
| Social Security disability payments |  |  |
| State disability payments |  |  |
| Cash reserve |  |  |
| Accrued Sick Pay |  |  |
| Sick Pay Plan STD |  |  |
| Sick Pay Plan LTD |  |  |
| Spouse income |  |  |
| Trust income |  |  |
| Investment assets income |  |  |
| Personal Disability Income Insurance |  |  |
| Long-term Care Insurance (LTCI) |  |  |
| Other |  |  |
| Other |  |  |

# The 4-Step Process to Determine the Need for Disability Income Insurance - Step 3

**Step 3: Calculate the amount and timing of income shortfalls in the event of a long-term disability.**

Each client's objectives, attitudes, and resources differ, but this simple strategic process of evaluating the need and assisting the client in finding a solution is an efficient methodology in which all clients can engage and understand. The table below can assist in outlining the post-disability income need, current resources to offset the need, and an accurate picture of shortfalls that can be resolved by financial planning adjustments and disability income insurance. Note that the needs must be determined not only by amount of income needed, but also by the timing of the needs.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | Duration of Disability | | | | | | |
| Needs: | Month 1 | Month 2 | **Month 3** | **Months**  **4-5** | **Month 6** | **Months 7-12** | **After**  **1 Year** |
| Post-Disability Required Family Monthly Disbursements |  |  |  |  |  |  |  |
| Income Resources: |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
| Totals of Resources: |  |  |  |  |  |  |  |
| Less Income Taxes: |  |  |  |  |  |  |  |
| Net Income shortfall of resources by Duration of Disability: |  |  |  |  |  |  |  |

# The 4-Step Process to Determine the Need for Disability Income Insurance - Step 4

Step 4: Tailor the design of disability coverage to supplement other insurance and income-producing resources.

The process of policy design is a relatively simple process of matching the shortfall calculations to the design of the policy features. Seven key decisions regarding the design of a disability income policy are best evolved if done in a progressive order as follows.

**Click each decision point to learn more.**

|  |
| --- |
| **1. Guaranteed Renewable or Guaranteed Renewable and Noncancellable** |
| Affluent clients, who will predominantly be business owners, executives and professionals, will usually prefer coverage that allows no room for policy or premium revisions. In addition, most insurance companies offering high-quality contract provisions will only offer guaranteed renewable and noncancellable coverage to affluent/professional individuals. For the client who is less risk averse and/or is willing to allocate only minimal funds for this insurance coverage, it would be advisable to explore both types of policy options and let the client choose his or her preference. |
| **2. Type of disability definition** |
| Affluent clients have a substantial investment in their chosen vocation and will typically desire a contract definition with an "Own Occ" definition of total disability. In addition, most insurance companies "package" an "Own Occ" definition with other contract provisions tailored to an affluent client. For the client who is less risk averse and/or is willing to allocate minimal funds for this insurance coverage, it would be advisable to also consider a policy with a less generous definition of total disability and probably a lower premium. This allows the client to choose his or her preference. |
| **3. Amount of long-term income need** |
| The chart created in Step 3 illustrates a determination of the long-term need for income coverage. This need must be addressed in the policy design. We will discuss this in more detail in Case Study One. |
| **4. Length of Elimination Period** |
| Generally, the client will select an Elimination Period for as long as his or her financial resources can sustain living expenses without substantial depletion of assets. Longer Elimination Periods lower the premiums. We will discuss this in more detail in Case Study One. |
| **5. Length of Maximum Benefit Period (MBP)** |
| Most clients will not opt for a short-term solution to resolve a long-term risk and most advisors will not be comfortable suggesting an MBP of less than Age 65 or Lifetime. A question that can arise is whether to select a Lifetime MBP or an Age 65 MBP with a retirement protection benefit rider (RPBR). If the latter is chosen, then in the event of disability, the RPBR makes monthly contributions to a retirement trust. Theoretically, over time the trust will accumulate a substantive balance of funds that will be available for withdrawals at age 65. The key determinates in making the choice between a Lifetime MBP and an Age 65/RPBR combination are the calculation of estimated income that could be provided by the retirement benefit rider at age 65 vs. a lifetime benefit.  There are several considerations when making this decision:   * This calculation depends on the age of the client, the size of existing retirement fund assets and the size of the retirement rider contributions. * If the client is older than typically about age 50 when the policy is issued, a Lifetime MBP will probably not be available when a new policy is issued. In this case, the RPBR is a substantive benefit with no alternative. * When a policy has a Lifetime MBP and the insured is disabled after about age 45, the actual Lifetime MBP past age 65 is scaled down. The amount actually paid would be a decreased percentage of the Monthly Indemnity depending on the actual age of disability. As the risk of disability increases as the client approaches age 65, the Lifetime Benefit is far less substantial than an Age 65/RPBR design. * You will also want to compare the Lifetime MBP vs. the Age 65/RPBR combination. If COLA is included in the coverage, the Lifetime MBP will be substantially more expensive since the lifetime benefits with COLA increases could theoretically last well beyond age 65. * The retirement benefit rider provides a death benefit to survivors if, after a disability, the insured dies before depleting the retirement fund assets.   Analysis of the client's situation, risk tolerance, and objectives will allow an advisor to present the most realistic options from which the client may choose. |
| **6. Need for Additional Monthly Benefits in early months?** |
| The long-term need for income is invariably a level amount once all resources for income are calculated, but some resources, such as Social Security benefits, group LTD, or a business buy-out, may be delayed for several months before payment begins. In these cases, a rider may need to be attached to boost the monthly indemnity in the early months of disability. Most financial professionals will encourage their clients to build emergency reserves to enable clients to self-insure shorter-term financial emergencies, but many clients will have not yet reached that level of financial security. |
| **7. Selection of various riders that suit the profile and objectives of the particular client** |
| The primary riders that most client situations will require consideration are the following:   * + - **Cost-of Living Adjustment Rider** – This rider increases benefit payments to keep pace with inflation.     - **Residual Benefit Rider** – This rider provides for partial payment of benefits, generally in proportion to loss of income due to disability. This allows an insured to return to work after a total disability on a gradual basis without losing all of his or her benefit, or typically allows an insured to receive benefits without the requirement of being totally disabled first. This benefit is particularly attractive to executives, professionals, or self-employed individuals without large self-sustaining businesses.     - Retirement Protection Benefit Rider - This rider makes retirement plan contributions into a retirement trust in the event of disability. Earnings in the trust are tax-deferred and provide a death benefit to named beneficiaries of the trust if the insured dies prior to depletion of the funds as retirement income. Selection of this rider limits the Maximum Benefit Period to Age 65 (versus Lifetime).     - **Guaranteed Insurability Options** - This rider guarantees the right of the insured to purchase additional coverage in the future without medical underwriting. This will typically be attractive to younger clients who anticipate substantial future earnings increases, such as young professionals.     - **Catastrophic Disability Benefit** - This rider has a relatively low cost, but can provide substantial and welcome benefits when additional medical care and assisted living services are required. However, this coverage will last only for the life of the policy (typically to age 65). In the event of a claim, benefits will be paid until the Maximum Benefit Period expires, or age 65, whichever is sooner. Consideration of this risk is an excellent entre to discuss Long-term Care insurance that would provide a guaranteed renewable *lifetime* of coverage to mitigate a substantial risk that is more likely to occur past age 65. |

# The Disability Income Marketplace - Three Market Segments

Disability risk management issues for various clients can vary widely due to their individual financial profiles, health status, personalities, family situations, and occupations. To accelerate your understanding of their most prominent risk management issues, however, you can easily segregate your prospects and clients into three market segments.

These segments are helpful because the disability risk issues of each segment are consistent but substantively different. On the following pages, we will examine how to address the needs of these segments with a series of case studies.

**Click each segment to learn more.**

|  |
| --- |
| **Employees** |
| When working with a client who is employed by any organization where the client has no or very little ownership interest, the client's risk management issues are limited to personal and family concerns versus financial responsibilities to employees, business partners, or creditors. The employee will rely on possible employee benefits, government programs, personal resources, and disability income insurance to resolve his or her risk of long-term disability. |
| **Professionals and Self-employed *Without* Employees or Partner** |
| The concerns and needs of this second group are identical to the first group of employees with one exception. While the "solo-self-employed" individual is also focused on earned income replacement in the event of long-term disability, this group must also consider business overhead expenses that will continue for some period of time after a disability begins. In addition, liabilities may need to be paid off that pertain to the establishment or expansion of the business or practice. |
| **Professionals and Self-employed *With* Employees or Partners** |
| Like the first and second group, the business owner must address the issue of income replacement in the event of their own disability. In addition, if the owner is a major factor in maintaining business revenue, the risk of continuing business overhead may be an expense that needs to be addressed and the owner may be personally liable for business liabilities.  A particularly difficult issue for an owner of a business or professional practice is to determine how long and how much to pay an employee in the event of the employee's disability. A business owner or professional may also need to address issues of business continuation and succession in the event of a long-term disability of a substantial and active owner. It may be beneficial to all parties concerned to establish *and fund* a buy sell agreement that is triggered by one of the "Four D's" - Death, Disability, Divorce or Departure. |

On the following pages, we will review case studies for each of these market segments.

# Segment 1 – Disability Risk Management for Employees

When working with a client who is employed by any organization where the employee has no or very little ownership interest, the client's risk management issues are limited to personal and family concerns versus financial responsibilities to employees or business partners.

When analyzing the needs and solutions for long-term disability, this client will need to coordinate disability, salary continuation, sick pay, and retirement, as well as possible benefits from government programs and any personal financial resources. The case study that begins on the next page illustrates this coordination of benefits and resources to evolve a recommendation of individual disability income insurance. In Case One, we have utilized the Four-Step Process that facilitates an orderly method to ascertain a need for Disability coverage.

# Case Study One – Jack Driver, Executive

Read through the following case study of Jack Driver, a business executive. On the following page, we will begin addressing Jack’s disability income planning needs by utilizing the Four-Step Process.

**The Story of Jack Driver**

Jack Driver is the general manager of a large automobile dealership in Atlanta. He has been with this particular national company for three years. Jack periodically receives offers to manage other dealerships for other companies, but has not yet been tempted to make an employer change.

Jack is 39, married, and has two children in a private junior high school. Jack's wife, Dana, is a full-time homemaker.

Jack has a base salary of $150,000, earned a performance bonus of about $100,000 last year, and expects the bonus to continue or increase in the future. His employer consistently contributes about $25,000 per year to his profit-sharing plan. The company provides family medical insurance, a medical reimbursement plan, and a Sick Pay Plan that provides Jack with one month of full salary per year of employment.

A group long-term disability (LTD) plan is in place that provides up to a 60% replacement of salary up to a maximum salary of $10,000 (or $6,000 benefit) per month. The company pays the entire LTD premium, which provides an occupational definition of disability for 24 months, then an "education, training and experience" definition thereafter to age 65. The Waiting Period is 180 days.

Jack is in very good health but has a family history of disabling diabetes and heart conditions. You have capably helped Jack with his small investment portfolio and life insurance in the past. He is concerned about his disability risk, but is confused about how to determine the amount of additional disability income coverage he can and should acquire. He has asked you to assist him in evaluating this conundrum.

Jack's financial condition is good. He owns his home with a mortgage; he owns one car with a small car loan, and has a small amount of credit card debt. He has a cash reserve of $10,000 in a Money Market account and a small mutual fund portfolio with a market value of $30,000, to which he contributes $500 per month. He is also contributing $500 per month into two 529 plans for his sons' college expenses. You discuss Jack's family living expenses and agree that he needs about $11,000 per month to meet his current obligations.

# .Case Study One – Step 1

# Step 1: Determine the Need for Post-Disability Income

In this case, you and Jack have calculated a need of $11,000 per month for living expenses. You note that the disability insurance underwriters will typically offer coverage of up to 60% - 65% of pre-disability earnings, thus $11,000 per month of total coverage is within underwriting issue limits.

He is also concerned about replacement of contributions to his retirement plan that he had not considered until you brought it up. The table below summarizes these income needs.

|  |  |
| --- | --- |
| **Post-Disability Required Family**  **Monthly Expenses** | **Average Monthly Disbursement Amount** |
| Household mortgage, utilities, supplies, M&R, insurance, RE taxes, etc. | $ 5,000 |
| Food/outside meals | 800 |
| Clothing & personal care | 500 |
| Transportation | 1,200 |
| Routine family medical/dental | 300 |
| Recreation | 200 |
| 529 contributions | 500 |
| Children's school costs | 2,500 |
| Other/Misc | 0 |
| **Subtotal of Required Monthly Expenses:** | **$ 11,000** |
| **Variable/Potential Monthly Expenses:** |  |
| Retirement plan contributions | 2,100 |
| Other/Misc. | 0 |
| **Subtotal of Variable/Potential Expenses:** | **$ 2,100** |
| ***TOTAL:*** | ***$ 13,100*** |

If Jack's disability required care and assistance beyond medical treatment, his income replacement coverage may be somewhat or substantially depleted by custodial/long-term care expenses. We will address this issue in Step 4.

# Case Study One – Step 2

# Step 2: Determine Current Post-Disability Sources of Income

You calculate Jack's current resources to provide for a long-term disability, as listed in the table below.

**Click the highlighted income resources for an explanation.**

|  |  |  |
| --- | --- | --- |
| **Potential Post-Disability**  **Income Resources** | **Monthly**  **Gross Income** | **Nature & Restrictions**  **of Payments** |
| **Social Security disability payments** | $ 1,500 | If claim approved, benefits begin accruing after 5 months |
| State disability payments | 0 | N/A in Georgia (or most states) |
| Cash reserve | 17 | 2% of $10,000 |
| **Accrued sick pay** | 12,833 | Jack has accrued 3 months |
| Sick Pay Plan Group STD Insurance | 0 | N/A |
| **Sick Pay Plan Group LTD Insurance** | 6,000 | 180 day Waiting Period |
| **Spouse income** | 0 | N/A |
| Trust income | 0 | N/A |
| **Investment assets income** | 25 | 1% of $30,000 |
| Personal Disability Income Insurance | 0 | N/A |
| Long-term Care Insurance (LTCI) | 0 | N/A |

Social Security Disability Payments

We assume Social Security would provide about $1,500 of monthly income with the limitations discussed earlier in the course. No partial or residual benefit.

Accrued Sick Pay

The company Sick-Pay Plan would currently provide full salary to Jack for up to 90 days and may increase in the future to the extent he does not use the sick leave and as long as he remains employed with the same company. This type of plan is often self-insured.

Sick Pay Plan Group LTD Insurance

The group Sick-Pay Plan insurance for a Long Term Disability would provide up to $6,000 of monthly income after a 180-day elimination period, with the limitations discussed earlier in the course. No partial/residual benefit is included. Remember, this coverage is typically offset by Social Security and retirement plan benefits payable to the employee in the event of disability.

Spouse Income

In the event of Jack's disability, Dana would need to stay home to continue maintenance of the home, assume an increased burden of raising the children, and possibly an increased responsibility for Jack's care.

Investment Assets Income

Jack's investment assets are insufficient to have any impact on his disability risk management at this time. Jack would prefer to think of his retirement plan assets as a retirement fund, not a contingent asset for financial emergencies. In fact, you will encourage Jack to build his emergency fund substantially so that he could maintain his living expenses for at least six months in the event of any contingency of lost or reduced income.

# Case Study One – Step 3

**Step 3: Calculate the amount and timing of income shortfalls in the event of a long-term disability.**

We now need to determine the exact amount and timing of income shortfalls that would occur in the event of Jack's long-term disability. The chart below summarizes the data from Steps 1 and 2 and calculates the projected shortfalls of post disability income needs.

**Click the highlighted row headings for comments about specific rows.**

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Duration of Disability** | | | | | | |
| Post DisabilityNeeds: | Month 1 | Month 2 | **Month 3** | **Months**  **4-5** | **Month 6** | Months **7-12** | **After**  **1 Year** |
| RequiredExpenses: | $ 11,000 | $ 11,000 | $ 11,000 | $11,000 | $ 11,000 | $ 11,000 | $ 11,000 |
| Variable orPotentialExpenses | 2,100 | 2,100 | 2,100 | 2,100 | 2,100 | 2,100 | 2,100 |
| Total Monthly Needs: | $ 13,100 | $ 13,100 | $ 13,100 | **$ 13,100** | $ 13,100 | $13,100 | $13,100 |
| IncomeResources: |  |  |  |  |  |  |  |
| AccruedSick Pay | $ 12,833 | $ 12,833 | $ 12,833 | $ 0 | $ 0 | $ 0 | $ 0 |
| SocialSecurity | 0 | 0 | 0 | 0 | 1,500 | 1,500 | 1,500 |
| Sick PayGroup LTD | 0 | 0 | 0 | 0 | 0 | 4,500 | 4,500 |
| Asset Income | Nominal | Nominal | Nominal | Nominal | Nominal | Nominal | Nominal |
| Less Est.Income Taxes | (2,500) | (2,500) | (2,500) | 0 | (200) | (900) | (900) |
| Totals Income Resources | $ 10,333 | $ 10,333 | $ 10,333 | $ 0 | $ 1,300 | $ 5,100 | $ 5,100 |
| Net Income Shortfall | **$ (2,767)** | **$ (2,767)** | **$ (2,767)** | **$(13,100)** | **$ (11,800)** | **$ (8,000)** | **$ (8,000)** |

Total Monthly Needs

This row totals the preceding two rows to illustrate the total monthly need for income as determined in Step 1.

Accrued Sick Pay

Jack has three months of accrued leave. This amount could vary up or down in the future, depending on how much sick leave he uses. If he changes jobs, this benefit may or may not be replaced. A substantial cash reserve is the best solution to mitigating a short-term disability. In most cases, only the salary (versus bonuses) would be payable as indicated here.

Social Security

If Jack qualifies for Social Security, the benefits would begin accruing after 5 months and he would theoretically receive the first check in the sixth month. We assume here that he does qualify for Social Security. Up to 85% of Social Security benefits may be income taxable, depending on the amount of Jack's annual taxable income after disability.

Sick Pay Group LTD

The group LTD would begin accruing benefits at 180 days and actual receipt of checks would begin in the 7th month. Group LTD benefits would be reduced by the amount of Social Security benefits (SSDI) received. In this case, we assume the SSDI benefits are received, thus the Group LTD gross benefit of $6,000 would be reduced to a net benefit of $4,500 per month. Jack's LTD premiums are employer paid, thus the benefits would be income taxable.

Less Estimated Income Taxes

In this case, all of the benefits would be taxable. The actual tax rate would vary in the early months of disability (up or down) based on how late in the tax year the disability begins due to calendar year earnings prior to disability.

Totals Income Resources

This row totals the monthly income resources, net after estimated income taxes. There are several considerations to note here:

* The resources provide an uneven amount of income for the first six months of disability, and we will need to account for this uneven income stream in the design of the disability insurance policy.
* The Social Security benefits may or may not be payable, depending on the severity of Jack's disability. In this case, except for the fifth month of disability, if Social Security benefits were payable, they would offset the gross benefit payable from the group LTD.
* The group LTD benefits are not entirely predictable since the definitions can vary from employer to employer, although most executives will find the coverage to be satisfactory.
* Group LTD is often paid for by the employer and the "free" insurance coverage is difficult to decline unless the quality of the coverage is unusually poor.

Net Income Shortfall

This row shows the “net income shortfall of resources,” which is derived by subtracting the total income resources from the total needs. The shortfall in the first three months could be handled by Jack's emergency fund. Note that the shortfall in the 4th, 5th and 6th month (the Social Security benefit in the 6th month is ignored due to the likely delay of payment and relative insignificance after income taxes) is $13,100 per month, or a total of $39,300, and thus should be insured. After six months, Jack has a shortfall of $8,000 per month for as long as his disability lasts. Inflation would increase his need for income over time.

# Case Study One – Step 4

Step 4: Tailor the design of disability coverage to supplement other insurance and income-producing resources.

# As previously discussed, we now begin addressing the policy design by progressively addressing the seven key decisions.

# Click each decision point to learn more.

|  |
| --- |
| **1. Guaranteed Renewable or Guaranteed Renewable and Noncancellable** |
| For reasons previously discussed, Jack will likely prefer coverage that allows no room for policy or premium revisions. However, both options should be considered, allowing Jack to choose. |
| **2. Type of Disability Definition** |
| As previously discussed, Jack will probably prefer “Own Occ”, but other options should probably be considered to give him a choice of assuming more risk with lower premiums. |
| **3. Amount of Long-Term Income Need** |
| As noted in Step 3, Jack has a long-term need of $8,000 per month. |
| **4. Length of Elimination Period** |
| In Step 3, Jack has a need for modest income with accumulative total of $8,300 in the first three months. However, he has a cash reserve that would easily handle the shortfall, and a 90-day elimination period (EP) would result in a substantial reduction of premium compared to a 30-day EP. Jack will most likely select a 90-day EP when his Sick Pay Plan benefits stop. |
| **5. Length of Maximum Benefit Period** |
| As mentioned earlier, this is a subjective decision of clients based on their level of risk tolerance, willingness to pay premiums, age, and financial planning priorities. Most likely, Jack will select an MBP of Lifetime or Age 65. If he selects Age 65, consideration should be given to a retirement protection benefit rider. Most financial professionals would be uncomfortable suggesting consideration of insurance coverage that runs out before the client does. The financial professional is wise to show a range of realistic options to a client and let the client decide with complete disclosure of pros and cons of each option. |
| **6. Need for Additional Monthly Benefits in Early Months?** |
| Since we believe the sixth month's Social Security benefit is very contingent and probably taxable, we assume that Jack will need an additional monthly benefit of $5,100 in months 4, 5 and 6. The Additional Monthly Benefit Rider can be designed to provide this extra monthly indemnity for the specified three-month period. |
| **7. Selection of Various Riders that Suit the Profile and Objectives of the Particular Client** |
| * + - **Cost-of-Living Adjustment Rider –** Certainly inflation can significantly decrease the value of benefits over a period of time; thus, Jack may want to consider a rider that increases benefit payments to keep pace with inflation.     - **Residual Benefit Rider –** As a business manager, Jack is likely to be interested in the ability to gradually return to work, after a full disability, without totally losing benefits once he resumes work. Jack should be offered this benefit and may very well decide to include this rider in his coverage.     - **Guaranteed Insurability Options -** This rider guarantees the right of the insured to purchase additional coverage in the future without medical underwriting. This should be an attractive benefit to Jack since his income and living expenses are likely to increase in the future and, if he should change of employment, employer-provided disability coverage is uncertain.     - Retirement Protection Benefit Rider (RPBR) - Consideration of this rider would typically be a choice between this rider and a Lifetime Maximum Benefit Period, which could involve a good deal of number crunching, evaluating nuances of policy provisions by different carriers and the specific characteristics of a particular client. The financial professional will develop his or her own perspective of the advantages and disadvantages of using this rider or the Lifetime MBP over a period of study and experience. In addition, many students of this course may rely on Disability Income Insurance specialists in their organization to assist in making these policy design decisions to present to a client. Earlier in the course, we discussed the advantages, disadvantages and considerations of using the RPBR versus a lifetime MBP. In the links below, we have summarized the advantages and disadvantages of the Lifetime MBP vs. the RPBR. Click each heading to review the tables.   **Click each heading to review the tables.**  **Lifetime Maximum Benefit Period**  **Retirement Protection Benefit Rider**   * + - **Catastrophic Disability Benefit** - As we stated previously, this coverage will last only for the life of the policy (typically to age 65). In the event of a claim, benefits will be paid until the Maximum Benefit Period expires, or age 65, whichever is sooner. Consideration of this risk is an excellent entree to discuss Long-Term Care Insurance (LTCI) that would provide a guaranteed renewable *lifetime* of coverage to mitigate a substantial risk that is more likely to occur past age 65. At Jack's age, LTCI is relatively inexpensive and provides coverage both before and after retirement. |

Lifetime Maximum Benefit Period

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| Advantages | Disadvantages |
| The potential lifetime payout (well beyond age 65) is higher, especially if the RPBR is a relatively small percentage of the policy's Monthly Indemnity. | When coupled with a Cost of Living Adjustment (COLA), this option will be at least double the cost of a RPBR with an Age 65 MBP. |
|  | Unlike the RPBR, there is no survivor benefit in the event of a long-term disability. |
|  | When a policy has a Lifetime MBP and the insured is disabled after about age 45, the actual Lifetime MBP past age 65 is scaled down. The amount actually paid would be a decreased percentage of the Monthly Indemnity, depending on the actual age of disability. As the risk of disability increases as the client approaches age 65, the Lifetime Benefit is far less substantial than an Age 65/RPBR design. |

Retirement Protection Benefit Rider

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| Advantages | Disadvantages |
| With a Cost of Living Adjustment (COLA), this option will be less than half the cost of a Lifetime MBP. | In the event of a long-term disability that begins before about age 45 and extends well beyond age 65, the Lifetime MBP will provide more substantial benefits if the RPBR is a relatively small percentage of the policy's Monthly Indemnity. As the age of disability increases and/or the RPBR contributions are relatively small, the RPBR may not have enough time to build capital to produce a substantial lifetime income comparable to a Lifetime MBP, especially with COLA. |
| This rider does not affect the maximum benefit of Monthly Indemnity issued - it is supplemental to the Monthly Indemnity. |  |
| The benefits will be greater if a long-term disability ceases before age 65. |  |
| In the event of death following a long-term disability, the RPBR may provide a substantial benefit to surviving beneficiaries. |  |

# Case Study One - Conclusion

It is important to remind Jack that this coverage cannot be cancelled by the insurance company prior to age 65, even if he has claims; nor can the premiums be increased. He owns the policy, thus it can be maintained even if he changes employers. In the event of a permanent disability, the potential benefits could be several million dollars.

Remember that you are assisting clients in identifying a substantial financial risk and assisting them in determining how to efficiently and effectively protect themselves and dependents against the risk. It is important that you use numbers and assumptions that the clients agree to.

This analysis in the hypothetical case of Jack Driver may seem a bit tedious, but there are three primary reasons why a study of this analysis is important.

* First, by reviewing a detailed analysis, you "experience" the reality of what the nature, characteristics, and reasons for an income shortfall would be in a typical situation of a long-term disability. It should create a sense of confidence and conviction when discussing the need to insure this potentially very substantial financial risk.
* Also, it may be helpful to use these or similar worksheets when evaluating a potential need.
* Finally, a client may often have a very difficult time evaluating the amount of risk he or she faces unless presented with a graphic summary using agreed upon numbers. This assists the client in making a decision to insure with confidence and conviction.

# Segment 2 - Disability Risk Management for Professionals and Self-employed Without Employees or Partners - Part I

# Professionals such as physicians, attorneys, etc. are typically in an employee capacity, part of a professional practice that they own part or all of, or they may work alone with part-time or high-turnover employees. Likewise, many individuals own small businesses or work on a contract basis and have no employees.

# The concerns and needs, as well as the solutions, of this second group are identical to the first group of employees with one exception – they must also consider business overhead expenses that will continue for some period of time after a disability begins. Even a short-term disability that lasts only a few months can be financially devastating to a small business that relies on the professional or owner to generate revenue to cover overhead as well as income.

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| **Overview** | *Professional or Business Overhead Expense Insurance* can be obtained to provide coverage for the liability of overhead during a short-term or long-term disability. The summary below discusses this relatively simple and inexpensive insurance coverage.Click each topic to learn more about Professional or Business Overhead Expense Insurance. |
| Policy Structure | * **Elimination Period:** typically 30, 60 or 90 days * **Maximum Benefit Period:** Typically 12, 18 or 24 months (Note, however, that if monthly benefits are not completely used, most policies will carry over the unused portion to extend the maximum benefit period.) |
| Policy Mechanics | This is a "reimbursement" contract in the event of total or possibly partial disability. Eligible expenses are submitted monthly to the insurer and payment is made for full reimbursement up to the maximum monthly benefits provided by the policy. |
| Covered Expenses | As a general rule, think of covered expenses as any legitimate deductible business expense that would continue even if the professional or owner is disabled, such as:   * Office rent * Equipment rent/depreciation * Loan interest * Employee or professional/management replacement salary * Utilities/Telephone * Taxes on business property * Etc. |

# Case Study Two – Joplin Janice, M.D.

The following case study illustrates the supplemental need of professionals and self-employed *without* employees, and shows how this need can be addressed with Professional or Business Overhead Expense Insurance.

**Joplin’s Story**

You have been discussing the need for income replacement insurance with Joplin Janice, MD, a psychiatrist who has been in private practice for 20 years. She is 45, unmarried, and has no children.

You have determined that she has adequate income replacement disability insurance. You also know that she shares an office with five other therapists who all operate as separate practices, but they have a written office-sharing agreement. Upon review of the agreement, you realize that Dr. Janice has an obligation for her share of the office overhead (about $3,000 per month) in the event of a short-term or long-term disability. For a long-term or permanent disability, she retains the obligation until her office can be filled with another therapist or for twelve months, whichever comes first.

She also has some business expenses outside of the office-sharing arrangement, including an automobile lease that she uses to commute daily to visit patients at various hospitals.

Dr. Janice is concerned about these potential expenses, which she would not want to pay out of her personal funds or from her income replacement insurance if she were to become disabled.

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| |  |  | | --- | --- | | DocumentationIcon_32px | **Click the icon to view the solution.** | |
| Solution  The solution is straightforward. She decides to purchase a Professional Overhead Disability Expense policy with a maximum monthly benefit of $3,500, a 30-day Elimination Period, and a Maximum Benefit Period of 12 months. The premiums are deductible as a business expense and the benefits are taxable income (that will be offset by deductible expenses). Dr. Janice believes that if she were permanently disabled, her office space would be leased by another professional within 12 months. She believes that some of her expenses could be trimmed after a few months, and that the excess benefits could be applied to her car lease and any other incidental expenses, including professional assistance in transferring her patients.  Dr. Janice is delighted to refer you to the other four therapists in her office since it is in their mutual interest to have the office overhead liabilities insured in the event of disability. Dr. Janice also agrees that she would like additional life insurance to make sure that these types of liabilities are also covered in the event of her death prior to retirement. |

# Disability Risk Management for Professionals and Self-employed *Without* Employees or Partners - Part II - Case Study Three

In many cases, a young professional or business owner may have incurred debt to purchase, establish, or expand a business or professional practice. A long-term disability would not eliminate the debt that the disabled borrower would be unable to repay without earned income, thus putting both business and personal assets at risk. In addition, some lenders may require life and disability coverage to insure the debt and/or may offer better terms if the debt is secured by life and disability insurance.

The following case study illustrates such a need and introduces a potential solution.

Case Study Three - Disability Reducing Term Insurance

**Mr. Jones’ Needs**

Sam Jones, DMD, has worked in the office of Jim Baker, DMD, for two years. Dr. Baker has decided to retire and Dr. Jones wishes to purchase the practice. They agree on a price of $250,000. Dr. Jones finds a lender who will loan him $250,000 with terms of 9% payable in monthly installments over ten years. While he can afford to make these payments, Dr. Jones, as well as his creditor, is concerned about how to cover this liability in the event of his disability or death prior to the repayment of the loan.

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| **Solution**  A "disability reducing term insurance" policy is designed specifically to make a needed level of loan payments for up to the life of the loan in the event of a borrower's long-term disability. The policy's benefit payments are assigned to the lender. In this case, Dr. Jones could also purchase a $250,000 term life insurance policy that is assigned to the creditor for the loan balance. The assigned insurance coverages reduce the risk to the lender and to Dr. Jones. In addition, the lender may reduce the interest rate on the loan. The lower interest rate may more than cover the cost of the insurance. |

A Note about Working with Young Professionals

Many young professionals, including physicians, dentists, attorneys, CPAs, veterinarians, etc., will have minimal income but a substantial potential for earning future income. Many insurance companies will issue coverage to individuals, ranging from professional students to first-year working professionals, regardless of their current earned income level. Monthly indemnity benefits may range from $1,000 to $4,500 per month, depending on profession and professional status. In addition, step-rated or graded premiums may allow a young professional to acquire substantial coverage at very low initial rates and "lock-in" guaranteed rates at a young and often "healthy" rate.

A financial professional may do a young professional a significant service by assisting him or her in acquiring this coverage at a young age. This will also allow the financial professional to establish a long-term relationship with a client who has substantial future potential for wealth management services.

# Segment 3 - Disability Risk Management for Professionals and Self-Employed With Employees and/or Partners

In addition to the needs previously discussed, the business owner or professional with employees has an additional need: addressing the risk of disability of one or more employees. A particularly difficult issue for an owner of a business or professional practice is to determine how long and how much to pay an employee in the event of the employee's disability. This situation can be particularly acute when a long-term employee is disabled and earns substantial compensation. Such needs can be addressed through Qualified Sick-Pay or Salary Continuation Plans.

### Qualified Sick-Pay or Salary Continuation Plans \*

A formal Qualified Sick-Pay Plan or Salary Continuation Plan funded by disability income policies can resolve the following potential problems and risks before they occur:

* The potentially very substantial liability or benefit is assumed by an insurance company.
* All covered employees feel a greater sense of security.
* The employer is not burdened with subjective decisions regarding a disability, e.g., when does disability begin, how much to pay, when does the disability end, how to deal with recovery, relapse, or rehabilitation, etc.
* Employees can share in the cost of coverage.
* The premium cost of even a small group will likely be discounted and underwriting may be liberalized.
* No adverse income tax consequences will result that can occur without a Qualified Sick-Pay Plan.
* It provides flexibility in that the details of coverage can vary per class of employees.

*\*It is beyond the scope of this course to provide a detailed discussion of corporate Qualified Sick-Pay and Salary Continuation Plans (two commonly used names for the same plan) that provide disability benefits to employees. However, if a plan of some type is not in place for a specified class of employees, communicated to employees, and enforceable by employees, any disability payments to employees or owner-employees of the business are not deductible to the business and taxable income to the employee.*

# Case Study Four - A Qualified Sick-Pay or Salary Continuation Plan

The following case study illustrates the use of a Qualified Sick Pay or Salary Continuation Plan.

**Smith and Weeks**

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| Smith and Weeks is a small law firm that specializes in litigation. Sam Smith and Wally Weeks practice as equal law partners. They have two associate attorneys who are paid $60,000 per year and three staff members who are paid an average of $36,000 per year. The two partners have variable incomes from year to year, but their net annual incomes average about $500,000. The two partners are primarily interested in disability coverage for themselves, but they recognize the benefits of providing coverages for their associates and staff. | * 48% of small businesses fail due to a disability in the business * 70% of small businesses DO NOT provide disability protection for employees   *Source: LIMRA International* |

The associates seem to turn over about every two to three years. Staff turns over a little more slowly. Because of the turnover, the partners want to minimize the cost of coverage for the employees.

Both partners are in their early forties. Associates and staff are all under forty. Currently all of the employees are healthy.

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| **Solution**  The optimal plan of quality would be to insure all members of the firm with individual noncancellable and guaranteed renewable policies. However, the partners want to minimize cost and the turnover would cause increased administration and possibly greater underwriting difficulties as employees turn over. Therefore, the financial professional proposes the following levels of coverage to fund a Qualified Sick-Pay Plan:  Level 1: Add group LTD coverage with their existing group medical insurance carrier. The Elimination Period would typically be 90 or 180 days. This coverage would provide 60% of compensation up to $3,000 of monthly earnings (i.e., a maximum monthly benefit of $1,800) for all employees. They may wish to add group STD for the five employees, which would provide benefits with a shorter Elimination Period, with a Maximum Benefit Period of 90 to 180 days.  Level 2: Purchase bar association coverage for the four attorneys for an additional monthly benefit of $1,500. This coverage is portable for the associates and provides them with up to $3,300 as a total monthly benefit.  Level 3: Purchase individual "noncancellable" and guaranteed renewable policies on the attorneys to the maximum that underwriters will allow, with due consideration to their personal financial statements. They will probably be able to acquire at least $10,000 of monthly benefit plus a Retirement Protection Benefit Rider. The office manager, who is paid $60,000 per year, would also receive an individual policy for $1,200 of monthly indemnity to assure full coverage at 60% of earnings.  **Click here to view the additional concerns** |

Three Additional Concerns of Disability Risk Management

1. Depending on the nature of the practice, the partners may be interested in, and may be able to acquire, Professional Disability Overhead Expense insurance to cover some overhead expenses in the event a key partner is disabled for several months or long-term.

2. In addition, the two partners should address the need to establish a buy-sell agreement that should address the prudence of funding a buy-out in the event of a partner's long-term disability. \*

3. Finally, the small business will often borrow substantial sums to capitalize the start or expansion of the business. These loans often require personal guarantees for the owners, which put their personal income and assets at risk. Disability Reducing Term Insurance can mitigate the risk of jeopardizing business and personal assets to guarantee payment of loans, salary or performance guarantees, and purchase agreements. \*

Note that in this case study, as opposed to Jack Driver in Case Study One, tailoring coverage to each individual is not a primary driver or objective. The employers want coverage for themselves, but they also want to provide benefits for their employees as well as "hiring" insurance companies as intermediaries to resolve a difficult situation if an employee becomes disabled.

*\* These business risks are discussed in more detail in our Business Continuation and Business Succession courses.*

# Multi-Life Disability Insurance

# A substantial opportunity to leverage sales of individual disability income policies in "Multi-Life" cases exists in virtually any institution that employs large numbers of employees that include higher income executives or professionals. A multi-life case is defined as a sale of individual disability income policies to a group of employer-selected employees. Premiums are typically either paid by the employer, paid by the employee, or by both the employer and the employee. Purchasing individual policies as a group can provide substantial benefits to employers, employee executives and financial professionals. There are several factors that are primary "drivers" for multi-life disability sales:

**Multi-Life Sale Drivers**

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| Multi-Life Sale Drivers Presented by **J. W. Burriss**   |  |  | | --- | --- | | A graduate of Emory University, Woody Burriss is a CFP® Professional with more than 35 years of experience in the Financial Services industry. Additionally, he has earned the Chartered Life Underwriter, Chartered Financial Consultant, and Chartered Advisor for Senior Living designations from The American College. |  | | |
| A typical group long-term disability plan discriminates against higher income executives. A group plan will usually provide a benefit of 50% to 70% of salary with a maximum income benefit that is relatively modest for the higher paid executive. For example, a maximum benefit of $5,000 per month is not a substantive benefit to an executive earning $500,000 a year. |  |
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| Group LTD benefits are usually employer-paid or paid for pre-tax by the employee and are thus, taxable income. As illustrated in the chart, an executive receiving a taxable disability of $6,000 per month could receive substantially less in the gross monthly benefit after income taxes. For an executive earning $40,000 per month, this benefit replaces only about 11% of compensation. |  |
|  |  |
| An LTD plan typically covers salary and commissions but does not cover compensation such as bonuses, deferred compensation, stock options, and contributions to retirement plans. As this chart illustrates, these additional sources of compensation can make up a significant portion of an executives actual earnings. In this example, the group LTD only covers 12.5% of the executive’s total compensation. After a presumed income tax reduction of benefits at a 28% rate, the net monthly benefit of $4,320 only represents 9% of total compensation. This represents a reverse discrimination of benefits to the higher paid employees. |  |
|  | |

Statistically, over 90% of individual disability income multi-life cases are sold to *supplement* existing LTD plans. These custom-designed programs provide the following advantages to the employer, executives and financial professional who sell or introduce a multi-life specialist to the prospect.

**Click each heading to learn more.**

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| **Multi-Life Disability Insurance Plan Advantages to the Employer** |
| * + - It provides flexibility. The details of coverage can vary per class of employees.     - Resolves the issue of "reverse discrimination" of disability benefits provided to higher-paid employees.     - It provides cost-effective, tailored, high quality coverage for key employees.     - Since LTD plan pricing is based on the insurer’s experience with claims, costs can vary significantly from year to year. Multi-life plans funded with individual noncancellable and guaranteed renewable contracts have predictable/guaranteed costs.     - Executives are more willing to participate in the cost of a plan that is of optimal quality, substantially discounted, easy to acquire, and portable.     - The employer is not burdened with subjective decisions regarding a disability, e.g., when does disability begin, how much to pay, when does the disability end, how to deal with recovery, relapse, or rehabilitation, etc. |
| **Multi-Life Disability Insurance Plan Advantages to the Employees** |
| * + - Rate discounts are typically as high as 35%.     - Allows a higher-paid employee to insure a higher percentage of their total compensation.     - Streamlined or guaranteed issue underwriting.     - Portability of coverage. The executive is the owner of the policy.     - Premiums are conveniently paid via payroll deduction and/or employer paid.     - Superior contract provisions.     - Benefits are not offset by social insurance, LTD, or pension benefits. |
| **Multi-Life Disability Insurance Plan Advantages to the Financial Professional** |
| * + - Leverage of sales efforts. Similar to a sale of a 401(k) Plan, one sale to a company can result in a "package" of many individual sales.     - New potential base of multiple clients.     - Multi-life sales specialists are typically available to assist with sales and service in this specialized market; the financial representative can often just provide the introduction and benefit from the sale.     - Insurance companies or specialized firms typically provide the substantial administrative services required for these cases. |

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| **Who are Ideal Prospects for a Multi-Life Case?** |
| * + - Minimum requirements will vary by carrier, but typically there must be at least 20 participants. More lives equals more liberal underwriting, better benefits, and larger discounts. (Cases of down to 2 or 3 lives will usually be given 10 - 15% discounts with full underwriting.)     - High percentage of white-collar executives. This is the group subject to reverse discrimination of disability benefits.     - Employer-paid group LTD in place (employer is already sold on need to provide Disability Income Insurance). |

# The Disability Insurance Sales Process: Understand and Engage

Having discussed the needs and solutions of the three key client segments, let’s now turn our attention to the disability insurance sales process.

The disability insurance sales process can be broken into these steps. **Click each step to learn more.**

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| **1. UNDERSTAND** | Fully understand the client’s situation:  Triggers to look for:   * + - A primary income earner in a family (represents greater risk to the family if that sole income earner became disabled)     - Clients who rely primarily on current earned income     - Clients with increasing income potential (who might lose out on that potential if suffering a disability)     - Clients in professional occupations, high income executives or business owners   Incremental Profiling requirements:   * + - What types of disability coverage do you have under your corporate benefits plan?     - Have you, or do you know anyone who has experienced any significant long-term impairment or disability? |
| **2. ENGAGE** | Engage the client on the top 3 needs:  1. No Disability Income Coverage  **High-Impact question to ask:**  *How are you protecting yourself and/or your family against the potential loss of your earned income?*  2. Too little Disability Income protection  **High-Impact question to ask:**  *How might you fill the gap between your current compensation and your current disability insurance coverage should you become disabled?*  3. Inappropriate Policy Structure  **High-Impact question to ask:**  How have you reviewed your disability income insurance coverage to ensure it addresses the unique needs of your current situation? |

# Objections You Will Likely Encounter

As you engage clients regarding their need for disability income insurance, you are likely to encounter objections. Objections are part of our natural resistance to change. However, objections can be your friends because they illuminate what stands in the way of a client making a decision. The following are three common objections you will encounter, with guidance for responding to each.

**Click each objection to learn more.**

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| **Objection #1: "I already have disability insurance through my employer** |
| Many companies offer disability income insurance as an employee benefit. It frequently covers approximately 50%-60% of an employee's salary and is often available at no cost because the company pays all premiums. Because the premiums are paid directly by the employer, the benefits paid are fully taxable at the federal and state levels.  The coverage for such group policies typically does not cover bonuses, deferred compensation, stock options or retirement plan contributions, which for many affluent clients can be a significant portion of their compensation. In addition, group LTD typically has a long elimination period.  **Example**  Assume your client earns $150,000 a year. The client needs to analyze if he/she can afford to live on the following benefit.  **Pre-Disability Gross Monthly Income $12,500**.00   * Group disability income insurance benefit   (50% of salary) $6,250.00   * Less income tax (at 33% bracket) ($2,062.50) * Net after-tax income $4,187.50   **Percentage of gross monthly income 33.5%**  Clearly, disability income insurance provided by an employer may not offer a sufficient benefit to maintain a client's lifestyle in the event of disability. In addition, should a client change jobs, he/she typically cannot transfer the coverage. Moreover, company-sponsored policies are often more strict in their definitions of disability than individual policies and, therefore, typically issue benefits less frequently under the same circumstances. |
| **Objection #2: "I can rely on Social Security for Disability coverage."** |
| Another common misconception is that disability benefits offered by Social Security will provide clients and their families with adequate protection. For affluent clients, Social Security typically provides a small portion of income replacement and requires a waiting period of six months before income payments begin. In addition, benefits may be up to 85% income taxable.  To qualify for benefits under Social Security, you must meet several very restrictive criteria. As stated on the Social Security Administration website: "Social Security pays benefits to people who cannot work because they have a medical condition that is expected to last at least one year or result in death. Federal law requires this very strict definition of disability."  As you can see, a client who relies on Social Security Disability Income is taking additional risk should they become disabled. |
| **Objection #3: "If I become disabled, I can make a claim under Workers' Compensation** |
| Workers compensation is only available when someone is disabled on the job. If a disability is not work-related, no benefits will be paid under workers compensation. Coverage and benefits from Worker's Compensation varies widely from state to state and often only provides nominal payments that are received for a short period of time. |

In summary, while each of these might provide some level of protection for a client, careful consideration must be made to address the realities of the scope of coverage and benefits available under these alternatives. Especially in cases of working, affluent clients, you should engage the client on the realities of their needs and the coverages they will want to protect their financial situation.

# Review Exercise

**Review your knowledge of disability income insurance by answering the following questions.**

1. **Income replacement resources that are often available to affluent clients in the event of a long-term disability include all of the following EXCEPT:**
   * Social Security

Incorrect. Social Security disability benefits are typically available to most American workers.

* + LTD group or professional association group coverages

Incorrect. These group coverages are often available to employees, professionals, and possibly business owners.

* + - State disability insurance

Correct. Only five states (CA, NY, NJ, TI and HI) provide disability benefits when workmen's compensation does not apply.

1. If an individual income insurance policy is "guaranteed renewable," this means that:
   * + The policy cannot be cancelled.

Correct.

* + The premiums cannot be changed.

Incorrect. If the policy is "noncancellable," the premiums cannot be changed.

* + The policy cannot be cancelled and the premiums cannot be changed.

Incorrect. To meet these criteria, the policy must be "guaranteed renewable and noncancellable."

1. All of the following are usual limitations of group LTD EXCEPT:
   * + The group coverage usually provides monthly benefits up to about 60% of salary, bonuses, deferred compensation, stock options, qualified plan contributions, etc.

Correct. Group coverage usually provides monthly benefits up to about 60% of salary only.

* + Group LTD is typically payable for non-occupational benefits only or benefits are reduced by workmen's compensation payments.

Incorrect. This is a typical limitation of group LTD.

* + Premiums are not guaranteed and the carrier can cancel the coverage.

Incorrect. This is a typical limitation of group LTD.

* + The definitions and provisions of group LTD are invariably more restrictive when compared to a quality individual disability income contract.

Incorrect. This is a typical limitation of group LTD.

1. A professional is concerned about disability protection if unable to work his or her chosen profession for which he or she was specifically trained. Which definition of disability would best serve the professional?

* Any Occ

Incorrect. With this definition, the person could be unable to perform the job for which they were trained but be unable to receive benefits because the person could still do other jobs. The fact that the person could still perform other jobs would likely result in a substantial loss of income if the insured could no longer perform the job of his or her chosen career (i.e., a neurosurgeon becoming a general practitioner or professor).

* Own Occ

Correct. The fact that the person could still perform other jobs would likely result in a substantial loss of income if the insured could no longer perform the job of his or her chosen career (i.e., a neurosurgeon becoming a general practitioner or professor).

1. The general rule is that when an individual pays premiums on an after-tax basis, then the disability benefits are:

* Taxable

Incorrect. Try again.

* Taxable once cumulative benefits exceed premiums paid

Incorrect. Try again.

* Tax-exempt

Correct.

1. The “elimination period” is:

* The time between the occurrence of disability and the day disability benefits begin to accrue.

Correct.

* The time between application for disability insurance and the beginning of coverage.

Incorrect. Try again.

* The time period after which disability benefit payments cease.

Incorrect. Try again.

1. The maximum duration of benefit payments with a long-term disability policy is typically:

* 20 Years

Incorrect. Try again.

* 40 Years

Incorrect. Try again.

* Until age 59½

Incorrect. Try again.

* Until age 65 or Lifetime

Correct.

1. Social Security Disability Income (SSDI) benefits of affluent clients are typically taxable.

* True

Correct. Up to 85% of SSDI benefits are taxable if the recipient’s income exceeds certain thresholds, which will typically occur with affluent clients.

* False

Incorrect. Up to 85% of SSDI benefits are taxable if the recipient’s income exceeds certain thresholds, which will typically occur with affluent clients.

1. All of the following are characteristics of Business Overhead Expense insurance EXCEPT?
   * The premiums are deductible.

Incorrect. This is a characteristic of BOE.

* + The benefits are taxable.

Incorrect. This is a characteristic of BOE.

* + The Maximum Benefit Period is usually no more than 24 months.

Incorrect. This is a characteristic of BOE.

* + - In the event of the insured's disability, the policy pays the full Monthly Indemnity amount regardless of the amount of insurable expenses incurred.

Correct. The policy would reimburse the policy owner monthly for the lesser of submitted qualified overhead expenses or the maximum monthly benefit.

* + The maximum benefit period can be extended to the degree monthly benefits have not been fully utilized.

Incorrect. This is a characteristic of BOE.

# Conclusion

This concludes this course on Disability Income Insurance. To provide focus for your learning and retention of this information, the following topics should not only be familiar to you, you should also be able to define, explain and articulate the concepts with a client. This will ensure you are prepared and confident in discussing disability insurance with your clients.

**Disability Income Insurance Course Summary**

* Define the risk of disability
* What resources are available to replace earned income in the event of disability? Under what conditions are the resources available? Will the resources provide substantive benefits for affluent clients?
* Important disability income policy provisions and structures
  + Guaranteed Renewable
  + Noncancellable
  + Noncancellable and Guaranteed Renewable
  + Expiration Date
  + Indemnity Amount
  + Elimination Period
  + Maximum Benefit Period
  + Definitions of Disability
  + Recurrent Disability
  + Waiver of Premium
  + Preexisting Conditions
  + Exclusions
  + Rehabilitation Benefit
* Important Optional Contract Provisions
  + Cost of Living Adjustments Rider (COLA)
  + Residual Disability Benefit Rider
  + Guaranteed Insurability Options Rider
  + Retirement Protection Benefit Rider
  + Catastrophic Disability Benefit Rider
* Taxation of Disability Benefits
* Disability Income Underwriting
* The 4-Step Process to Resolve the Financial Risk of Long-term Disability
  + Determine the need for post-disability income.
  + Determine the current post-disability sources of income.
  + Calculate the amount and timing of income shortfalls in the event of long-term disability.
  + Tailor the design of disability coverage to supplement other income-producing sources.
* Think of potential disability prospects as in one of three categories because their risks and motivations differ:
  + Executive Employees
  + Professionals and Self-employed *Without* Employees or Partners

# Professionals and Self-employed *With* Employees and/or Partners

* Consider developing a multi-life market.
* Understand and develop a process of selling disability in your practice.
* Anticipate and be ready to deal with typical objections you will encounter.

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