

DISABILITY INSURANCE

Disability insurance is often an overlooked component of an individual's risk management portfolio. If you are permanently injured or develop a chronic illness that renders you unable to work, disability insurance helps replace a portion of your lost income. Your income is the foundation of your lifestyle and the most important asset during your working years. Disability insurance serves as "paycheck protection" for times when an individual is unable to earn an income over both the short and long term.

DEFINITION OF DISABILITY

If you get into an accident that restricts your ability to work, you may consider yourself disabled. However, disability insurance policies have specific definitions of disability that must be met in order to qualify for benefits. Generally, disability claims fall into two broad categories: own occupation and any occupation. Below you will find an explanation of several disability policy definitions.

- ▶ **Any Occupation** – An any occupation policy defines disability as the insured's inability to engage in any gainful occupation or employment that the insured is reasonably suited for based on education, work experience, and other individualized factors. This is the most general definition of disability and the most difficult to qualify for, making the policy less expensive.
- ▶ **Own Occupation** – To be considered totally disabled, an own occupation policy requires that the insured be unable to perform the material and substantial duties of their own occupation—even if they can still perform some other occupation. This allows the individual to receive benefits and find alternate employment. This type of policy provides the most favorable protection and is also the most expensive.
- ▶ **Specialty Own Occupation** – Typically, these policies use the own occupation definition of disability with an added layer of specialty language built into the contract. Under this policy, the insured may limit their occupation to the material and substantial duties of a single specialty (medicine, dentistry, law, etc.) which will be considered their occupation for determining disability.
 - For example: if an orthopedic surgeon develops a hand tremor and is unable to perform surgery, they would be considered disabled and receive benefits because they could no longer perform the material and substantial duties of their job. However, they would still be permitted to work and earn an income by meeting and consulting with patients.
- ▶ **Modified Any Occupation** – This definition is commonly used for employer group disability policies and is considered a hybrid between any occupation and own occupation. This split definition defines disability as the inability to engage in any reasonable occupation for which the insured may be suited for based on education, experience, or for which they could easily become qualified. Similar to any occupation coverage, this definition leaves the determination of whether or not you are disabled up to the insurance company. Policies with this definition of disability should be considered supplemental insurance to a more protective disability insurance policy.
 - For example: if you are an attorney who can no longer practice, but could teach law classes, your benefits will likely not be payable or at the very least your coverage will be limited.

- ▶ **Social Security Definition** – There is also the Social Security definition of disability, which is even more restrictive than that of a private disability insurance policy. To be awarded Social Security disability benefits, an individual must suffer from a mental or physical impairment that prevents them from engaging in any substantial gainful employment. Furthermore, the disability generally must have lasted for 5 months and be expected to last a total of at least 12 months or result in the death of the individual. We do not recommend anyone relying solely on receiving Social Security disability benefits.

CONTINUATION PROVISIONS

Another important factor to consider before purchasing a disability insurance policy is whether the policy may be renewed and under what terms. Insurers may offer several different renewal options. Accordingly, a policy may be purchased with any of the three following continuation provisions.

- ▶ **Non-Cancelable** – A non-cancelable insurance policy provides the greatest amount of security for the insured at the greatest premium cost. With this provision, the insurance company guarantees the renewal of the policy for a stated period without any increase in future premiums.
- ▶ **Guaranteed Renewable** – Under this policy, the right to renew is guaranteed, but the insurance company is permitted to increase the premium. A premium increase, however, would affect an entire class of policy holders, not individuals on a case-by-case basis. Additionally, if a policy is guaranteed renewable, the insurance company is required to renew for a specific period (usually age 65) regardless of changes to the health of the insured.
- ▶ **Conditionally Renewable** – A policy with a conditionally renewable provision allows the insurance company to cancel and not renew policy benefits—an unfriendly option for the policyholder. Additionally, the insurer may increase the premium on the policy if it allows the policy to be renewed.

ELIMINATION PERIOD

The elimination or waiting period is the timeframe the insured must wait after becoming disabled before they begin to receive benefits. A longer elimination period will result in a lower overall disability policy premium. Typical elimination periods are 30, 60, 90 and 180 days, with 90 days being the most common. This means the insured will need to cover at least part of the financial loss and self-fund their living expenses until benefits begin. We recommend setting aside at least 3 months of living expenses in a savings account or consider purchasing short-term disability coverage to bridge this income gap until long-term disability benefits are received.

TAXATION OF BENEFITS

Disability benefit payments may be taxable depending on who paid the annual premium and if the premiums were paid with pre-tax or after-tax dollars. Premiums paid by an employer for coverage provided to employees will cause any benefits received by the employee to be fully taxable. This is also the result if disability premiums are paid through a flexible spending account (FSA) with pre-tax dollars. However, if premiums for a personally owned disability policy are paid with after-tax dollars, any benefits received would be tax-free. In the event that you are both the employer and the employee, there is a special taxation rule and we recommend reaching out to your tax professional for more detail. This generally applies to partners or shareholders of an organization.

WHAT IS THE APPROPRIATE AMOUNT OF COVERAGE?

When evaluating disability coverage it is important to remember that disability insurance is for income replacement. Therefore, the benefit amount should be appropriate relative to your compensation, the number of years you expect to work, and cover both sickness and accidents. Certain policies will even provide for the lost retirement plan contributions a worker would have made if he/she had been working. Likewise, the definition of disability should be prudent to the worker—providing income protection if they are unable to perform their job. Lastly, when choosing a policy, balancing benefits and cost is crucial. The cost of disability insurance varies depending on the insured's occupation, age, and sex, as well as the benefit amount, length of coverage, and elimination period.

REVIEWING OR CHANGING COVERAGE

If you are concerned about your risk or have existing coverage and want to determine if it's appropriate, we can facilitate an evaluation. Aldrich Wealth does not sell insurance; we simply guide you through the evaluation and education process. We do, however, have relationships with credible insurance brokers in our geographic markets. Brokers are able to place policies with many different companies, allowing them to find the most suitable insurance company and product for your specific needs. Aldrich Wealth does not receive any payment, commission or revenue sharing for the policies sold by these brokers. If you do not already have a trusted insurance agent or broker we would be happy to introduce you to a local professional.

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