FINANCIAL PLANNING PERSPECTIVES

Most Americans Need to Prepare for Financial Impact of Disability

Most Americans are not prepared to deal with the possibility of becoming disabled due to sickness or injury and leaving the workforce for an extended period of time. In fact, more than half of U.S. adults said they would be unable to pay their bills or meet expenses if they became disabled and could not work for a year or longer, according to a recent National Association of Insurance Commissioners (NAIC) study.

And the possibility of becoming disabled and unable to return to work is quite high for many Americans. One-fifth of this nation's population will actually become disabled for a year or more before reaching age 65, according to the Social Security Administration (SSA). The most common causes of long-term disability are heart disease, back injuries and cancer, followed by stress, anxiety and depression according to the U.S. Department of Education and the National Institute on Disability and Rehabilitation. By contrast, slightly more than one in 10 Americans surveyed by NAIC say that it is somewhat or very likely they would become disabled and unable to work.

These findings, according to the NAIC and financial planners, underscore the need for long-term disability insurance. Nearly half of Americans do have long-term disability insurance, but much of it is employer provided rather than individually purchased. And that means, according to the NAIC, that a significant number of people could lose their coverage in the event of a change in employment status.

So what then is disability insurance? Disability insurance is insurance designed to protect people financially by replacing some of their lost income. The two main types of disability insurance are short-term and long-term. Short-term disability insurance, which some states require employers to carry for their employees, replaces a portion of the policyholder's salary for a short-period - typically from three to six months following a disability, according to NAIC.

Long-term disability insurance coverage typically begins after the policyholder is disabled and unable to work for at least six months, according to NAIC. The coverage period can extend for a specific number of years or until the policyholder retires or turns 65, depending on the policy selected and the type of disability.

For insurance purposes, disability is typically defined as the inability to work due to an illness or injury, according to the NAIC. Of note, the insurer’s definition of disability is a key factor in how one should shop for a policy.

So what should Americans consider when evaluating disability insurance? Below are tips from the NAIC and financial planners:

First, determine how much money you'll need to cover all of your critical expenses (such as housing, food, utilities and transportation) should you become disabled. Generally, you should consider buying long-term disability insurance that covers about 60 percent of your annual income.

Those who have a pre-existing health condition, such as a back problem or heart ailment, may have to purchase a policy with an “exclusion” rider. If the disabled person can provide documentation that the pre-existing condition has improved, the insurer may remove the rider after a specified time period.

Your occupation is crucial in obtaining coverage. If possible, depending on your occupation, you want to get an “own occupation” definition.

Typically, younger, healthier individuals pay lower disability premiums. If you purchase disability insurance at a young age and can get a "non-cancelable" policy, your coverage can't be cancelled and the premiums can't be raised once your medical exam has been approved and your policy issued, assuming your premiums are paid on time. Also, consider buying an option to increase your coverage without additional medical underwriting if you’re young or if you expect your earning power to increase.

While a "guaranteed renewable" policy can't be cancelled, its premiums may be increased on the anniversary of the policy or when stated in the policy.

Most long-term disability insurance stipulates a waiting period, such as 90 days (the most common), 180 days or one year before benefits are paid. Disability insurance also stipulates a benefit period; for example, one year, two years, five years or until age 65.

Most companies offer policies that are offset by any benefits paid from Social Security. While receiving a benefit from Social Security is not likely, this is a way to reduce the cost of the disability policy.

The federal government does offer long-term disability benefits through the Social Security Administration under the following specific circumstances: "…if you cannot do work that you did before and we decide that you cannot adjust to other work because of your medical condition(s). Your disability must also last or be expected to last for at least one year or to result in death." And you must be disabled for at least 5 months. SSA disability is an “any” occupation definition of disability.

Before purchasing any disability policy, consumers should check with their state insurance department to make sure the company offering the coverage is legitimate, solvent and authorized to do business in their state. They should also evaluate the financial strength of the company and whether there are any complaints filed about their claims-handling experience.

March 2007 — This column is produced by the Financial Planning Association, the membership organization for the financial planning community, and is provided by Marnie Aznar, MBA, CFP®, a local member of FPA