

**Disability Insurance:  
A sound financial foundation  
includes income protection**

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## **Introduction**

Disability insurance helps ensure that a substantial portion of an individual's income – typically from 50-70 percent – would continue if he or she were to become ill or injured and unable to work for several weeks, months or even years. Benefit payments are made directly to the individual, usually once a week or once a month, providing money to help pay ongoing living expenses and keep retirement, education and other savings intact.

In today's economy, two-income households frequently rely on both incomes to maintain a family's lifestyle and keep up with a host of family financial commitments, including rental or home mortgage payments, car loans and insurance, utilities, food, health insurance, tuition, retirement savings and other expenses. Medical expenses related to a disability add to the ongoing bills.

Should a family lose one breadwinner's paycheck due to a disabling injury or illness, it likely would be a struggle to pay those expenses. And if a sole breadwinner loses the ability to work, even for a few weeks or months, savings (if available) could be quickly depleted and it could be difficult, if not impossible, to continue a lifestyle without support from close friends or family.

A typical employer-provided disability insurance plan replaces approximately 50-60 percent of pre-disability income. Depending on circumstances and the maximum amount payable, that may not be enough to maintain an individual's or family's current lifestyle. If no employer plan is available or is not sufficient by itself, long-term disability insurance obtained privately may help fill that potential income gap by replacing a significant portion of an individual's salary.

### **An important financial safety net**

Unfortunately, the risk of becoming disabled is significant. According to the most recent statistics from the National Safety Council, there are 3,000 disabling injuries every hour during the year.<sup>1</sup> And almost one in three women and one in four men in the U.S. will suffer a disability before retiring.<sup>2</sup>

The Life and Health Insurance Foundation for Education, a non-profit organization providing insurance information to the public, reports that one American worker in five can expect to be disabled for one year or more before retirement, and one in seven can expect to be disabled for five or more years.<sup>3</sup>

Such a disability, the foundation notes, can have far-reaching financial consequences, with a lengthy disability substantially impacting lifetime earnings:

*A 25-year-old worker earning \$50,000 a year who suffers a permanent disability could lose \$3.8 million in future earnings.*<sup>4</sup>

Lack of proper disability income coverage can create a serious financial hardship for an individual or a family, potentially putting a family's lifestyle and even their home ownership at risk:

- Disabilities have caused nearly half of all mortgage foreclosures and a significant number of personal bankruptcies.<sup>5</sup>
- The U.S. Department of Housing and Urban Development ranks illness and injury among the top four financial problems that can contribute to the loss of a home.<sup>6</sup>

The American Council of Life Insurers notes that a serious illness or injury can jeopardize a person's lifestyle and long-term savings, and outlines some of the benefits of disability income insurance:

*Disability income insurance helps you pay living expenses while you're unable to work. It offers paycheck protection – providing cash directly to you for spending on a mortgage or rent, groceries, utility bills, car payments, or whatever else you choose.*

*With disability income insurance, you can avoid depleting the savings you may have accumulated for your children's education or retirement.*<sup>7</sup>

<sup>1</sup> Source: *Injury Facts*®, 2009 Edition, National Safety Council®

<sup>2,3,4,5</sup> Source: *What you need to know about disability insurance*, Life and Health Insurance Foundation for Education, 2008

<sup>6</sup> Source: *Help for Homeowners Facing the Loss of Their Home*, U.S. Department of Housing and Urban Development, www.hud.gov, 04/2009

<sup>7</sup> Source: *Disability Income Insurance: Protection for the Unexpected*, American Council of Life Insurers, www.acli.com, 04/2009

### **Many are not eligible for Social Security or workers' compensation benefits**

In its most recent annual publication, *2009 Injury Facts*®, the National Safety Council reported that 12.9 million working Americans suffered a disabling injury in the year 2007. More than two-thirds of those injured – some 9.4 million people – were ineligible for workers' compensation because their injuries occurred off the job.<sup>8</sup>

Disability insurance through an employer-provided plan or through a private plan will typically pay benefits whether or not an injury is work-related. State-administered workers' compensation programs, however, only pay benefits to workers who become disabled due to an illness or accident suffered on the job. Payment, benefit levels and length of coverage vary widely by state.

The federal Social Security insurance program provides modest benefits to people with long-term disabilities who are unable to work. The average monthly benefit for disabled workers is \$1,004.<sup>9</sup> Benefits are based on salary and how long an individual has worked and contributed to the Social Security system. Qualification guidelines are strict. To qualify for Social Security benefits, a person must meet all of the following conditions:<sup>10</sup>

- Be disabled for five full calendar months.
- Have a disability that is expected to last at least 12 months or end in death.
- Be unable to be employed in any occupation, not just your own occupation at the time the disability began.

### **Types of disability insurance**

Disability insurance policies may be offered by employers or purchased individually through an insurance agent or broker, or through an association or affinity group affiliation. Some companies offer a core disability plan, and employees have the option of purchasing an additional amount of short- or long-term disability protection on a voluntary (employee-paid) basis. Long-term disability begins after short-term coverage ends and typically helps replace income for a period of two to five years or more, often up to age 65 or retirement age, or until you are able to return to work. There are also disability insurance plans designed to protect a business and help ensure business continuation.

### **Employer-provided plans**

The U.S. Bureau of Labor Statistics reports that 39 percent of all workers in private industry are covered by short-term disability income insurance, and 30 percent are covered by long-term disability income insurance.<sup>11</sup>

<sup>8</sup> Source: *Injury Facts*®, 2009 Edition, National Safety Council®

<sup>9</sup> Source: *Annual Statistical Supplement, 2008*, U.S. Social Security Administration, [www.socialsecurity.gov](http://www.socialsecurity.gov)

<sup>10</sup> Source: *Disability Planner*, Social Security Administration, [www.ssa.gov](http://www.ssa.gov), 04/2009

<sup>11</sup> Source: *Life Insurers Fact Book 2008*, American Council of Life Insurers

While about 90 percent of firms with 500 or more employees offer long-term disability insurance as a voluntary benefit, access to long-term disability insurance is relatively uncommon at small companies. According to a 2009 report from LIMRA International, only 26 percent of employees at firms with 10 to 19 employees – and just over half of the employees at firms with 20 to 99 employees – purchase the long-term disability plans offered by their employers,<sup>12</sup> leaving many workers uninsured.

Some individuals may face a gap in their income protection needs that can best be filled with a personal policy purchased as a benefit of membership in an organization or association.

### **Personal coverage purchased individually or through an association**

An individual disability insurance policy can be purchased through an agent, broker, association or alumni affiliation or through an employee-paid program that may be offered by an employer. Individual disability policies usually cover both occupational and non-occupational sicknesses and injuries and are designed to replace income through the working years.

There are some advantages to purchasing an individual long-term disability policy:

- Typically, benefits are not subject to income tax if the policyholder pays the premiums in full.<sup>13</sup>
- You will be covered whether you are injured on or off the job.
- Coverage is portable – you can take it with you if you change jobs.

Self-employed people and medical and legal professionals often purchase individual disability insurance policies. In addition, those whose employers provide only basic coverage may also supplement that coverage with an individual policy.

Individual disability policies typically require that a person provide a medical history and undergo a medical exam. Depending on the plan and the amount of coverage applied for, the exam may entail a blood and urine analysis or a more thorough exam from a medical doctor. Underwriting also typically considers a person's occupation in determining risk.

### **Business coverage**

There are a variety of disability coverages for a business owner to consider. They include key person disability insurance, which replaces lost income when the business owner or other key contributor is unable to work. Depending on the policy, benefits may be paid to an individual as salary continuation or directly to the business. Business overhead expense insurance helps cover overhead expenses, including salaries, should the owner become disabled.

<sup>12</sup> Source: "A Subtle Shift: Examining Employee Benefits in the Midst of Economic Uncertainty," LIMRA International, 2009

<sup>13</sup> Source: *Life Insurers Fact Book 2008*, American Council of Life Insurers

### **What to look for in a plan**

When analyzing a potential disability income plan, the first step is to evaluate your current resources, including savings and eligibility for other disability benefits from an employer, a private plan, the government or other program, such as workers' compensation insurance or Social Security. Unless such resources and programs replace a sufficient amount of your usual income, you may want to consider purchasing additional disability insurance, especially if these programs only pay benefits for a few weeks or months.

Also review the specific definition of disability, the benefit amount offered, your waiting period and length of time benefits will be paid, as well as specific options, exclusions and limitations. Costs will vary depending on the features you select.

You'll also want to look for a financially stable insurer, based on ratings from organizations such as A.M. Best and Standard & Poor's. You will usually have a certain period of time, ranging from 10 to 30 days, to review your insurance policy and return it for a full premium refund.

**Monthly benefit amount:** Most individual or group disability insurance plans reduce your benefit payment due to other income benefits available from all other disability plans you may have, so that the total of all disability benefits received from all sources (group or individual plans) does not exceed 60-70 percent of your current monthly income.

**Definition of disability:** Many plans pay benefits for total disability, defined as your complete inability to perform the functions of your regular job – the job you were performing prior to when your disability began. Some plans will pay benefits for partial disabilities. If you have a current health condition, carefully read plan details to determine how monthly benefits may be limited for a pre-existing condition.

**Own occupation coverage:** If you are a specialist or other professional, a plan offering benefits if you are unable to perform your particular specialty, not just any job, is particularly attractive, though it may cost slightly more. "Own occupation" coverage may be limited to the first two to five years of a plan. After that specified period of time, benefits will usually continue if you are unable to perform any gainful job for which you are reasonably fit by education, training or experience.

**How long benefits will be paid:** You will usually be able to select the period of time for which you want to receive benefits. For most plans, the shorter the benefit period, the less expensive the policy. Benefit periods can range from one to five years or more, and are often paid up to age 65 or when you retire under Social Security.

**Elimination period:** As a policyholder, you will select a waiting period before benefit payments would begin should you become ill or injured and unable to work. A waiting period could be 30, 60, 90, 180 or 365 days. Before selecting a waiting period, consider how long you could comfortably continue paying your monthly expenses from current savings or other sources. Usually, the longer the waiting period before you start to receive benefits, the lower your plan premium.

**Eligibility:** Typically, you must be under age 65 and actively at work on a full-time basis to be eligible to apply for a disability plan. With plans sponsored by an association or other organization of which you are a member, your spouse is often eligible to apply as well. You are typically required to provide a medical history, and in some cases you may be asked to undergo a medical exam, which is usually paid for by the insurance company.

**Proof of disability:** To file a disability claim, most insurance companies require a written notification within a specific period of time from the onset of the disability. The insurance company may send a special form to the policyholder to complete, and may also require the insured to undergo a medical exam at the company's expense. Most companies will require proof that you are under the regular care of a licensed physician.

**Monthly income options:** Most long-term disability plans offer a variety of monthly income benefit choices, which could range from \$100 to several thousand dollars per month. Benefits for disability plans are normally paid directly to the insured on a weekly or monthly basis, and are normally paid tax-free if you pay your own premiums. (Benefits are usually taxed if your employer pays for your disability insurance.) You'll want to consult a tax advisor. Some plans also offer a survivor benefit that continues to pay an insured's beneficiary a disability benefit.

**Partial disability benefit payments:** Some plans also offer residual disability benefits if you are only able to return to work part-time following a period of disability. This type of benefit can help make up for lost income by providing a benefit payment to you if you are experiencing a 20-25 percent or greater loss of monthly income or are unable to perform your normal responsibilities.

**Cost of living adjustment option:** An attractive plan option is a cost of living adjustment benefit which increases your benefit amount based on a factor such as the Cost of Living Adjustment Factor (COLA). This is typically the least of one half the Urban Consumer Price Index or 6 percent annually to age 65.

**Guaranteed purchase option:** Another option may be one which enables you to increase the monthly disability benefit you want, often up to 25 percent of your original benefit selection, without providing any additional health information. This option may be limited to those under age 40 or 50.

**Rehabilitation benefits:** Some plans offer benefit payments while you are undergoing rehabilitation from a disability, such as special training.

**Waiver of premium benefit:** A plan may include a benefit which, after a specific period of disability, waives your premium payments while you are receiving disability benefits.

**Hospital disability benefit:** Some plans also offer added benefits for a specified period of time while the insured is hospitalized for a disability.

**Limitations and exclusions:** Check the exclusions and limitations section of a plan you are considering. Most plans will not pay disability benefits if you become disabled due to an intentionally self-inflicted injury, attempted suicide, military service, participation in a crime or for pregnancy. Limited monthly benefits are typically paid for disability resulting from a pre-existing condition, mental, nervous or emotional disorders, alcoholism and drug addiction.

## Summary

The American Council of Life Insurance emphasizes the importance of long-term disability income insurance:

*Prolonged unemployment due to disability can jeopardize a worker's lifestyle and savings for retirement. Disability income insurance serves as paycheck protection for workers by replacing a portion of earnings if an insured employee is unable to work due to accident or illness.<sup>14</sup>*

Your ability to earn an income is one of your most valuable assets. Losing your income due to an unexpected disability could create a financial hardship for your family and force a drastic change in your standard of living. Protecting your income with disability insurance in the event you are unable to work for months or years at a time due to a disabling injury or sickness can help provide valuable financial security for you and your family.

For professionals, a disability insurance plan that will pay you a disability benefit if you are unable to perform your particular specialty may be especially valuable. In addition, plans offering residual disability benefits should you only be able to return to work part-time also may be an important policy benefit to look for.

Individuals need to evaluate their own potential economic situations should a family breadwinner suddenly become disabled and unable to continue working and earning an income. With a sufficient disability income insurance plan in place, you can help ensure you can continue to provide for your family if you lose your ability to work due to a disabling accident or illness.

<sup>14</sup> Source: *Life Insurers Fact Book 2008*, American Council of Life Insurers