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# Disability Income and Related Insurance

## A. Benefit Limits and the purpose of disability income

- 1) **Pure Loss of Income/ Indemnity** Disability income insurance (a.k.a. *loss-of-time*) insurance is to replace income when a disability prevents an individual from working to earn an income. The maximum coverage is usually two-thirds (2/3) of the insured's gross income because disability income benefits are income **tax-free** (if the insured is paying his/her own premiums). With a limit set according to an insured's salary, they will not be over-indemnified and won't make more money staying home.
  - Premiums paid by individuals for disability income insurance are **not tax deductible**.
- 2) **Insuring Agreement** As long as all of the provisions of the policy are met (i.e., the insured must be under a doctor's care and meet the definition of disability), the insurance company agrees to pay periodic payments as stated in the policy. *Payments must be at least monthly*. The best policies provide benefits for *accidents and sickness*.
  - **Sickness** is an illness or disease that is not the result of an accident.
  - **Accidental bodily injury** is defined as a bodily injury that is the **result** of an accident (an occurrence that is unforeseen and unintended, independent of disease).

## B. Qualifications of Disability

- 1) **The definition of total disability...** This definition will vary from policy to policy. The definition is important because it will determine whether the insured is totally disabled and thus eligible for benefits.
  - a) **Own Occupation...** The most protective of your needs is the *own occupation* definition for disability. **Total disability** means that you are unable to perform the important duties of your "own" or "regular" occupation, and you are under the regular and personal care of a physician. *For example, if a surgeon is unable to perform surgery, but can still be a doctor, the insurer **still must pay** the entire benefit. **With an own occupation definition, it is easier to qualify for being disabled than the any occupation definition.***
  - b) **Any Occupation** is the insured's inability to perform any occupation for which the insured is **reasonably suited** by education, training, or experience. **With an any occupation definition it is harder to qualify for being disabled than the own occupation definition.**
  - c) **Combinations** of the above definitions are common. Since the "Own Occupation" definition is less restrictive, it is more desired by an insured; however, the cost is more expensive. Some policies will have a two-year Own Occupation and thereafter have an Any Occupation provision, thus lowering the premium.

- 2) **Partial Disability Provision** states that if an insured cannot perform one or more of the duties of his occupation due to a disability but can still go back to work and earn a partial income, the provision will pay 50% of the monthly benefit payable for a maximum period of **six months** (in addition to the partial income).
- 3) **Residual Disability Provision** coverage applies when an insured returns to work at a reduced income following a period of total disability. Benefits are payable in proportion to the reduction in the insured's earnings before the onset of the disability. This provision is more beneficial than the Partial Disability clause.
- *For example, an insured returns to work and, due to the disability, only earns 2/3 of his pre-disability income. Since the insured lost 1/3 of his pre-disability income, the residual benefit will pay 1/3 of the insured monthly disability income benefit. These benefits are limited in time to the benefit period of the contract or until the insured reaches 80% of their former gross salary.*
- 4) **Recurrent Disability Provision** states if the insured goes back to work after a period of disability appears to be over but becomes disabled again from the same problem (or a disability arising out of the original disability), the insured will be able to receive benefits again **without having to meet a new elimination period**. However, **the disability must recur in a certain time frame**. *For example, within 90 days from the insured's return to work.*
- *For example, the insured owns a five-year disability income policy and is disabled for two years. He returns to work but the disability recurs within two months, and he is unable to work again. The insured will still have three years of benefits remaining and **will not need to meet another elimination period**.*
- 5) **Presumptive Disability** means a disability that is presumed to be total and *permanent* in cases involving the loss of sight, hearing, speech, or loss of any two limbs. Under these circumstances, the insurance company does not require the insured to submit to periodic examinations to prove continuing disability. Companies will waive the waiting period and pay benefits immediately or may pay benefits in a lump sum. Payments may continue even if you can work in another occupation.
- a) **Permanent Disability** is defined as a disability that is permanent.
- b) **Temporary Disability** occurs when an insured is unable to work while recovering from an illness or injury, but is expected to recover fully from that illness or injury, such as a broken foot.
- 6) **Occupational versus Non-Occupational**
- Non-occupational policies are generally group plans since there is workers' compensation available if someone is injured at work or becomes ill from working.
  - Occupational policies cover an insured 24/7, both on and off the job.

## 7) Special Note Regarding Benefit Payments:

- **Most policies will reduce the amount of the policy benefits, dollar for dollar, for benefits received from other sources (sometimes called non-duplication of benefits).**
- **If Workers' Compensation or other types of disability income benefits are paid to the insured, the disability income policy will pay secondary (excess) over other benefits paid.** *For example, if a policy benefit was \$4,000 per month, and the insured started receiving \$1,000 in Social Security benefits, the policy benefit paid to the insured would be reduced to \$3,000 (\$4,000 minus \$1,000).*

## C. Individual Disability Income Insurance

- 1) Elimination Period, a.k.a. Waiting Period** is the period of time between the onset of a disability and the beginning of the benefit period. **This is a deductible expressed in time instead of dollars.** (60 days instead of \$3000.00) **The longer the waiting period, the lower the premium.** Insurers offer a variety of elimination periods such as 30, 60, 90 days, or longer.
  - ***The length of the waiting period should be used to help fit the policy to the insured's financial means.*** While a longer elimination period means a lower premium, it also is the amount of time that the client pays for everything from their savings.
  - ***Benefits are paid in arrears.*** This means that the insured will receive his first check approximately 30 days after the benefit period begins. *For example, if an insured selects a 30-day elimination period, he will receive his first benefit check around the 60<sup>th</sup> day. If an insured has a 90-day elimination, the first check will be received around the 120<sup>th</sup> day.*
- 2) Waiver of Premium Provision** is included in disability income policies. The provision waives premium payments after the insured has been disabled for a period of time.
- 3) Probationary Period Provision** is the time period in which there is ***no coverage for sickness (usually 30 days)*** and begins when a **policy goes into effect**. This provision helps the insurer to avoid paying benefits for losses due to illness contracted before the policy was issued (*adverse selection*). Injuries from accidents are fully covered after the elimination period, illnesses diagnosed during the probation period will never be covered.
- 4) Cost of Living Adjustment (COLA)** is a rider that adjusts the benefits being received. The CPI, Consumer Price Index, is used by the insurer to make annual adjustments for the following year. An increase in coverage based on the CPI will be offered; premiums will be increased by the amount necessary to maintain the new coverage amount. This benefit will be offered until the client turns it down.

- 5) **Guaranteed Insurability Option** (a.k.a. **Future Increase Option**) guarantees that an insured can purchase additional disability coverage to correspond with the insured's increase in income, **without evidence of insurability**. The insured must pay the premium for the increase in coverage.
- 6) **Benefit Period** is the length of time during which benefits will be paid. *E.g., 5 years, 10 years, benefits payable to age 65, or normal retirement age.* Some policies or riders will offer coverage for life.
- 7) **Change of Occupation** provision states that by changing to a more hazardous occupation, the insured is entitled only to the indemnities the original premium would have purchased in a policy written for that more hazardous occupation. This means the income benefit will be lowered. By changing to a less hazardous occupation, the insured is entitled to a reduced premium and a refund of premium.
- 8) **Exclusions** These policies may not pay for injuries sustained from war or acts of war, attempted suicide, normal pregnancy, injuries on the job, criminal or intentional acts, pre-existing conditions, or injuries while flying other than as a fare-paying passenger on a commercial airline. Mental limitations may limit the policy benefit period, alcohol and substance abuse may also be limited, etc.
- 9) **Other Cash Benefits**
- a) **Multiple Indemnity Rider** is a provision that provides that some or all of the benefits under the policy will be **increased by a stated multiple**, such as 100% or 200%, if a peril occurs in a specific way. *For example, an accident policy may pay 300% of the benefit if the accident is due to plane travel or 200% if the accident is due to public transportation, such as train or bus travel (also known as **common carriers**).*
  - b) **Rehabilitation Benefits** generally will be offered by companies to help the insured recover from whatever caused them to be on the disability income benefits in the first place. There are two parts to this benefit: payment of some or all of the rehabilitation costs that are not covered by another insurance, and a guarantee that participating in physical therapy or what the doctor deems to be the best rehabilitative treatment will NOT reduce or eliminate benefits.
  - c) **Medical Reimbursement Benefit...** If the insured is injured in an accident that requires medical treatment but has no loss of income, this benefit will pay for the cost of treatment. It acts as a limited medical policy.

**10) Refund Provision** otherwise known as return of premium will refund or return a percentage of the insured's paid premium at specific intervals subtracting any claims paid out. Since the premiums paid were not tax deductible, the refund is not taxable income. Although there is no accrued interest, neither is there a loss if the stock market drops, and if the insured is disabled a benefit is paid. The money could be left with the company, creating a cash value account that will be available when the insured chooses to not renew the contract – like at retirement.

## 11) Unique aspects of Individual Disability Underwriting

- a) **Occupational Considerations;** With Disability Income, the client's occupation is critical to the underwriters. The occupation dictates the type of definition (own occupation/any occupation) as well as benefit and premium.
- b) **Premium** is charged based on the classification of the job. *E.g., professionals such as CPAs or attorneys, executives or skilled office workers, and heavy machine operators or welders.*
- c) **Alternatives** to issuing a policy as requested would be declining the offer, rating the offer (charging more money), or putting an exclusion rider in place. A pre-existing condition is a condition that you were treated for or advised to have treatment for within the past year. These may be excluded from a disability income policy, either permanently or for a period of time.
- d) **Benefit Limits** are according to the policy. An individual policy is written for a specific amount, usually 2/3 of a person's gross income. The company will verify income prior to paying a claim to protect its interests. Group plans may pay 80% of an insured's gross income but this income is taxable so it ends up at about the same 2/3 in a check. The other limit in a policy is the policy or benefit period.
- e) **Guaranteed renewable**, disability income policies are guaranteed to renew to age 65 and will only be canceled due to nonpayment of premium or fraud. The premiums may increase but not on an individual basis, only on a classification basis, *e.g., all persons of the same age and zip code.*

**D. Group Disability Income Plans** may be written on a group basis (non-medical) as well as on an individual basis (medical). *The differences between group plans and individual plans include:*

- 1) **Group short-term plans** usually have a maximum benefit period of up to two years. These plans are often paid for by the employer. Since the employer pays the premium and it is tax deductible, the benefit will be taxed. Group plans usually specify the benefits based on a percentage of the worker's income, while individual policies usually specify a flat amount of benefit. Short-term disability can pay 80% of the salary which is then taxed and the net is about 2/3 of the gross salary.
- 2) **Group long-term plans** generally provide benefit periods of more than two years up to about five years. Group long-term insurance is often optional coverage and can be purchased by the employee. This plan is purchased with after-tax dollars so the benefit is not taxable. The benefit will be offered at 2/3 of the gross salary.
  - Group disability plans also have minimum participation requirements, and the employee must work for 30 to 90 days (a.k.a. employment probation period) before they become eligible for the coverage.
  - Group plans will work similarly to individual plans in that there is an elimination period and the definition of disability – the total and continuous inability of the employee to perform all the duties of his or her regular occupation.
- 3) **At-work Benefits or partial disability** – The ability to work part-time and the difference made up by the disability income is generally not covered.
- 4) **Group plans will coordinate benefits** with Social Security Disability Income to ensure the employee is not over-indemnified.
  - Common exclusions from a group policy would include occupational injuries or illnesses, self-inflicted injuries, injuries as a result of war, et cetera. Group plans do not cover disabilities for job-related accidents and illnesses because Workers' Compensation covers on-the-job losses.
  - Group Disability Income and Group Health policies are often referred to as **Non-Occupational coverage** because they will NOT cover the insured for on-the-job (occupational) losses.
  - Individual plans provide coverage on and off the job; often referred to as **Occupational coverage**.



## E. Business Uses of Disability Income Insurance:

**1) Key Person/Partner** insurance protection replaces the income lost when an essential employee, who can also be the owner, is unable to work. *The policy pays benefits directly to the business to help fund the hiring and training of a replacement.* Some of the money could also be used to pay a disability income to the key employee.

- \* The policy is owned by the business
- \* The premium is paid by the business but is NOT tax-deductible
- \* The business is the beneficiary and receives an income tax-free benefit
- \* The person (usually an employee) is the insured
- \* The key person (insured) must qualify for the coverage

*This policy is not funding a buy-sell agreement so there is no large payout after a year of income.*

**2) Buy-Out**, a.k.a. Buy-Sell is an agreement to buy out the interest of a partner or a person's interest in a firm, following a disability. This is a document drawn up by an attorney or it can be part of the articles of incorporation for a company. As a producer you will not prepare the agreement, you will sell a policy that funds it.

A Disability Income policy would fund the buy-out agreement. *Disability Buy-Sell coverage can be designed to provide benefits to a corporation to buy out a disabled stockholder's or director's share of the business.* The policy will generally pay an installment benefit to the corporation for up to a year and then finally *pay out a lump sum benefit to the corporation so it can buy out the disabled partner.*

Premiums are not tax-deductible; however, the benefits are received tax-free.

**3) Business Overhead Expense...** Disabled individuals not only suffer a loss of income but also may incur a loss because of continuing business expenses. This situation frequently arises among self-employed persons such as doctors, lawyers, and insurance producers.

Business Overhead Expense insurance is designed to cover routine overhead (*e.g., rent or lease payments, utilities, advertising, etc.*) and wages. The purpose is to allow the business to keep its doors open and the business intact until the owner returns or can sell the business. Benefits usually are paid for 1 or 2 years. BOE premiums are tax-deductible to the business, and thus the disability benefits received are taxable to the business. However, the taxable benefits are then used to pay tax-deductible expenses.

## F. Social Security

Social Security pays benefits when a covered worker retires (Medicare and retirement benefits), dies, or becomes disabled. It is funded by Social Security taxes and is also known as **Old Age Survivor Disability Health Insurance (OASDHI)**.

- 1) **Qualification:** To be eligible for benefits, a person must become “insured” as defined in the Social Security law. Fully insured means you are eligible for all the Social Security benefits. To become fully insured you must work (and pay Social Security taxes) for 40 quarters. A quarter is  $\frac{1}{4}$  of a calendar year. Currently insured (you have worked 6 quarters during the last 13 quarters) will pay out some survivor benefits.
  - 2) **Definition:** To qualify for **Disability Income Benefits**, the beneficiary must be unable to engage in **any gainful occupation** for which he is reasonably suited by education or training to perform, and the disability is expected to last for 12 months or longer, or to result in death.
  - 3) **Elimination / Waiting period:** There is a **five-month waiting period**. The benefit is a percentage of the worker’s **primary insurance amount**. After being on SSDI for 24 consecutive months, an insured is eligible for Medicare benefits.
- **The Primary Insurance Amount** for a worker is based on his or her average level of earnings and is updated and published annually in tables by the federal government. ***Most types of Social Security benefits are a percentage of the individual’s Primary Insurance Amount.*** ([www.ssa.gov](http://www.ssa.gov)) ***Some of the benefits may be taxable.***

**The Primary Insurance Amount (PIA)** for a worker is based on his or her average level of earnings and is updated and published annually in tables by the federal government. Most types of Social Security benefits are a percentage of the individual’s PIA. ([www.ssa.gov](http://www.ssa.gov)) ***Some of the benefits may be taxable.***