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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. Your most important asset is your ability to work and earn an income. So many people live paycheck to paycheck that if someone is sick with a long term illness or has an accidental injury and cannot work, they have no savings to pay the bills. Not just food and mortgage or rent, but health insurance premiums, deductibles, and copays. Disability income insurance is designed to pay a regular amount to cover those basic needs.

2) **Indemnity Contracts** are those contracts that are designed to make an insured whole, to bring you back to the original position you were in before the loss occurred with ~~no loss and~~ no gain. Disability income contracts are indemnification contracts. ~~This is why the amount paid is not 100% of the gross 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. They can also be considered a valued contract because they pay the amount set forth in the contract up to the indemnification amount.

   - *Example: if Miss Maryann purchased a policy to pay $4,000 per month when her income was $6,000 per month, $4,000 is what the plan would pay out if she were disabled. If her income dropped to $4,500 per month and she files a claim, the carrier likely would calculate 2/3 of the $4,500 and pay out $3,000 in benefits and refund the premium for the difference. Otherwise, Miss Maryann may never want to recover since she is financially better off collecting disability income during the benefit period.*

- Premiums paid by individuals for disability income insurance are **not tax deductible**, so the benefits are not taxable, leading to 2/3 of the gross salary as the most common plan.
  - Individual plans are Occupational (full) coverage, meaning you are covered all the time.

- Premiums paid by the employer on a group plan **are tax deductible** so the benefit is taxed, leading to 80% of the salary as a benefit (before it is taxed - it will end up at about 2/3 of the gross after taxes).
  - Group plans are non-occupational, meaning you are covered only when not working. Workers Compensation covers injuries on the job.

3) **Insuring Agreement** - As long as all the provisions of the policy are met (i.e., **the insured must be under a doctors' 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 *accident 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 which is the **result** of an accident (an occurrence which is unforeseen and unintended, independent of disease, including continuous or repeated exposure to the same general harmful condition).

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. The definition focuses on the inability to perform the duties of your Own Occupation or the inability to perform the duties of Any Occupation due to illness or accident.

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 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.

- *For example, if a surgeon could not perform surgery but **could do other work**, such as teaching at the university, this **policy would NOT pay**.*
- ***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.

- *If a surgeon could not perform surgery, even if they could work, they would receive a benefit for the first 2 years. After the 2 years had passed , if they were able to work the benefits would stop. If they were unable to work after 2 years the benefit would continue to be paid.*

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 earned income).

- *For example, an insured returns to work and, due to the disability, only earns 2/3 of his pre-disability income. Since the insured returned to work the carrier will pay 50% of the benefit for up to 6 months in addition to any salary earned.*

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 because the time limit is not up to 6 months, rather it is either the end of the benefit period or when earnings reach 80% of the former amount.

- *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.*
  - *This is not dollar paid for dollar lost. A client with a salary of $6,000 per month would have a benefit of $4,000 per month. If they returned to work and earned 2/3 of their former income, (bring home $4,000 gross taxable income) they would be paid 1/3 of the benefit ($1,333 non-taxable income.)*

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.***
- *This encourages the client to go back to work without the fear of another elimination period if they are not healed enough to continue working. If they need to leave work again the claim is reopened as though they never went back.*
- *This is also used if someone tried to go back to work during the elimination period. If they need to leave work due to the same health concerns they will have 'time credit' for the amount of time they were out before. i.e., Ms. G left work due to an illness but went back after 2 weeks. Her policy has a 60 day elimination period so there were no benefits paid. If after a week at work her doctor recommends more time recovering, she would have an elimination period of 60 days less the 2 weeks she already was out of work for.*

5) Presumptive Disability means a disability which 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.

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) Benefit Limits: As mentioned above, a disability income policy is written for a percentage of your gross salary, usually 2/3, that is the limit of the monthly benefit. These are indemnification contracts. Designed for the client to suffer no loss and no gain. The policy does not state the carrier will pay you a specific dollar amount, it guarantees you will receive a specific dollar amount each month.

- ***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 were $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).*
- *A disability income policies carrier may also provide attorney services if needed to assist in the filing of Social Security disability Income.*

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, rather than dollars.* (For example, 60 days instead of $3,000.) **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****. A longer elimination period in a policy has a lower premium but you need to make sure the client has enough funds to survive for that long without an income.*
- **Benefits are paid in arrears**. This means that the insured will receive his first check approximately 30 days after their elimination period ends following being disabled. *For example, if an insured selects a 30-day elimination period, he will receive his first benefit check around the 60th day. If an insured has a 90-day elimination, the first check will be received around the 120th day.*
- **Another use of this elimination period is to wrap the individual plan around a group plan**. *For example, let's say the client has a short term disability policy through work. If unable to work they*

could use the group plan which may have a benefit period of 1 year. After 1 year, if they are still unable to work, the individual plan – now past its elimination period – starts to pay.

2) Waiver of Premium Provision is <u>included</u> in disability income policies. The provision waives premium payments after the insured has been disabled for a period of time (usually 90 days).

3) Probationary Period Provision is the time period in which there is *no coverage for sickness* (<u>usually 30 days</u>) and begins when a <u>policy goes into effect</u>. This provision helps the insurer to avoid paying benefits for losses due to illness contracted before the policy was issued (*adverse selection*). Accidents are covered, illness is not.

- *Mr. S was experiencing chest pain so he immediately called his insurance agent to get a disability income policy before he goes to the doctor. No coverage.*
- *Mr. R was skiing and broke his leg 2 weeks after the policy effective date. He cannot work with a broken leg. He can file a claim and is covered. He will receive his first payment 30 days after the elimination period ends.*
- *Mr. K was skiing 2 weeks after the effective date of the policy. He fell and didn't break anything but ended up in the hospital with pneumonia. This claim would not be covered because the illness occurred during the probationary period.*
- Once the 30 days have passed the probationary period is over and never shows up again. The Elimination Period is at the start of any claim, while Probationary is only once, at the start of the policy.

4) Cost of Living Adjustment (COLA) is a rider that makes an adjustment in the benefits being received. The Consumer Price Index is used by the insurer to make annual adjustments for the following year. This can also be done with a flat percent each year.

- *If Miss M is unable to work permanently and has a benefit of $4,000 in the year 2000 and still has that same benefit in the year 2010 or 2015, the purchasing power of that money has dropped considerably due to inflation. A COLA will keep the benefit in line with inflation so Miss M can afford groceries.*

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, **<u>without evidence of insurability</u>**. 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. There are policies or riders that will offer coverage for life. The assumption is, there was no extra money to put away for retirement if you are on disability income and if you did have some extra, you cannot put it in a retirement plan since those must be funded with earned income.

7) Change of Occupation provision states that by changing to <u>a more hazardous occupation</u>, 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 excess 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, 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%, in the event that 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 Benefit** will generally 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.

d) **Survivor Benefit** will continue to pay a beneficiary a limited amount if the insured dies while on benefits.

e) **Transitions Benefits** or Recovery Benefits for business owners will help to offset the cost of rebuilding your business after a disability.

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) Cash Surrender Value This rider creates a cash value from a portion the premiums paid. This amount can be made available to the insured when they choose to not renew the contract, usually at retirement age, less any claims paid. It is similar to the refund provision except for the timing. The cash is not available at renewal time here.

12) 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) **Benefit Limits:** Benefits are limited according to an individual's salary at the time of purchase. Companies generally will sell 2/3 of the salary since there are no taxes taken from the benefits if the individual pays. If this is a group plan, benefits are generally 80% and then they are taxed. They are tax deductible to the employer, so they are taxable to the employee.

- Premium is charged based on the classification of job. Companies will have their own listing of job classifications but there will be some similarities. The partial list below would be an example of the different classifications and corresponding different premiums.

    1) Professional occupations
    2) Executives, managers, skilled office workers
    3) Retail workers, salespersons
    4) Skilled manual labor – plumbers, electricians
    5) General laborers, heavy machine operators

- Companies need to know what you do, not what your job title is. One restaurant owner may be a manager while another is the head chef.

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.

D. Group Disability Income Plans

may be written on a group basis (non-medical) as well as on an individual basis (medical). When you first join the group or when the plan is first available to a group, enrollment is on a non-medical basis. You are eligible as a member of the group. Should you choose to decline the coverage and later change your mind, you will be asked to show proof of insurability. This is to avoid adverse selection, which has a risk of people signing up for coverage only when they wish to file a claim.

The differences in group plans and individual plans include:

- 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.
- **Group short-term plans** usually have a maximum benefit period of up to two years.
- **Group long-term plans** generally provide benefit periods of more than two years up to about five years.
- 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 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** (full) coverage.
- Group plans will work similar 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.
- **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.
- **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.
- The amount of coverage is closer to 80% of the gross income. This benefit is paid for by the employer and is tax deductible to the employer. This means the benefit to the employee is taxed. So, starting at 80% and then taxing it leaves the client with about 2/3 of their gross income.

E. Business Uses of Disability Insurance:

Businesses are made up of people. If an owner or a key person becomes disabled and cannot work it can have a large impact on the business, the employees, the customers, etc. The majority of businesses are small businesses and the negative impact of an owner not being able to work could be catastrophic. There are 3 policies that are designed to help business owners with a potential loss or potential business closure by offering (selling) insurance coverage on a few select individuals. The coverage pays the business for personnel replacement or for continuing expenses.

1) 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 an agreement drawn up by an attorney or it can be part of the articles of incorporation for a business.

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, if needed, *pay a lump sum benefit to the corporation so it can buy out the disabled partner's share.*

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

2) Key Person/Partner/Employee 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

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

The biggest difference between this plan and the buy sell is the length of the payments and the lump sum payout after a year with the buy sell funding. Both plans are designed to keep the business open if someone is unable to work due to a disability. Key person policies are for any person who is key to the business and are considered short term in that they can generally pay for 6 months to a year. Buy-Sell funding will pay out for a year and, if needed, pay out a lump sum to buy out a partners share of the business.

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

Business Overhead Expense is designed to cover routine overhead *(e.g., rent or lease payments, utilities, advertising, etc.)* and wages. This policy will NOT cover the owner's wages, they need a disability income policy to do that. The purpose is to allow the business to <u>keep its doors open and the business intact until the owner returns or is able to sell the business</u>. Benefits usually are paid for 1 or 2 years. The benefit purchased is not a specific dollar amount rather a listing of expenses to be covered up to a policy limit. The policy will pay those bills *(e.g., rent, utilities, salaries, etc.)* up to a stated limit.

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 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**.

a) **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 ¼ of a calendar year. Currently insured (you have worked 6 quarters during the last 13 quarters) will pay out some survivor benefits.

b) **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.

c) **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) ***Some of the benefits may be taxable.***