



## About AHIP

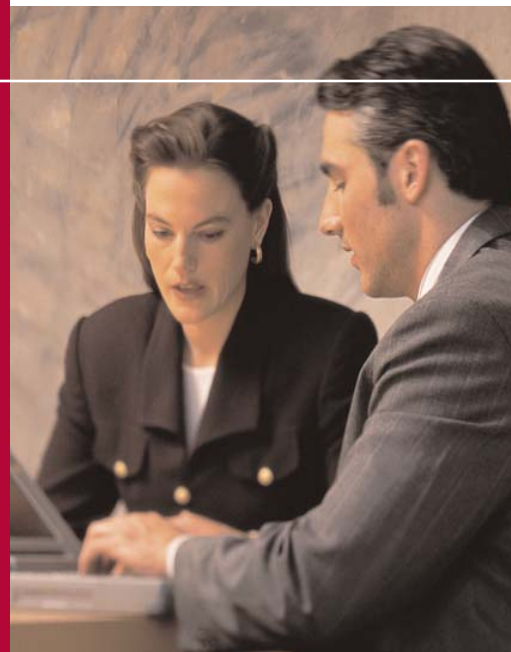
America's Health Insurance Plans is a national association representing nearly 1,300 members providing health benefits to more than 200 million Americans. AHIP and its predecessor organizations have advocated on behalf of health insurance plans for more than six decades.

As the voice of America's health insurers, our goal is to advance a vibrant, private-public health care system, one characterized by consumer choice, product flexibility and innovation. We support empowering consumers with the information they need to make health care decisions, promoting health care quality in partnership with health care providers, and expanding access to affordable health care coverage to all Americans.

AHIP's mission is to effectively advocate for a workable legislative and regulatory environment at the federal and state levels, one in which our members can advance their vision of a health care system that meets the needs of consumers, employers, and public purchasers.

**America's  
Health  
Insurance  
Plans**

# Guide to Individual Disability Income Insurance



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Although frequently revised, this guide includes information that is subject to changing federal and state law. AHIP provides this booklet for guidance only. It is not a substitute for the advice of licensed insurance professionals or legal counsel.

## Introduction

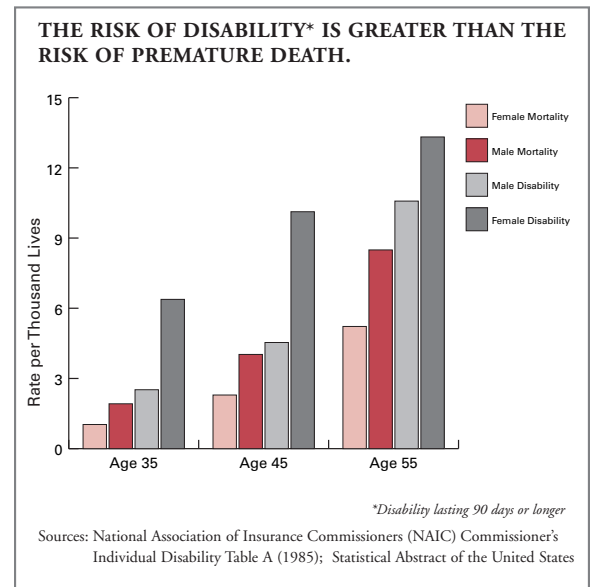
Could you continue to support your family and pay your bills if you were unable to work for any length of time because of illness or injury? If you were to become disabled, do you know how much money would be coming in each month and from what sources?

Some people can rely on group disability coverage provided by their employers and/or government disability income programs. But, for a great many workers, a disability that stops their paycheck would leave them – and their families – in financial hardship. Individual disability income insurance is designed to replace a significant portion of income lost when illness or injury prevents the policyholder from earning a living. It is designed to help pay ongoing bills while the policyholder is recuperating and unable to do his or her job.

This guide explains the likelihood of disability, the financial risk it poses, potential sources of disability income, disability income insurance, and what disability income insurance covers. It includes a checklist of policy features you can use to compare disability income insurance policies. This information will help you make an informed decision about whether you need individual disability income insurance and, if so, what features are most important to you.

## How Likely Is A Disability That Could Prevent You From Working?

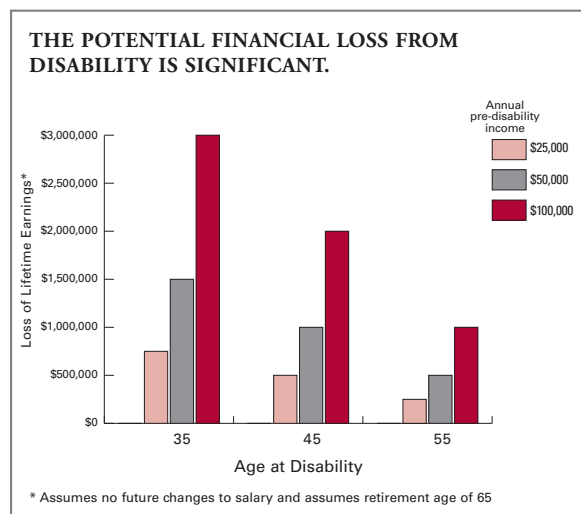
The risk of a disabling illness or injury that prevents a worker from doing his or her job is more significant than most people realize. According to information compiled by the National Association of Insurance Commissioners (NAIC), a male U.S. worker at age 35 faces a one-in-five chance of disability taking him off the job for 90 days or longer during his working career. A 35 year-old woman faces a nearly one-in-three risk of disability lasting at least 90 days before reaching retirement. In fact, the risk of an extended disability during a worker's career is greater than the risk of premature death. Most workers would never think of going without life insurance protection for their families.



The most common causes of long term disability are musculoskeletal problems (22%), cancers (14%), circulatory system problems (10%), injuries/poisonings (10%), and mental disorders (9%) (JHA, Inc., 2002 Risk Management Study).

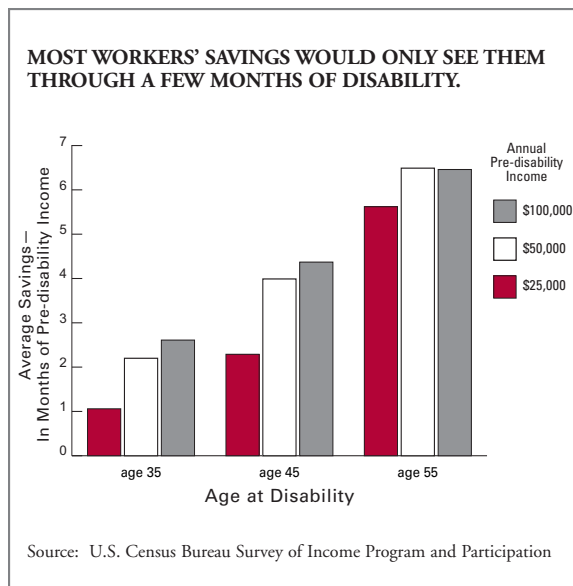
# What Might Disability Mean Financially For You And Your Family?

For most workers, the ability to earn a living is their most significant financial resource. A lengthy disability, therefore, can be financially devastating to workers and their families. For example, the figure below shows that a 45 year-old worker with an annual salary of \$50,000 who suffers permanent disability stands to lose \$1,000,000 in future earnings. He or she would also be unable to continue building a retirement nest egg.



A disability that turns a breadwinner into a dependent not only reduces income, it can also bring significant additional expenses – for health care, for assistance in performing routine functions, and for other needs.

Savings can be an important source to draw upon to meet financial needs during a disability. However, as the figure below shows, most workers' savings would only see their families through a few months of disability.



## What Is Disability Income Insurance?

Disability income insurance provides you and your family with income should you become unable to work due to illness or injury. It helps protect against family financial catastrophe by providing income to meet financial needs during a disability.

Disability income coverage comes in three primary forms:

- ▶ Government-sponsored programs, such as workers' compensation and the Social Security Disability Insurance (SSDI) program,
- ▶ Employer-sponsored group disability plans, and
- ▶ Private individual disability income policies (paid for by individuals) that ensure income in the absence of adequate employer- or government sponsored coverage.

The following pages discuss these sources of disability coverage, and will help you understand the coverage you have, as well as the coverage you may need.

## Are You Covered By Group Disability Benefits?

First, find out exactly what benefits your employer offers in the event of a disabling illness or injury. Most employers allow some short-term sick leave, which may last from a few days to as much as six months. In some states (Hawaii, New Jersey, New York, Rhode Island, and also Puerto Rico), state law requires most employers to provide temporary disability income benefits for up to 26 weeks. In Rhode Island, most employers must provide such coverage for up to 30 weeks and in California, state law requires such coverage for up to 52 weeks.

No state or federal laws require employers to offer long-term disability insurance (covering disability that lasts beyond six months), but the U.S. Department of Labor, Bureau of Labor Statistics indicated that in 2003 nearly one in three U.S. workers had employer-sponsored group long-term disability (LTD) coverage. Generally, employer-sponsored group long-term disability benefits replace about 60% of salary (usually bonuses are not included), start when short-term benefits are exhausted, and continue anywhere from five years to life. Often, group long-term disability insurance coverage is fully paid for by employers without contributions by employees.

Check with your employer to see if you have disability income coverage and, if so, what benefits would be available to you.

Find out how long after the start of disability you would have to wait before benefits begin and how long payments would continue.

Find out, too, whether your employer's plan takes other disability coverage (such as government programs) into account, or benefits are subject to a maximum dollar amount, when calculating your long-term disability benefits

Ask for a booklet describing the disability coverage your company offers.

## What About Social Security Disability Insurance (SSDI) Benefits?

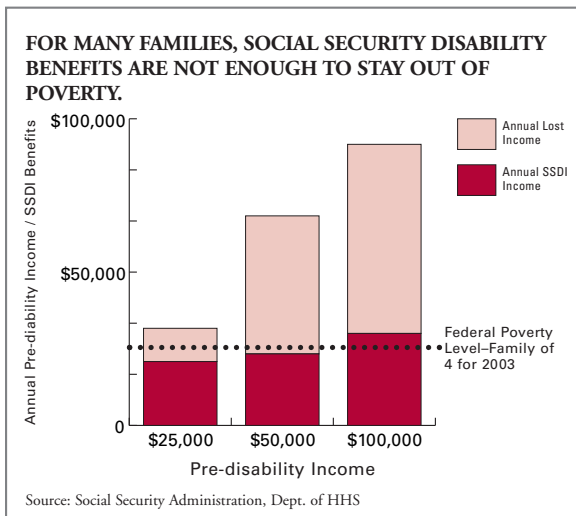
Most workers in the United States participate in the federal government's Social Security program. Social Security is best known for its retirement benefits. But the Social Security Administration (SSA) also administers the Social Security Disability Insurance (SSDI) program. There were more than 7.5 million SSDI beneficiaries in 2003 (including eligible spouses and children of disabled workers).

If you qualify for SSDI benefits, your pay and work history determine the amount of your SSDI benefits. In October of 2004, the average monthly payment for a disabled worker was just under \$870. Contact your local Social Security Administration office for an estimate of the disability benefits to which you would be entitled should you to become disabled. There is also a disability benefit calculator and other SSDI program information available at [www.ssa.gov](http://www.ssa.gov).

SSDI benefits can be an important source of income should you suffer a disabling illness or injury, but here are some important points to bear in mind:

- ▶ It can be difficult to qualify for SSDI benefits. Eligibility is based on being unable to perform any gainful employment, not just the job you were performing at the time the disability began. And you must remember that eligibility for Social Security disability benefits is contingent upon your disability being expected to last for at least 12 months or lead to your death.
- ▶ Even if you are disabled, getting SSDI benefits takes time. A disabled individual is eligible for benefits after five months of disability and if the disability is expected to last at least 12 months or result in death. The time it takes the Social Security Administration to make an SSDI eligibility determination often delays benefits for additional months.

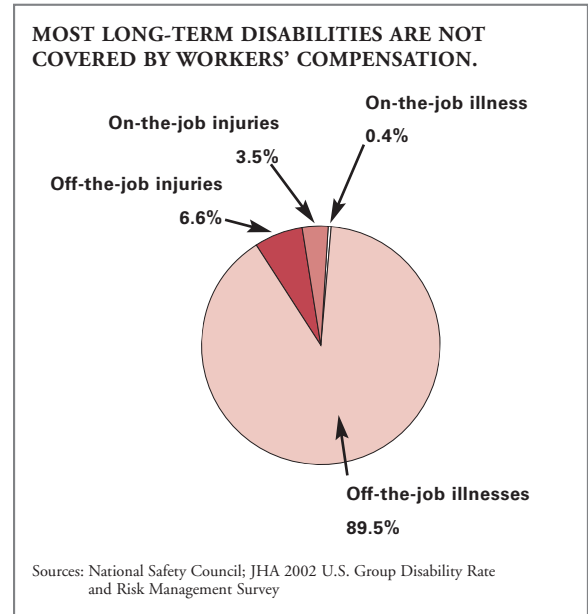
- ▶ SSDI payments may be reduced by disability income entitlements under other government programs. Why? Because total combined payments under Social Security, workers' compensation, civil service, and military programs generally cannot exceed 80 percent of average pre-disability earnings. A government pension may also reduce SSDI benefits.
- ▶ Social Security disability payments are subject to federal income tax if your "combined income" (adjusted gross income plus any nontaxable interest income and half of your Social Security benefits) exceed certain limits.
- ▶ SSDI benefits are often not enough to maintain the standard of living for those who do qualify. In fact, as the figure below shows, relying on SSDI benefits alone would leave many families at or below poverty – as defined by the U.S. Department of Health and Human Services Federal Poverty Level.



## What About Workers' Compensation?

All states require employers to provide workers' compensation coverage to most workers. Under these programs, workers who become injured or sick on the job

are entitled to limited disability income benefits. Typically, these benefits are equal to two-thirds of pre-disability income, within various state limits. However, workers' compensation does not provide disability income for those whose injuries or illnesses are not job-related. Most people who become disabled are not eligible for workers' compensation.



## Are You Eligible For Disability Income From Other Sources?

There are a number other potential sources of income if you become disabled:

- ▶ Veterans Administration pension disability benefits, for eligible veterans
- ▶ Civil service disability pay, for federal or state government workers
- ▶ Black lung program for miners
- ▶ State vocational rehabilitation programs
- ▶ Group union disability coverage

- ▶ Automobile insurance, if disability results from an auto accident
- ▶ Private insurance, such as credit disability insurance, that makes monthly loan payments when you are disabled
- ▶ Supplemental Security Income (SSI) for persons with low incomes and limited assets

The availability and extent of these and other programs vary widely. But, because one or more may be an important source of income should you become disabled, it is important to determine whether you are eligible. If you are, you should also find out how long benefits will be paid.

Of course, your own resources, such as the savings you've put aside over the years can be another important source of disability income.

## How Much Disability Income Will You Need?

Add up all the benefits you may be entitled to under the public and private programs mentioned, along with the monthly income you could count on from other sources such as your personal savings. If the total approaches your required income after taxes, you can assume that, should total disability strike, you would be able to pay your day-to-day bills while recuperating. Please bear in mind, however, that a disability could very well bring additional expenses. A disabled individual may face increased out-of-pocket health care costs. He or she might also need extra money to pay for help with shopping, housework, yard work, cooking, or transportation. Funds may also be needed for making the home disabled-accessible by adding ramps and widening doorways.

If the total from employer benefits, Social Security, and other programs along with your own resources will not be close to your pre-disability, after-tax income and will not be adequate to support your family, you will want to consider buying additional disability income insurance to make up the difference.

**Please Note:** The amount of long-term disability benefits you may receive through your employer's group plan or your personal insurance benefits may be reduced by the amount of Social Security or other government benefits that may be paid. In addition, although disability income benefits are tax free when purchased and paid for by an individual worker, benefits are taxable when paid on a policy paid for by an employer. This fact must be taken into account in determining disability income needs.

### A special note for employers

If you are an employer, consider a group policy for you and your employees. If you are a sole practitioner, or if you work for a business that does not provide benefits under a group policy, considering an individual policy is a good idea.

### An agent can be helpful

Whether you are an employee or an employer, an insurance agent can help you analyze your sources of disability income, determine waiting periods for various benefits, and determine whether additional coverage would be wise.

## What Do I Look For In A Policy?

If you find that you need an individual disability income policy over and above any other income protection you may have, here's what you need to know:

### Definition of Disability

Policies vary. Some pay benefits if you are unable to perform the duties of your regular occupation, while others pay only if you can engage in no gainful employment at all. Be sure to determine how various policies define disability.

### Extent of Disability

Some older policies require that you be totally disabled before payments begin. Partial disability sometimes is covered for a limited time but most often only if the partial disability follows a period of total disability for the same cause. Some policies may not require total disability before partial disability payment.

## **Residual Benefits**

If you are able to work but your income is reduced because you cannot fulfill all of your job responsibilities, residual benefits can help to make up the difference in your income. A standard feature in some policies (added with a rider to others), a residual benefit allows partial payment based on your loss of income generally without prior total disability.

## **Presumptive Disability**

Under some policies, even if you can still perform some or all of your regular job, you may be presumed fully disabled and entitled to full benefits under certain specified conditions, such as loss of sight, speech, hearing, or use of limbs. In these cases the elimination period is generally waived.

## **Amount of Benefits**

Monthly benefits are generally calculated in terms of stable, earned income at the time of purchase. A typical disability insurance benefit is 60% of pre-disability income. But, to avoid “overinsurance,” that is disability income approaching or exceeding pre-disability income, individual disability insurance benefits can be affected by disability income from other sources – which can include SSDI benefits, group disability benefits, etc. Insurers, not wanting to provide benefits so sizable that they would encourage workers to remain at home, may limit benefits from all sources to no more than 70 to 80 percent of monthly income. Lower-paid workers can expect to receive more of their pre-disability incomes while higher-paid workers generally receive less.

## **When Payments Begin**

Many policies allow you to decide when benefit payments begin. You can choose a waiting period at the time of application; these range anywhere from the 31st day to 180 days or more after the onset of the disability. Depending on how much money you have saved, and your other resources, you can reduce your premiums by electing to wait 60 days, 90 days, or even 180 days before you start to receive benefit payments. Remember, though, that the first benefit check is usually not paid until 30 days after the waiting period.

## **Length of Coverage**

By choosing a benefit term, you will elect benefits that are payable for one year, two years, five years, to retirement age. Since disability benefits are designed to replace the income you would otherwise earn by working, most people do not need benefits extending beyond their working years. Electing shorter benefit periods can save premium dollars, but bear in mind that if you need this insurance at all, you probably need it most to cover a disability that permanently removes you from the workforce. A lengthy disability threatens your financial security much more than a short-term disability.

## **Keeping Pace with Inflation**

For an additional premium, you may be able to add a cost-of-living adjustment (COLA) to basic disability income coverage. This provision increases benefit payouts by a specified percentage, generally 4 to 10 percent, after each year of disability and can be important particularly during a lengthy period of total disability. Some policies offer the opportunity to buy additional disability coverage to keep pace with a rising income, without having to submit to a medical examination or to provide further medical evidence of insurability.

## **Waiver of Premium**

Most policies include a waiver of premium provision, so that you don't have to pay any more premiums after you're disabled for 90 days and until your disability ends.

## **Non-Cancelable Versus Guaranteed Renewable**

Selecting the level and duration of benefits is only the first step. To be sure that coverage will continue, you should ask about renewability. Most disability income insurance comes with one of two types of renewability provisions: Non-cancelable policies give you the right to continue a policy by timely payment of premiums, and the insurance company cannot change the premiums and benefits shown in the policy. Guaranteed renewable policies will be automatically renewed, with the same benefits, but the premium may be increased if it is changed for an entire class of policyholders.



While most individually purchased disability income policies are either non-cancelable or guaranteed renewable, other kinds do exist. Conditionally renewable policies can be canceled by class, geographic area or for reasons stated in the policy other than deterioration of health. Optionally renewable or conditionally renewable policies are extended at each anniversary or premium due date if the insurance company decides to do so. (Some policies are renewable to age 75 if you are still employed full-time.)

### **What the Policy Does and Does Not Cover**

Some policies pay only for disability arising from accidents, but not illnesses. However, illnesses are a frequent cause of disability. In fact, as you get older, it is more likely that you will need to be covered for an illness than for an injury. Be sure to consider carefully the kind of protection that is best for you and your family.

## What Else Do You Need To Know?

### **Tax Considerations**

In general, if you pay the premiums for an individual disability policy, payments you receive under the policy are not subject to income tax. If your employer had paid some or all of the premiums, some or all of the benefits may be taxable.

### **Is Business Protection Available?**

Disability insurance is particularly important if you own a small business. In addition to standard disability income replacement, business protection is available through:

- ▶ Recovery benefits that pay after you return to work full-time, during the period in which you are reestablishing a customer or client base.
- ▶ Overhead expense coverage that pays for certain office expenses.
- ▶ For jointly owned businesses, a disability buy-out policy disburses funds for one partner, or the business entity, to buy a disabled partner's share of the business.

- ▶ Key-person insurance, which protects a firm against the loss of income resulting from the disability of a key employee.

## Disability Insurance Policy Checklist

Take into consideration that every policy may have different features. The following checklist will help you compare policies you may be considering:

1. How is disability defined? - inability to perform your own job? - inability to perform any job?
2. Does the policy cover accidents? - illness?
3. Are benefits available for total disability? - for partial disability?- for residual disability? - only after total disability?
4. Are full benefits paid, whether or not you are able to work, for loss of sight?- speech? - hearing? - use of limbs?
5. The maximum benefit will replace what percentage of income?
6. Is the policy non-cancelable, guaranteed renewable, or conditionally renewable?
7. How long must I be disabled before premiums are waived?
8. Is there an option to buy additional coverage, without evidence of medical insurability, at a later date?
9. Does the policy offer an inflation adjustment feature? If so, what is the rate of inflation? Is there a maximum?

### **And Remember...**

*...a well-trained benefits consultant, financial counselor, or insurance agent can help. Ask about the following.*

- ▶ What is an adequate level of benefits, in relation to your present and future obligations?
- ▶ How long of a waiting period should you select to fit your circumstances until benefits begin?
- ▶ How long do you want to receive disability income should it become necessary?
- ▶ How much coverage are you eligible for at your present salary?

## A Final Word

Insurance policies are legal contracts. Read and compare the policies you are considering before you buy one, and make sure you understand all of the provisions. Marketing or sales literature is no substitute for the actual policy. Read the policy itself before you buy.

Ask for the insurance company's ratings. The A.M. Best Company, Standard & Poor's Corporation, and Moody's all rate insurance companies after analyzing their financial records.

Ask for a summary of each policy's benefits for an outline of coverage. Good agents and good insurance companies want you to know what you are buying.

Don't be afraid to ask your insurance agent to explain anything that is unclear. If you are not satisfied with an agent's answers, ask for someone to contact in the company itself.

And bear in mind: Even after you buy a policy, if you find that it doesn't meet your needs, you generally have 10 to 30 days (this varies by company and state) to return the policy and get your money back.

Finally, you should know that every state has a department of insurance that regulates insurers and assists consumers. If you need more information, or if you want to register a complaint, check the government listings in your local phone book for your state's department of insurance.

### **For More Information**

- ▶ You can find AHIP online at [www.ahip.org](http://www.ahip.org). This site offers additional consumer information about disability income insurance and other insurance coverage.
- ▶ To find an insurance agent or financial advisor near you who has earned the Disability Income Associate (DIA) designation, call AHIP's Insurance Education Program at 202.778.8471.