

DI madeEasy.com's IDEAL ELEMENTS OF A DI POLICY and The Consequences of Not Having Them in Your Policy.

Many professionals understand how important disability income insurance is in protecting their income in the event of sickness or injury. However, few (including many agents) understand how drastically disability income policies vary in contract language and how important the setup and design of the policy can matter at claim time. The ill informed often shop around on price alone and ignore the language of the disability policy. This can be financially detrimental in the unfortunate event of a claim. For life insurance claims, the process is simple; the claim is paid upon death. There are not any arguments between the insured and the insurance company whether the insured is "really" dead or not. I often say jokingly with clients and brokers, "unless you are a vampire it is easy to determine whether you are dead or alive, but whether you are disabled by definition and going to get paid is determined by your DI policy language."

Do you know what constitutes a good disability policy and why? I want to discuss in simple terms my ideal elements of a DI policy, why they are important, and the consequences of not having these important features. Make sure to consider these features when discussing purchasing a disability income policy as all policies are definitely NOT the same.

◆ Non-Cancellable and Guaranteed Renewable (Non-Can and GR):

Definition: Non-Cancellable and Guaranteed Renewable means the insurer cannot cancel or change the policy and premiums will not increase as long as the premiums are paid on time.

One consequence of not having a policy with this structure is that the rate of the policy could go up to a level that you could no longer afford as the rate can go up. Another consequence of your policy not having this basic structure is the entire policy can be cancelled without your consent. Have you heard of someone getting into an accident and right after the claim was paid was dropped by their insurance carrier in an attempt to prevent another claim? Well obviously an auto insurance policy is not non-cancellable nor guaranteed renewable. Imagine having your disability policy dropped right after conclusion of a claim. You would not be protected if you had any other impairment or if your condition returned. Another consequence of lacking both the Non-Can and GR structure is that in certain situations, the insurance company can change the definitions of the policy. For example, regarding a health insurance policy, possibly you've heard of a situation where the client files a claim and learns that the company no longer covers that situation or condition. You definitely don't want your disability policy to have that option. Group disability income insurance is most likely to have this option as premiums and policy language can change.

◆ 90 or 180 Day Wait and Benefits at Least to Age 65

Definition: The waiting period is the amount of time that must pass before benefits become payable (like a disability deductible). The benefit period is the maximum amount of time the benefit can be paid in the same claim.

A consequence of having a waiting period too long is that you may not have enough savings to pay your bills before disability benefits begin. Regarding a benefit period to age 65 or longer (if available), according to the 1985 Commissioners' Individual Disability Table about 60% of all people that have a disability that lasts a minimum of 90 days will make a complete recovery within a five-year period. This also means that 40% of the people that go on disability claim have a need for a benefit that lasts longer than five years. The consequence of not having a benefit period to retirement age is that you place yourself at risk if you suffer a long lasting disability. From my experience in the industry, I have learned that generally speaking there is a minimal difference in premium between a 5 year and an age-65 benefit period. Since most DI claims are "front loaded", meaning shorter claims occur more often than longer claims, the difference in premium between a 5 year benefit to an age 65 benefit period is usually not all that significant when you consider the increased potential payout. In my opinion it is worth the extra cost for clients to purchase an age 65, age 67, or even a graded lifetime indemnity rider in certain situations, if available.

◆ Protect Yourself in Your Own Occupation and Specialty-True "Own Occupation"

Definition: Being protected with a true own occupation definition means you are totally disabled if due to injury or sickness you are unable to do the material and substantial duties of your occupation (or occupations if more than one), even if you are at work in a different occupation.

A huge consequence of not having a true own-occupation definition of disability is, if you choose to do work elsewhere when on a claim, benefits being received may end or be reduced. The lesser definition of disability that is often confused with own occupation is called "modified own occ." It reads very similarly to a true own occupation definition in a policy but adds the phrase "and not working" to the own occupation definition. Most people do not really understand the importance of having a true own occ disability income policy vs. having a modified own-occ disability income policy. To truly understand the difference we must first look at a typical claim from a different perspective. I do not know of any carrier that will insure you for 100% of your after tax income (unless you qualified for an extra benefit called catastrophic, more on that later). This means that when you are on a total disability claim and not working, there is always a reduction in net income to you. The companies do this so there is an incentive for you to get better, go back to work, and therefore hopefully end your claim. One of the problems with this is when you are totally disabled, you automatically suffer from a net loss of income. Without having a "true own-occupation" definition of disability, you cannot do something else to better yourself financially because essentially anything you do that earns money may reduce or end your disability benefit. You wind up on a financial plateau and who wants to be there? Being on a financial plateau means you are unable to better yourself financially, unless your new occupation pays more money than your old occupation, which in most cases is very unlikely.

Below are two different claim scenarios to further explain the differences. The first scenario is "modified own occupation" and the second scenario is "true own occupation". Which scenario would you prefer?

-Modified Own Occupation Claim Example: "I'm sorry Mr. or Mrs. Client for what happened to you. Since you are totally disabled by definition of the disability policy you purchased, you will receive your \$10,000 monthly disability benefit. I know that when you were working you made \$265k and you likely cleared after all income taxes more than \$10k a month, but it was

the maximum benefit your disability carrier was willing to issue as no company will insure you for 100% of your income. Unfortunately, now that you are considered disabled by the insurance company, you pretty much have to stay home. Why, you ask? Because if you work you may no longer be considered disabled and your benefits may end or be reduced. So, the financial goals you wanted to achieve: buy a second house, buy a Porsche, save for retirement, and pay for your kids to go to college-are not likely to happen anymore.”

-True Own Occupation Total Claim Example: “I’m sorry Mr. or Mrs. Client for what happened to you. Since you are totally disabled by definition of the disability policy you purchased, you will receive your \$10,000 monthly disability benefit. I know that when you were working you made \$265k and you likely cleared after income taxes more than \$10k a month, but it was the maximum benefit your disability carrier was willing to issue as no company will insure you for 100% of your income. Fortunately, you have what is called a true “own occ” disability policy. As long as you are unable to perform the material and substantial duties of your original occupation, but may be able to work, you will be able to work in another capacity, supplementing the disability benefit. This may allow you to better yourself and your family financially plus give you the opportunity to possibly reach your pre-disability financial goals. So maybe you can still achieve the financial goals you discussed with me; buy a second house, save for retirement, buy the Porsche and pay for your kids to go to college. Don’t let your disability stop you from achieving your financial goals!

Do you see now why true own occ is important for the professionals? This contract language gives the freedom of being able to do something else to better oneself financially when on claim. Even if you choose to not work, you will be happier knowing that you can make this choice.

Another important item regarding the true own occupation definition of disability is the importance of specialty language for medical and dental occupations. For example, one example of specialty language states if you have limited your occupation to the material and substantial duties of a medical or dental specialty, that specialty will be considered your occupation. Yes, it can be that specific.

Individuals that have specialized occupations tend to be very ambitious. If they were not ambitious, they would not have been willing to do what it takes to get certified in their specialty. For example, a typical doctor goes through four years of college, followed by years of medical school, and then they complete residencies and sometimes fellowships. They spend a significant amount of time and money to become a specialist in their field. The moment you tell them they can't do something, that's when they really want to do it. Having a true own occ policy with specialty wording gives them the freedom to choose to do something else to better oneself financially. The person with that choice will likely be much happier at time of claim because there is a chance that they can still improve their financial situation by choosing to pursue another occupation.

◆ Protect You with Quality Partial/Residual Benefits with Unlimited Recovery Period

Definition: Residual disability provides benefits when you are gainfully employed but because of injury or sickness you suffer a loss of income. Usually the residual benefit is equal to the percent of income loss. For example: 50% loss of income = 50% of policy benefit.

Having a quality residual benefit is a very important feature of a disability policy that is often misunderstood. The best residual provisions do not require a total disability first have a 15%

loss of income threshold (vs 20%), have no requirement for loss of time and duties, and provide an unlimited recovery benefit. The consequence of not having a residual benefit with your policy is that your policy becomes an “all or nothing” policy, meaning if you are not totally disabled, you get no benefit. Keep in mind that most people at some point of a disability will be working in their own occupation while they are either getting better or getting worse. In other words, people are not usually totally healthy one day and totally disabled the next day or vice versa.

The percent loss of income threshold is worth noting. The best carriers use a 15% loss of income unlike the common 20% loss requirement. This allows in many situations a quicker qualification of claim as the benefit may be paid on a smaller loss of income. Additionally, a 15% loss threshold potentially allows paying a claim longer.

“Time and duties” clauses reflect another area of concern. In order to get a residual claim paid, a “time and duties” clause adds the requirement of a time and/or a loss of duties in addition to the income loss. The best residual provisions have no “time and duties” clauses meaning if you have a loss of income solely due to disability, you simply get paid.

Another consequence of not having a high quality residual disability benefit provision is that the policy may not have or may have a limited recovery benefit. What does that mean? After you make a complete physical recovery from your ailment, your residual benefit may end, even if you are still suffering from a loss of income. You may still have a loss of income after you recover because you've lost some of your referral sources and your reputation. People are hesitant to go back to you for your services because they know you were disabled. In some cases you may have a loss of income for the rest of your life. A good residual policy will pay you residual recovery benefits up to the full benefit period as long as that income loss is due solely to your disability even if you are now completely recovered as long as you can show an indexed 15% loss of income. Other policies that have a residual recovery provision, may produce a lump sum payment or a monthly recovery benefits for a limited time period. Ideally, the recovery provision should be up to the maximum benefit period.

◆ Protect Your Benefits Against Inflation-COLA

Definition: Cost of Living Adjustment is protection from the effects of inflation while disability benefits are being paid.

The consequence of not having the cost of living adjustment (COLA) rider on your policy is that when on claim you will be on a fixed income, as your benefit will not adjust to compensate for inflation. Imagine living today on the income you have now and never getting a raise, or worse yet, imagine living on the income that you made five or ten years ago. Everyone needs their benefit to increase with inflation to make sure they are able to maintain their standard of living. The better COLA riders out there have minimum compound increases, typically 3%, and are not tied to the consumer price index (CPI), for increases less than 3%. Additionally, there is a relatively new option regarding COLA, which is a delayed onset COLA. This allows long term inflation protection, but at a lower cost because the insured self insures inflation for the first 3 years of claim. Depending on the situation, this may be a good option to help you save premium.

◆ Full Mental Disorder and Substance Abuse Coverage

Definition: Not having your benefit limited for mental disorder claims, i.e. depression, anxiety, drug abuse, etc.

According to the 2006 Long Term Disability Claims Review, conducted by the non profit Council for Disability Awareness (CDA), website: DisabilityCanHappen.org, these claims cause a significant number (6.5%) of all new disability claims. For example, imagine losing a child, losing your spouse, or going through a divorce. You could be emotionally devastated. Any normal person going through an experience like that may be disabled due to such a loss. Many of them will have a loss of income. It may be temporary or permanent. Think about this; imagine being out of work for a year or two because of severe depression that occurs after an emotionally difficult situation. Your clients or patients will go somewhere else because you are unable to give the service they need. Now you recover and have to start from scratch. Unfortunately, now people know about your past and you may never be able to get back to where you were. Having full mental disorder coverage allows the benefit period to go all the way up to age 65 or even lifetime, whatever your benefit happens to be.

◆ Future Increase Option (FIO)

Definition: A policy rider that allows the insured to increase your coverage, as your income rises, even if your health deteriorates so long as you are not already on claim.

The consequence of not having this feature is that as your income rises you will have to be fully underwritten for any increases in coverage. Most people when young are, as they say “young and healthy”; however, as most people get older, they develop health issues. Those health issues may prevent them from getting the additional coverage they need. Adding the future increase option rider to a policy guarantees the ability to buy more coverage without evidence of medical insurability to keep one’s income protection at the proper level as long as you financially qualify. You're medically underwritten only once when young and healthy, so you can be protected later. Your income is going to go up, so why only cover the income you have now?

The best FIO riders allow the benefit to be exercised every year, have a pool of potential benefit to purchase from, add the additional coverage to the existing policy, allow off anniversary exercises for special situations like loss of underlying group DI insurance or graduation from residency providing an employment contract.

◆ The Extra Benefit if Catastrophically Disabled (CAT)

Definition: Catastrophic disability provides extra benefit above the base or regular disability benefit if a severe (or catastrophic) disability occurs. To be considered catastrophically disabled with most carriers, one must have: permanent blindness, permanent deafness, permanent loss of speech, permanent loss of use of any two limbs, inability to do 2 of 6 Activities of Daily Living (ADLs), or a permanent severe cognitive impairment.

The consequence of not having a catastrophic benefit feature is that you put yourself at risk because your basic disability benefit may not give you enough income to protect your standard of living in the event of a catastrophic disability. When catastrophic disability occurs, your living expenses are going to increase for the extra healthcare and assistance you're going to need. The catastrophic benefit feature gives you extra benefit on top of your base to help compensate for these added expenses. By using this feature, a quality carrier can bring you potentially to 100% of your prior income tax-free. Yes, 100% of your income tax free will give you more spendable dollars than 100% of your after income tax earnings. However, this

extra income may be needed to help offset the increased cost of living often associated with a catastrophic disability.

For example, let's assume you are a highly compensated individual, say a surgeon, that makes \$465k a year and has \$15k month of a quality own occupation individual DI policy. You become totally disabled by definition of the policy and can no longer perform surgery due to loss of fine motor control of your dominant arm and hand. Assuming that you are otherwise healthy, the \$15k month would likely be enough to maintain your household even though the \$15k benefit is less than what was being cleared after income taxes when working. What would happen if you had a stroke, a horrible car accident that resulted in paralysis of the 4 limbs, etc? In any of those catastrophic situations the \$15k may be inadequate due to the added cost of living due to the very significant change in health. You may need around the clock care and may even need to hire a nanny to take care of the kids in addition to home modification to accommodate a wheelchair. Does this make sense why I am a big believer in the CAT rider? Another thing to note is that it is not an expensive rider but may pay significantly more if you qualify.

◆ Unemployment Premium Waiver Rider (UPWR)

Definition: This rider waives the premium for one year if the insured is laid off and collecting unemployment benefits for 60 consecutive days.

Without this rider in today's uncertain financial times, many run the risk of not being able to pay the premium (lapse the policy coverage) in the event of prolonged unemployment.

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