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Disability Insurance Replaces Income When You Can't Work

By Sandy John, Contributing Reporter

How would you pay your bills if you couldn't work? Where would the money come from if you developed a serious illness or suffered a disabling accident that kept you off the job for months -- or years?

An oft-repeated statistic is that nearly one-third of working age people will suffer a disability that lasts at least three months at some point during their careers. Financial experts recommend disability insurance to cover the loss of income in such an event.

Some common misconceptions may keep people from buying a disability policy. Many, for example, think Social Security will cover a disability. However, Social Security only covers you if you are unable to work at any job, not just the career you're trained in. To be eligible, your disability also has to be expected to last at least one year or to lead to your death. If you do qualify, the benefit may not be enough to cover your needs. In 1999, the average monthly disability payment from Social Security was $733.

Others assume worker's comp will cover them, but worker's compensation only covers job-related disabilities. Auto accidents and illnesses aren't covered.

Finally, many workers have a group disability policy through their job, and they think that's enough. However, such policies often provide only about 60 percent of your salary, and might cap it at a smaller dollar amount if you are highly paid. Plus, if the company pays for the policy, the benefits are taxable, further cutting into your income. (If you pay the premiums, the benefits are tax-free.)

So, for many people, a good individual disability policy (or a supplemental policy to go along with your employer-provided plan) is necessary. Shopping for a disability policy can be tricky, however, because there are so many elements to consider.

Consumers are often surprised to find out that individual policies, unlike group policies, don't express benefits as a percentage of income. Instead, you'll be offered insurance that promises a specific monthly amount -- and if your have a high income, it could be less than 60 percent of your monthly salary. "Disability insurance isn't there to make the rich richer," said Steve Crawford, managing director of Guardian Disability Insurance Brokerage in Rockville, MD. (http: www.guardiandibrokerage.com). "It's to allow you to maintain your standard of living and give you an incentive to return to work when you are able."

When buying a policy, the most important aspects to look into are the definition of disability, the company's stability, and the renewability of the policy, Crawford said. Don't just shop rates, he cautioned, because a cheap policy probably defines disability so narrowly that few people will ever qualify for benefits.

What you want, even though it will cost more, is an "own-occupation policy." With this kind of policy, you are eligible for benefits when you can't carry out the duties of your regular occupation. With an "any-occupation" policy, you wouldn't qualify for benefits unless you are completely unable to work at any job. The policy should also cover both accidents and illness, according to the Health Insurance Association of America. The older you get, the more likely it is you'll be disabled by illness, rather than an injury.

It's also important to get a policy that is "non-cancelable." Such a policy is guaranteed renewable, as long as you pay the premiums, and the premiums can't be raised. A "guaranteed renewable" policy sounds like it's the same thing, but it doesn't lock in premiums, so you have less protection.

Other features to consider:

- Residual benefits -- this features helps make up the difference in income if you can only work part-time or at a lower-paying job than your regular occupation.
- Benefit period -- how long benefits will be paid. Since you don't know how long you'll be disabled, financial experts recommend coverage that will last until you are 65, when you can start drawing retirement. The longer the benefit period, the higher the premiums.
- Elimination period -- also called the waiting period, this is the amount of time (90 days, 120 days, a year) that will lapse before benefits kick in. A shorter waiting period means higher premiums. If you have a sizable emergency nest egg, you can save on premiums by choosing a long elimination period.
- Inflation adjustment -- this rider helps benefits keep up with the rising cost of living.

The financial strength of the insurer is another important consideration, Crawford said. Look for one that's been in business a long time and is financially stable by checking the insurance rating services. A few companies have reputations for not being willing to pay claims, Crawford said, adding that consumer complaints on specific companies are frequently posted on Internet bulletin boards. Also check with your state insurance office to see about complaints.