AHIP

America's Health Insurance Plans

Guide to Disability Income Insurance

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Introduction

Could you continue to take care of your family and pay your bills if you were sick or injured and unable to work for any length of time? Do you know how much money would be coming in each month—and from where—if you were to become disabled?

Not everyone is covered for disability income. Some can rely on their employer's group disability coverage. Others are covered by government disability programs. But, for many people, an illness or injury that stops their paychecks would create problems for them and their families.

Disability income insurance can help.

It is designed to replace a major portion of income when sickness or injury prevents a person from earning a living. It can help pay regular monthly bills while a person is recovering, but is still unable to do his or her job.

This guide explains a number of important things:

- The chances of becoming disabled
- How it can affect your finances
- Possible sources of disability income
- What disability income insurance is
- What disability income insurance covers

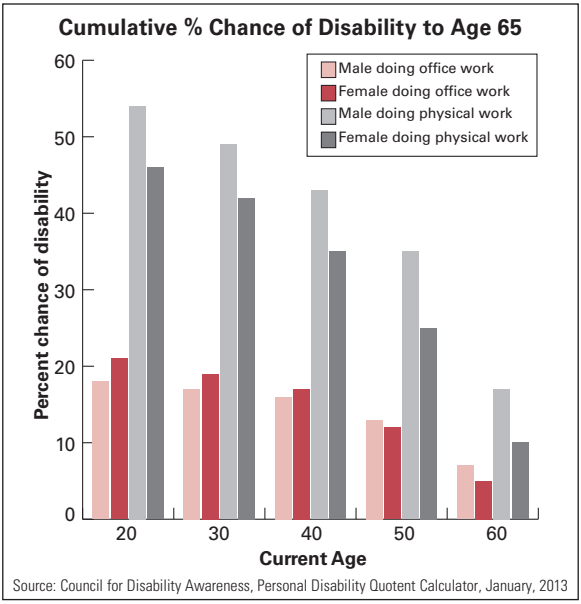
This guide will help you think about how much income you would need if you became disabled and were unable to work, and possible sources of disability income. It also includes a checklist to help you compare disability income insurance policies.

How Likely Is a Disability That Could Prevent You From Working?

According to the Council for Disability Awareness (CDA):

- A 30-year-old male employed in a job requiring physial labor faces very nearly a one-in-two chance of diability before reaching age 65.
- A 20-year-old female employed doing office work faces more than a one-in-five chance of disability before reaching 65.

The risk of a long-term disability during a worker's career is greater than the risk of premature death. Yet most workers would never think of going without life insurance protection for their families.



Source: Council for Disability Awareness, Personal Disability Quotent Calculator, January, 2013

The most common causes of long-term disability are:

- Muscle, bone, and joint conditions (26%)
- Cancers (15%)
- Injuries and poisonings (11%)
- Heart and blood vessel conditions (9%)
- Mental health disorders (8%)
- Nervous system disorders (8%)

(Source: Gen Re, 2012, U.S. Group Disability Rate & Risk Management Survey Data is for new long-term disability claims in 2011.

What Might Disability Mean Financially for You and Your Family?

It can take a huge toll on your finances.

A lengthy disability that takes away the main source of income can be devastating to a worker and his or her family. It reduces income while adding large expenses, such as the need for help with everyday activities.

For example, a 45-year-old worker making $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 retirement savings.

Savings often aren't large enough to help.

Savings can play a key part in meeting financial needs during a disability. But most workers' savings would only help their families through a few months.

- More than three-quarters (77%) of workers think that missing work for at least three months because of injury or illness would cause a financial hardship, while half think it would cause a "great hardship."
- Nearly all households (90%) say that they would suffer financial hardship if they were disabled and unable to work for a year.[1]

[1] Source: Consumer Federation of America and Unum, "Employee Knowledge and Attitudes About Employer-provided Disability Insurance," Opinion Research Corporation Survey, April 2012.

What Is Disability Income Insurance?

It is insurance that provides you with income if you ever become disabled. It helps protect against family financial disaster by providing income to meet everyday needs during a disability. It comes in three main forms:

Government-sponsored programs: These include workers' compensation and the Social Security Disability Insurance (SSDI) program.

Private employer-sponsored group disability plans: This coverage is an important benefit for many employees. It provides income replacement that enables employees who are disabled to pay bills and maintain their lifestyle.

Employers may sponsor short- or long-term disability coverage, or a combination of both. The employer often pays for all, or part, of the premiums for the coverage.

Private individual disability income policies: Individuals pay for these policies. They guarantee income when there isn't enough employer- or government-sponsored coverage.

Are You Covered by Group Disability Benefits?

First, be aware of the difference between short-term and long-term disability insurance.

Short-term: Many employers provide disability income benefits under a short-term disability plan, which may provide benefits for as long as six months. Coverage periods vary. Some state laws require most employers to provide temporary disability income benefits for up to 26, 30, or even 52 weeks.

Long-term: No state or federal laws require employers to offer coverage for long-term disability, typically defined as lasting for more than six months. But the Bureau of Labor Statistics, U.S. Department of Labor, indicated that in 2011 nearly one in three U.S. workers were offered employer-sponsored group long-term disability (LTD) coverage.

Generally, employer-sponsored group long-term disability

plans replace about 60% of base salary (usually, bonuses **are not** included). Long-term disability benefits typically start three or six months after a worker becomes disabled, and continue anywhere from five years to age 65. Often, group long-term disability insurance coverage is fully paid for by employers without any payments being made by employees.

Next, find out exactly what benefits your employer offers in the event of a disabling illness or injury.

Check with your employer to see if you have disability income coverage. If you do, find out:

- What benefits would be available to you
- How long after the start of a disability you would have to wait before benefits begin
- How long payments would continue
- If your employer's plan takes other disability coverage (such as government programs) into account
- If your long-term disability benefit is subject to a maximum amount you can receive

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

Would You Qualify for Social Security Disability Insurance (SSDI) Benefits?

Social Security Disability Insurance:

Most workers in the United States participate in the federal government's Social Security program. Social Security (SS) is best known for its retirement benefits.

The Social Security Administration also administers the Social Security Disability Insurance (SSDI) program. The SSDI program provides benefits for disability—not for retirement.

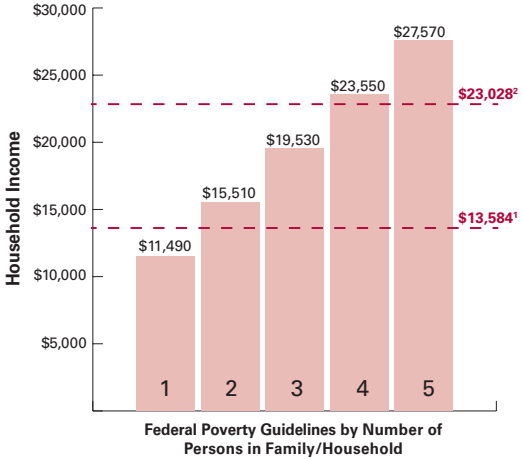
Find out if you would qualify for SSDI if you were ever to become disabled.

Contact your local Social Security Administration office to find out if you would qualify for SSDI if you were to become disabled. They can help you estimate the disability benefits you would get. You can go to the agency's website at www.ssa.gov to find a disability benefit calculator and other SSDI program information.

Know what to expect: If you qualify for SSDI benefits, your income and work history determine the amount of your SSDI benefits.

Be aware of what some people get: There were more than 10 million SSDI recipients in 2012. This includes eligible spouses and children of disabled workers. The average monthly SSDI benefit for a disabled worker is $1,113 (2013).

FOR MANY FAMILIES, SOCIAL SECURITY DISABILITY BENEFITS ARE BARELY ENOUGH TO STAY OUT OF POVERTY



Sources: U.S. Department of Health and Human Services 2013 Poverty Guidelines (48 Contiguous States and the District of Columbia), Federal Register, January 24, 2013, Social Security Administration Fact Sheet for 2013

[1] **Average Annual SSDI Benefit for Disabled Workers in 2013**

[2] **Average Annual SSDI Benefit for Disabled Worker, Spouse and one or more children in 2013**

SSDI benefits can be an important source of income should you suffer a disabling illness or injury. Bear in mind some important points:

- It can be difficult to qualify for SSDI benefits. To qualify for SSDI benefits, a disabled worker needs to prove that he or she cannot perform work that earns any significant amount of money. Disabled workers are eligible for SSDI benefits only if a disability is expected to last for at least 12 months or result in death.
- The time it takes the Social Security Administration to approve an SSDI claim often delays benefits for months—or years in some cases.
- Disability income payments made under other government programs may reduce SSDI payments. Why? Because the total combined payments from Social Security, workers' compensation, civil service, and military programs generally cannot be more than 80% of your average pre-disability earnings.
- SSDI payments can be subject to federal income tax. This is the case when your "combined income" (adjusted gross income plus any nontaxable interest income and half of your benefits) is more than a certain amount.

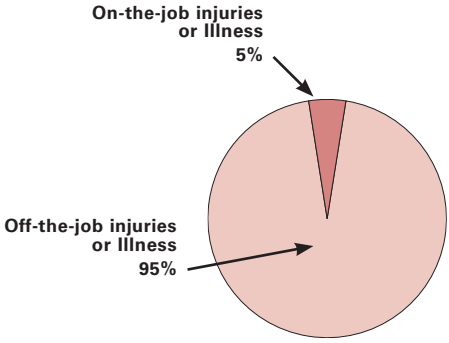
- SSDI benefits often are not enough to maintain an average lifestyle for those who do qualify. In fact, as the figure to the left shows, relying on SSDI benefits alone would leave many families near or below poverty, as defined by the U.S. Department of Health and Human Services Federal Poverty Guidelines.

What Does Workers' Compensation Cover?

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 eligible for limited disability income benefits. Typically, these payments are equal to two-thirds of pre-disability income, within various state limits.

Workers' compensation, however, 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.

MOST LONG-TERM DISABILITIES ARE NOT COVERED BY WORKERS' COMPENSATION.



Source: Council for Disability Awareness, 2012 Long Term Disability Claims Review

Are You Eligible for Disability Income From Other Sources?

There are a number of other possible sources of income if you become disabled. The availability and extent of these and other programs vary widely. But, one or more may be an important source of income should you become disabled.

For veterans: Veterans Administration pension disability benefits for eligible veterans

For civil servants: Civil service disability pay for federal or state government workers

For miners: Black lung program for miners

For union members: Group union disability coverage

For low-income citizens: Supplemental Security Income (SSI) for those with low incomes and limited assets

For people in debt: Private insurance, such as credit disability insurance, that makes monthly loan payments when you are disabled

Vocational rehabilitation: State occupational rehabilitation programs

Automobile: Automobile insurance, if your disability results from an auto accident

Your own savings: Of course, your own resources, such as a savings account, can be another important source of disability income

Find out if you are eligible for any of the above. If you are, find out how long benefits will be paid. If you have savings, figure out how long they will last.

How Much Disability Income Will You Need?

Here's how to find out:

Calculate your benefits. Add up all the income you may be entitled to under the public and private programs listed.

Calculate your savings. Add up the monthly income you could include from other sources, such as your personal savings.

Add them up. If the total income approaches the income you need after taxes, you can assume that, should total disability strike, you would be able to pay your day-to-day bills while getting better.

Then, think about added expenses. A disabled individual may face increased 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 to make the home disabled-accessible by adding ramps and widening doorways.

Decide if you need additional income. The total from employer benefits, Social Security, and other programs, along with your own resources, may not be close to your pre-disability, after-tax income. It may not be enough to support your family. If it is not enough, you will want to consider buying more disability income insurance to make up the difference.

Be aware that some things may reduce your disability income benefits.

Social Security or Other Government Benefits. The amount of long-term disability benefits you may collect may be reduced by the amount received from Social Security or other government programs. This is true whether you are covered through your employer's group plan or through your personal insurance benefits.

Taxes. Although disability income benefits are tax-free when an individual has paid the policy premiums, disability income benefits are taxable when received from a policy an employer has paid for.

These facts must be taken into account when you are trying to figure out your disability income needs.

Think about your work situation.

If you are an employer, consider a group policy for you and your employees.

If you are self-employed, an individual policy is a good idea.

If you work for a business that does not provide benefits under a group policy, an individual policy is also a good idea.

Consider using an agent.

Whether you are an employee or an employer, an insurance agent can help you analyze your sources of disability income, determine how long it will take to receive various benefits, and determine whether additional coverage would be wise.

What to Look for in a Policy

You may 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 look for:

Definition of Disability

Be sure to determine how various policies define disability. Policies vary. Some pay benefits if you can't do your regular job. Others pay only if you can't work at all.

Extent of Disability (Total or Partial)

Some older policies require that you be totally disabled before payments begin.

Partial disability sometimes is covered for a limited time.

But, most often, partial disability is covered only if it follows a period of total disability from the same cause.

Some policies may not require total disability before partial disability payments are made.

Residual Benefits

A residual benefit allows partial payment based on your loss of income. For example, suppose you were able to work, but your income is reduced because you cannot fulfill all of your job responsibilities. In this case, residual benefits can help to make up the difference in your income.

Residual benefits can generally be paid without total prior disability. It is a standard feature in some policies. But, in other policies, it is a feature that is added to the policy with a rider for an additional premium.

Presumptive Disability

Under some policies, you may be presumed to be fully disabled and entitled to full benefits, even if you can still perform some or all of your regular job duties. This can happen under certain conditions, such as losing your sight, speech, hearing, or use of your limbs. In these cases, the "elimination" period is generally waived. A plan's elimination period is the length of time between when the disability begins and the point at which the payment of disability benefits starts.

Amount of Benefits

Monthly benefits are generally calculated as a percentage of your stable, earned income at the time you buy the policy.

A typical disability insurance benefit is 60% of pre-disability income.

Disability income insurance policies generally require that disability payments from all sources cannot approach or exceed pre-disability income. So the amount of benefits paid by a disability income policy may be reduced when a disabled worker is getting disability payments from other sources, such as workers' compensation or the SSDI program.

When Payments Begin

Many policies allow you to decide when benefit payments begin. You can choose a waiting period at the time of application. The waiting period may range anywhere from 30 days to 180 days, or more, after the disability begins.

Depending on how much money you have saved, and your other resources, you can reduce the amount you pay for your policy by electing to wait 60 days, 90 days, or even 180 days before you would 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

When you choose a "benefit term," you are choosing how long benefits are payable to you: for one year, two years, five years, or to retirement age. Since disability benefits are designed to replace the income you would otherwise earn by working, most people do not choose benefits extending beyond their working years.

A lengthy disability threatens your financial security much more than a short-term disability. Choosing shorter benefit periods can save you dollars on the policy itself. Bear in mind that if you need this insurance at all, you probably would need it most to cover a disability that permanently removes you from the workforce.

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 the benefit payout by a specific percentage, after each year of disability. Generally, the increase is from 4% to 10%. This 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 undergo a medical examination or to provide further medical evidence that you are still insurable.

Waiver of Premium

- Most policies include a "waiver of premium" provision so that you don't have to pay any more money on the disability policy after you're disabled for 90 days and until your disability ends.

Non-Cancelable Versus Guaranteed Renewable

Selecting the kind and length of benefits is only the first step. You should also ask about your choices for keeping your disability policy in force. Most disability income insurance comes with one of two types of renewal options:

Non-cancelable policies give you the right to continue a policy by paying the premiums on time. In this case, the insurance company cannot change the premiums and benefits shown in the policy.

Guaranteed renewable policies will be automatically renewed with the same benefits. The premium, however, may go up if it is changed for everyone who has the same insurance policy from the company.

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 or 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

Consider carefully the kind of protection that is best for you and your family. Some policies pay for disability arising from accidents, but not illnesses. Illnesses, however, are a frequent cause of disability. In fact, as you get older, it is more likely that you will need disability coverage for an illness than for an injury.

What to Expect When Applying for Coverage

When someone applies for individual disability income coverage, the insurance agent or insurance company will require the person to provide information including general information, medical history, income, and employment.

General information includes name, address, sex, age, Social Security number, and citizenship status. This information is used to verify your identity; to permit access to important sources of financial information; and to provide information that the company needs to issue an insurance plan.

Employment information enables the insurance company to understand your occupation and work duties. Full and accurate disclosure is extremely important. You should, for instance, provide information on both full- and part-time jobs.

Medical history information includes information about any illnesses, accidents, or treatments you may have had, and whether you have had certain medical tests within the past few years. Occasionally, your application for individual disability income insurance may require one or more medical tests—such as an EKG. You will also likely be asked for blood testing, including a test for exposure to HIV (the virus that causes AIDS). The insurance company must handle these tests and test results in a way that keeps them confidential.

Financial information is necessary for an individual disability income insurance application so that the insurance company understands the income that is to be insured. The insurance company will ask you for information about wages, salary, and other compensation. Self-employed applicants are asked to provide information about net earnings. Information about other income, such as dividends, interest, and rents, must also be provided. It is very likely that you will be asked to provide copies of income tax returns. The insurer must treat all such financial information confidentially.

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 paid some or all of the premiums, some or all of the benefits may be taxable.

Business Protection for Small Business Owners

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

There are recovery benefits that pay after you return to work full time. These apply during the period in which you are re-establishing a customer or client base. There is overhead expense coverage that pays for certain office expenses.

For jointly owned businesses, there is a disability buy-out policy that provides funds for one partner (or the business entity) to buy a disabled partner's share of the business. And there is key-person insurance. This protects a firm against the loss of income resulting from the disability of a key employee.

Disability Insurance Policy Checklist

Every policy may have different features. The following checklist will help you compare policies you may be considering:

1. How is disability defined? Is it defined as the inability to perform your own job, or inability to do any job?
2. Does the policy only cover disability from accidents, or both accidents and illness?
3. Are benefits available for partial or residual disability, as well as for total disability?
4. Are full benefits paid, whether or not you are able to work, for loss of sight, loss of hearing, or loss 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 you be disabled before premiums are waived?
8. Is there an option to buy additional coverage, without undergoing additional medical tests or examinations, 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 a waiting period (until benefits begin) should you select to fit your situation?

How long do you want to receive disability income should it become necessary?

How much coverage can you get at your present salary?

A Final Word

Read the policy itself before you buy. 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.

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 that outlines the 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 within the company.

Be aware that you have some time to return your policy. 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, find out how to contact your state's department of insurance. You should know that every state has a department of insurance that regulates insurers and helps 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.

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About AHIP

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