CHAPTER 14
DISABILITY INCOME

Disability income insurance provides the insured with an income after being disabled due to an accident or illness. It is probably the most overlooked form of insurance. People frequently will purchase life insurance, health insurance, and annuities and forget about disability income insurance. Statistics show that if someone is 35, there is a 45% chance of suffering a disability for at least 90 days before turning 65. Once a disability has lasted 90 days, the average length of disability is 2½ years. When someone is out of work, his/her income can end and yet everyday expenses continue. When a person suffers this form of economic death, a disability income policy can provide the needed income. When purchasing a disability income policy, a person should take into consideration all other possible sources which might provide some income. Workers compensation will pay for work related injuries and illness. Social Security Disability would pay a benefit if the person could meet the Social Security definition of total disability. The person under 65 years of age would be covered by Medicare after being on Social Security Disability for 24 months. There is the California program of State Disability Insurance into which employees are required to contribute. Employers might provide group disability insurance for employees.

BENEFIT AMOUNTS

Benefits paid by a disability income policy are in the form of monthly payments. Benefit amounts are limited and are defined in terms of the insured's earnings. The benefit ceiling will be less than the insured's regular earnings. If disability income payments were more than an insured's earnings, there would be no incentive to recover and return to work.

Benefit payments will be based on a percentage of the insured's earnings or could be a flat amount. Under the percentage method, all sources of disability income will be taken into consideration. In other words, the various sources integrate the benefits they will pay. If a policy stated it would pay 60% of earnings, it would coordinate with other sources of income to make certain that the insured did not receive more than 60% of income. Some policies may pay a benefit that varies with length of disability. A policy could pay 100% of income for the first month of disability and reduce the amount for following months to a lower percentage rate (i.e. 60%-70%). This percentage method normally is used in group disability income plans.

A flat benefit amount method pays a specified payment if the insured becomes totally disabled. Limits of payments will be based on current income. This flat benefit amount typically is payable regardless of other sources of income. The flat benefit amount normally is found in individual plans.

DEFINING DISABILITY

In order to receive benefits, the insured must meet the definition of total disability. The term *total disability* will be defined in the policy and different companies will define the term differently. Most policies define total disability in terms of the insured's work activity. The insured's ability to do his/her own occupation or any occupation for which qualified.

Own occupation defines total disability as the insured's inability to perform any or all of the duties of his/her own occupation as a result of sickness or accident. This simply means the insured can no longer perform the job he/she was doing at the time of disability. This is the most advantageous definition for the insured. Such a policy also will carry the most expensive premium payment.

The own occupation policy may use the definition of own occupation for a certain length of time (e.g. 2 years to 5 years). After that amount of time, the qualifying definition can be changed to any occupation.

Any occupation defines total disability as the insured's inability to perform the duties of any occupation for which the insured is reasonably qualified by education, training, or experience. This is a more restrictive definition of total disability and is less favorable to the insured. A surgeon may no longer be able to perform surgery due to damage to one hand, but he still could function as a general practitioner. The surgeon would not qualify for benefits under the any occupation definition.

Permanent/Temporary Disability

A permanent disability is one that reduces or eliminates the ability of the insured to work for the remainder of his/her life. A temporary disability leaves the insured unable to work while recovering from the illness or injury. However, the insured is expected to make a full recovery from the temporary disability.

Presumptive Disability

Many disability policies will state that a presumptive disability classifies as a total disability. Presumptive disabilities involve extreme losses and automatically qualify the insured for total disability benefits regardless of whether the insured can work or not. Presumptive disabilities are loss of use of any two limbs, total and complete blindness, and loss of speech and hearing.

Another criterion for presumptive disability is the loss of earnings test. If the insured is working after such a disability and he/she suffers a loss of income that falls below a certain percentage of pre-disability earnings, the insured is considered to be totally disabled and eligible to receive full benefits even if working and earnings continue at this lower level.

Injury or Illness

Some policies may further break down whether a disability is covered based on if it is caused by an accident or illness. In these cases the policies may be referred to as a total accident (injury) policy or a total sickness policy. Today most polices cover disabilities caused by either an accident or sickness.

Another matter to consider is the manner in which the policy defines the cause of the injury. Policies that use the *accidental means provision* are concerned with the cause of the injury. The injury must have been caused by an unexpected, unforeseen event not under the control of the insured. Policies that use the *accidental bodily injury provision* are concerned with the result of the injury. The injury has to be unexpected and accidental.

If a person were to jump off a ski jump and suffer an injury, it would not be covered if the policy used the definition of accidental means. After all, the jump was intentional. If the policy used the accidental bodily injury provision, the injury would be covered as the resulting injury was unintentional and accidental.

Most policies use the accidental bodily injury provision. It is less restrictive than the accidental means provision.

Non-disabling Injuries

An insured could suffer an injury that does not qualify for income benefits under the disability income policy. Some of these policies pay a medical expense benefit that pays for the cost of treatment for the non-disabling injury. Normally the benefit is limited to a percentage of the monthly income benefit.

Partial Disability

A partial disability can be defined as the insured's inability to perform one or more important duties of his/her own occupation or the inability of the insured to work on a full-time basis. It is typical for disability income policies to make a provision for partial disability whether it is incorporated into the policy or added as a rider to the policy. Some policies may require that the insured originally suffer a total disability and then recover to the extent that he/she is partially disabled. The insured who is partially disabled can then return to work and perform some of the duties of his/her occupation or return to work on a part time basis. This shortens the length of time for total disability payments and protects the insured as he/she feels able to return to work knowing that all disability income benefits will not cease. A partial disability benefit normally pays 50% of the full disability income benefit.

Residual Disability

Some policies provide for residual disability benefits. An insured may be able to return to work, but due to the disability he/she cannot earn as much as prior to suffering the disability. A residual disability benefit is based on the percentage of income that the insured has lost due to the disability. For instance, an insured was receiving $1,000 a month disability payment due to a total disability. Eventually this insured recovered to the extent that working part time was possible, but the insured was now receiving $500 a month for the part-time work. The insured would receive $500 a month from the disability policy due to the residual disability. This benefit payment would be adjusted downward monthly to reflect any increase in earned income.

Recurrent Disability

A disability sometimes may appear to be over, but the disability recurs later due to the original sickness or accident. If the reoccurrence happens within 90 days to six months (whatever the time stipulated in the policy) after the insured has returned to work, it would be considered a recurrent disability (a continuation of the first disability). The recurrent disability would not require a new elimination period.

If the policy stipulated reoccurrence had to take place within six months and the insured had returned to work for seven months before suffering an additional disability, the second disability would be considered a new disability with a new elimination period.

Delayed Disability

A person could suffer an accident and have a delayed disability. At first the injury did not seem severe, but after awhile the individual became totally disabled. Most policies will pay disability income benefits to the insured if the disability occurs within a specified amount of time such as 20, 30, 60, or 90 days.

POLICY PROVISIONS

Probationary Period

The probationary period is the time that must elapse after the effective date of a policy before benefits are payable. The probationary period ranges from 15 to 30 days. The reason for the probationary period is to avoid adverse selection for the insurer by excluding pre-existing sicknesses from coverage. The probationary period only applies to sickness and does not apply to accident. A person could be aware of a potential sickness disability, but an accident disability cannot be anticipated or predicted.

Elimination Period

The elimination period is a waiting period after an insured suffers a covered disability until benefits become payable. It can be thought of as a deductible in time. In some disability income contracts, the elimination period may apply only to disabilities caused by an illness and not to disabilities caused by an accident.

Elimination periods range from 30 days to one year. An insured will need to determine how long he/she can go without an income. The longer the elimination period, the lower the premium.

Benefit Period

The amount of time for which benefits will be paid is the benefit period. Benefit periods can range from one year to age 65. The longer the benefit period, the higher the premium.

A short-term disability income policy typically pays benefits for six months. If a policy pays benefits for two years or longer, it is normally considered long term. A long-term policy may pay benefits to age 65 for illness and for life for disabilities due to injury. Most short-term policies cover non-occupational disabilities. Most long-term policies cover both occupational and non-occupational sickness and injuries. Occupational benefits will be reduced by any benefit amounts received through other sources such as workers compensation and Social Security.

EXCLUSIONS

Common exclusions in disability income policies include losses arising from war and military service, attempted suicide, overseas residence, piloting a private plane or being a crew member in a private plane, and injury sustained while committing a felony.

OPTIONAL DISABILITY POLICY RIDERS AND BENEFITS

Rehabilitation Benefit

If a disability income policy contains a rehabilitation benefit, it will provide coverage for physical therapy and vocational training besides paying disability income.

Waiver of Premium Rider

The waiver of premium rider allows the insured to waive premium during a period of total disability. The insured will have to be disabled for a time specified in the policy, normally three to six months. Most insurance companies will return any premium paid during the waiting period to the insured if the disability extends beyond the waiting period.

The waiver of premium rider normally ends upon the insured reaching a certain age, such as 60 or 65. The additional premium charged for the rider ends when the rider terminates.

The waiver of premium rider usually is included in policies that are guaranteed renewable or non-cancelable.

Return of Premium Rider

The return of premium rider actually refunds premium to the insured if he/she is not disabled. It may refund all the premiums paid if there are no claims or it may refund a portion of premium if claim costs do not exceed a specified percentage of the premiums paid.

This is a costly rider. If the insured should become disabled, he/she would receive the exact same benefits under the disability income policy. The insured would have paid a lot of additional premium for benefits he/she would not receive.

Cost of Living Adjustment Rider

The cost of living adjustment rider helps the insured keep up with inflation. Normally the benefit amount will be adjusted to changes in the Consumer Price Index. The insured's monthly benefit will be adjusted annually while receiving benefits.

When the disability ceases, the insured has the right to decide to maintain the policy at the new increased benefit amount and pay a higher premium, or the insured may decide to allow the policy to return to its original amount and keep the same lower premium.

Guaranteed Insurability Rider (Automatic Increase Option)

The guaranteed insurability rider (guaranteed purchase option) allows the insured to purchase additional amounts of disability income coverage at specified intervals until obtaining a certain age (e.g. 50) without proof of insurability. The rate charged for the additional coverage will be based on the insured's attained age at the time of the additional purchase. The insurance company will require the insured to show proof of increased income to purchase the additional disability income in order to avoid overinsurance.

Social Insurance Supplement Rider

The social insurance supplement rider or Social Security rider provides additional income payments to an insured when his/her social insurance benefits have not started, have been denied, or are being paid at a lesser benefit than anticipated. The benefits expected by the insured must be reasonable and reflect his/her earning level. The insured must apply for social benefits. When these benefits are received, the social insurance supplement rider will pay the difference between the expected benefit stated in the policy and the actual benefit paid.

Social insurance benefits include those received from workers compensation, Social security disability, and any local or state program.

Accidental Death and Dismemberment (AD&D)

The accidental death and dismemberment rider pays a death benefit if the insured dies as a result of an accidental bodily injury. This death benefit really is a form of life insurance and, therefore, the beneficiary rider designates the entity to receive the death benefit which is referred to as the *principal sum*. If the insured suffers a dismemberment, he/she will receive a payment (called the *capital sum*) according to a schedule in the policy. This lump sum payment for dismemberment can be used for rehabilitation and training for a job for which the insured is suited.

Hospital Confinement Rider

Disability income policies have an elimination period. However, the hospital confinement rider pays the regular total disability benefit to the insured while confined to the hospital during the elimination period. The benefit is paid only as long as the insured is hospitalized. If the insured had a disability income policy with a 30-day elimination period that paid $1,500 a month and he/she were hospitalized for three days, the rider would pay 3/30 or 1/10 of the monthly benefit or $150.

BUSINESS USES OF DISABILITY INSURANCE

Key Person Disability

Key person disability insurance will replace income lost due to disability of a key employee. A key employee is a person essential to the smooth running of a business. The benefit from the key person disability insurance can be in the form of salary continuation. In other words, the benefit is paid directly to the disabled key employee. The business will free up money in this way allowing it to replace and train a new employee.

Key person disability insurance can pay the benefit directly to the business. The funds from the policy help to protect the company should it suffer a loss of income due to losing a key employee.

Disability Buy-Sell

Business partners may wish to purchase disability insurance to fund a buy-sell agreement. Should a partner become disabled, the disabled partner might want to dispose of his/her interest in the business. If the remaining partners cannot afford to buy out the disabled partner's interest, the business may have to be liquidated. A disability buy-sell insurance policy will provide the needed funds to buy out the disabled partner.

Business Overhead Expense (BOE)

Business overhead expense is a policy sold to business owners to cover routine overhead and wages if a business owner becomes disabled. Such a policy is not meant to cover costs such as new inventory and capital goods. It is meant to keep the business afloat until the recovery of the business owner.

Reducing Term Disability

A business might have long-term financial commitments that require regular payments. If a business owner or key employee were to be disabled, the business might experience a loss of revenue making these financial obligations difficult to meet. To cover decreasing financial obligations, decreasing term insurance can be used. The amount of insurance decreases as the loan amount decreases.

GOVERNMENT DISABILITY PROGRAMS

The federal Family and Medical Leave Act (FMLA) and California's Family Rights Act (CFRA) entitles eligible employees working for covered employers to take unpaid, job-protected leave for up to 12 workweeks in a 12 month period. The leave may be taken for the birth, adoption, or foster placement of a new child, to care for a seriously ill child, parent, or spouse, or for the employee's own serious health problem.

California's Paid Family Leave is a component of the state's unemployment compensation disability insurance program (SDI) and is funded through employee contributions. It provides up to six weeks of wage replacement benefits in a 12-month period. SDI also provides benefits for workers who need time off due to their own non-work-related injuries, illnesses, or conditions, including pregnancy. A new mother can apply for Paid Family Leave insurance benefits as soon as she recovers from the pregnancy-related disability and is no longer in receipt of State Disability Insurance benefits.

REVIEW QUESTIONS

1. A disability income policy could exclude coverage for all of the following except:

    A. Injury due to an act of war
    B. Injury while committing a felony
    C. Injury occurring while flying a private plane
    D. Non-occupational injury

2. What type of disability insurance would provide benefits if someone becomes ill and is unable to work?

    A. Major medical insurance
    B. Credit life insurance
    C. Credit disability insurance
    D. Disability income insurance

3. An insured's accident policy uses the phrase "accidental bodily injury" to define what constitutes accidental injury and /or resulting death. This phrase:

    A. Means the insured will receive a lower benefit than a policy that uses the phrase "accidental means".
    B. Means the same as the phrase "accidental means".
    C. Is less restrictive than the phrase "accidental means".
    D. Is more restrictive than the phrase "accidental means".

4. Total disability can be defined differently in various policies. Which of the following means that the insured cannot perform the duties of an occupation for which he/she is reasonably qualified by education, training, and experience?

    A. Own occupation
    B. Any occupation
    C. Residual disability
    D. Delayed disability

5. George returned to work after recovering from a disability. However, he now is earning less as he can only work on a part-time basis. This is referred to as a:

    A. Partial disability
    B. Presumptive disability
    C. Recurrent disability
    D. Residual disability

6. A person is classified as being totally disabled as he suffered the loss of a leg and an arm in an automobile accident. This is called a:

   A. Recurrent disability
   B. Residual disability
   C. Presumptive disability
   D. Delayed disability

7. The period of time after an insured suffers a covered disability until benefits become payable is the:

   A. Probationary period
   B. Eligibility period
   C. Elimination period
   D. Benefit period

8. There is a rider that can be added to a disability income policy that makes up for social insurance benefits that have not started, were denied, or paid at a lesser benefit. It is called:

   A. Guaranteed insurability rider
   B. Cost of living rider
   C. Rehabilitation rider
   D. Social insurance supplement rider

9. A company that wishes to protect itself from various possible losses might wish to consider purchasing:

   A. Reducing term disability insurance
   B. Business overhead expense insurance
   C. Key person disability insurance
   D. All of the above

10. Benefit amounts under disability income policies:

   A. Are not related to the insured’s earnings.
   B. Frequently are more than the insured’s earnings if he/she has several disability income policies.
   C. Are normally paid on a semi-annual or annual basis.
   D. Are limited and defined in terms of the insured’s earnings.