Most People Don't Have Enough Disability Insurance ─ Don't Make That Mistake

Disability insurance protects your ability to earn an income. It provides money to pay your rent, mortgage and all your basic living expenses if you are injured or sick for an extended period. It is called disability Insurance or disability income protection but think of it as income replacement when you are sick or hurt and cannot work. At any age, you are about six times more likely to be disabled for some period of time than to die.

Think your employer's coverage is enough? Think again. You may have whatever sick leave you have coming, and then if an employer offers short-term disability coverage, it generally doesn't last more than 12 weeks. There are employers that offer long-term disability coverage, but if you've never checked the terms of that coverage, you should.

It never hurts to consult a financial advisor with expertise in this subject, such as a Certified Financial Planner™ professional.

Basic components of long-term disability coverage:

Monthly benefits: Long-term disability insurance is generally structured to pay 70 percent of your income up to age 67 or your normal retirement age. See if the policy you're buying offers you the chance to buy more insurance as your income increases in future years.

Benefit term: For each disabling incident, your policy may pay benefits for a certain period – two, five years or until retirement. It's all in how your policy is constructed. Many policies may pay for life if you purchase this benefit and you are disabled prior to age 60.

Buying younger is generally cheaper: Like health and life insurance, the younger you buy, the less you'll pay. Occupation enters into the picture because high-risk jobs (where disability is a greater work-related factor) tend to draw more claims. Like health insurance, it will consider your medical history and your lifestyle, including your weight, pre-existing conditions and whether you smoke.

Premium cost: The premium will depend on a wide array of factors and can vary dramatically from person to person. Such things as your age and your gender (women pay more for disability insurance because they tend to live longer and may work longer) will be considered.

Non-cancellation provisions: Make sure that once you're approved, the insurer can't cut your coverage unless it decides to stop writing coverage for everyone in your job class. It should also state that the insurer can't raise your rates.

Guaranteed renewable: Like the category above, it means you can't be canceled, except if the insurer stops writing insurance for your job category. The insurer can, however, raise the rates for everyone in the category.

Own occupation vs. any occupation: If you have "own occupation" coverage, it is intended to go into effect if you can't perform the functions of the job you're now in. "Any occupation" coverage pays only if you can't work at any job where you've been reasonably trained to do the tasks. For example, if you're working a desk job, you could easily be transferred to a receptionist's job or some other function within the company that you can now do or is your former position. That could significantly interfere with your recovery time, so consider the benefits of (specify) "own occupation" coverage.

Elimination period: Like a deductible in home, health or car insurance, the elimination period is a big cost determinant in disability coverage. Most policies will kick in after 30 days after you've been declared disabled. But if you specify an elimination period of 60, 90 or 120 days, your premium will be lower. An important point about the 30-day elimination period: the benefits don't start accumulating until you've been laid up a month after the ruling date and you won't get your payment until a month after that. Be very clear with your insurer when you'll get your first check based on what elimination period you choose, and funnel the money you'll need in the meantime to your emergency fund.

Partial payments/Residual benefits: Some policies may offer you 'residual benefits' or a partial payment if you're less than 100 percent disabled, but still can't perform all the duties of your job.

If you're thinking about self-employment: You'll likely need disability coverage. But the time to buy is while you're still in your current job. Why? Because you won't be able to prove your income once self-employed, so consider obtaining your desired coverage as you can before you leave.

March 2008 — This column is produced by the Financial Planning Association, the membership organization for the financial planning community, and is provided by Marnie Aznar, MBA, CFP® , a local member of FPA.