

DISABILITY INSURANCE: IT'S A BETTER DEAL NOW

AFTER AN INDUSTRY SHAKEOUT, IT'S EASIER TO FIND POLICIES THAT ARE AFFORDABLE AND FLEXIBLE. **BY KIMBERLY LANKFORD**

NOT SO LONG AGO, DISABILITY INSURANCE WAS ONE

of the industry's blackest eyes. Companies that sold disability coverage, which replaces lost earnings if you can't work, incurred massive losses during the 1990s, partly due to questionable payouts on claims

for "nerves" and "stress." Then a multistate investigation by insurance commissioners, completed in 2005, found that some of the largest insurers were delaying and stonewalling the payment of legitimate benefits and committing other breaches of trust. That, plus a spate of lawsuits, led about 40 companies—most of them not the chief offenders—to quit selling individual policies. The insurers that stayed in the business raised rates for new buyers and tightened their underwriting rules, making it tougher to buy adequate coverage.

Now disability insurance is recovering its health and reputation. Claims battles have faded from the headlines, and it's easier than it has been in years to find an affordable policy. Some say that's because insurers were scared straight by lawsuits involving some prominent attorneys. "Insurers

know that there are big guns aiming at them if they deny a claim in bad faith," says Larry Schneider, of the Disability Insurance Resource Center, in Albuquerque.

Another reason it's a good time to shop for disability protection: Insurers are more flexible about who can get coverage, says John Ryan, of Ryan Insurance Strategy Consultants, in Greenwood Village, Colo. If, for example, you've been diagnosed with depression but it's under control with medication, you may no longer be summarily rejected. And in the past, if you started a new business, you would have been ineligible for a year, if not two. Now Ryan finds that some insurers will take you right away if you can show five or more years of experience with your former employer, and that you are staying in the same industry and have contracts lined up.

●● HOW MUCH DO YOU NEED?

If you were too ill to work for six months, how would you get by? If you don't have a ready answer, you probably need disability coverage. To calculate how much individual disability insurance you need or whether to add to your current coverage, figure your monthly living expenses if you had to stay home for an extended period. Factor in, for example, that you would save on transportation if you didn't commute. Then subtract the benefits due from your workplace group disability plan, if you have one. Keep in mind that if an employer pays the premiums, disability insurance checks are taxable. If you pay for the insurance, disability benefits are tax-free.

It's likely that your workplace benefits would fall short by several thousand dollars a month. Employer-paid group benefits max out at 60% of pretax income (not counting bonuses), with a monthly cap of \$5,000, and you pay tax on that money. If you earn more than \$100,000, the gap could be enormous.

You should price individual disability policies from an insurance agent or broker. You won't be able to replace

every dollar of your salary—normally, you can arrange to get up to about 65% of your total pretax income, including workplace benefits, if you supplement those benefits with personal coverage. And the payouts that come from your own policy will be tax-free. For example, if you earn \$100,000, you could get \$60,000 in group benefits, but you would need to pay taxes. If that left you with \$45,000, you could buy \$20,000 of individual disability insurance to bring your total payouts up to about \$65,000.

The cost varies with age, gender and occupation. A healthy, 35-year-old man who earns \$75,000 per year in a white-collar profession would pay about \$100 a month to The Guardian for a policy with a \$4,000 monthly income benefit that continues to age 65 if he's permanently injured. If he buys it at 40, the same insurance costs about \$120 a month. A 35-year-old male doctor who earns \$200,000 and buys a \$9,200 monthly benefit until age 65 would pay \$275 a month.

These rates are for *own-occupation* disability coverage, which is the best kind because it pays if you cannot perform your current occupation (see the explanation below). Cheaper forms of disability insurance often require you to take other jobs if you can, even if that damages your career or undervalues or ignores your skills. And such policies don't cost that much less than full-scale, own-occupation coverage—sometimes only 15% to 30% less, depending on the type of work you do.

●● PICKING A POLICY

David and Allison Kochman, of New York City, graduated from law school in 2004. They're now successful attorneys and avid investors. "We started to make money and build our investment portfolio from the ground up," says David, 31. David's disability policy at his firm, where he is a litigator, covers 60% of his income, and those benefits would be taxed. "If my employer said it would be cutting my salary by one-third, that would put us in a tough spot," he says. Allison, 32, had

no disability insurance from her job as a general counsel.

The Kochmans spent months shopping, and in 2005 they selected disability policies from Northwestern Mutual. Now they each have total coverage of about 80% of their after-tax income—the maximum the company allows. The couple decided it was critical to guarantee that they could keep saving and keep the roof over their

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WHERE TO BUY EXTRA COVERAGE

First, check whether your employer lets you buy extra insurance at a workplace discount, which may provide the same coverage as an individual policy but cost about 15% less.

If that's not an option or you need more coverage, consult an agent who specializes in disability insurance or a representative of one of the big insurers that offer comprehensive coverage. John Ryan, of Ryan Insurance Strategy Consultants, in Greenwood Village, Colo., often works with The Guardian, Principal Financial Group, MetLife, Standard Insurance Co., Union Central and MassMutual. Northwestern Mutual products are sold by the company's own agents. About 15 companies are now in this business.

Premiums for comparable income benefits can vary up to 20% among companies, but for some people, the choices may be limited. "If someone works 80% of the time from a home office, one company may not want to underwrite that person, while another has no problem," Ryan says. Or if you took medication and received therapy in the heat of a divorce, say, but no longer require treatment, some companies will charge less than others.

Also, if you already have a disability policy that excludes back pain (a notorious area for fraud and contested claims), you might be able to get rid of the exclusion if you go three years without additional back treatments—and can prove it to the insurance company.

heads. "Our most valuable asset is our income stream," David says. "I couldn't justify putting money in investments without protecting the source of that money." The Kochmans intend to boost their disability coverage regularly as their income and expenses increase. Their policies have a cost-of-living adjustment that indexes the payout to inflation in the event of a claim.

But the main reason the Kochmans chose their policies is the policies' definition of *disability*. The most comprehensive disability plans, such as theirs, are own-occupation policies that pay if you're unable to carry out the "material and substantial duties of your own occupation," even if you can physically do other work. (If you do other work, you still get full benefits.) This is ideal for highly trained specialists, such as surgeons, who could be sick or hurt and unable to operate but capable of doing lower-paid work in teaching or administration.

If you aren't in a specialized profession and wouldn't lose much by working elsewhere (or if you can switch roles at your current employer), you might be able to safely save money with bare-bones coverage. But if you're worried about replacing tens of thousands of dollars in income, get the own-occupation umbrella.

Some disability policies, by contrast, may have a slippery *modified own-occupation* standard. You get paid if you are unable to do your regular job and do not work at anything else. If you do work elsewhere, you lose some or all of your benefits, or the insurance company covers only the gap between your pre-disability income and what you're currently earning.

That's not the lowest rung on the quality ladder, however. A policy may define *disability* by changing just one or two words—from "aren't working elsewhere" to "can't work elsewhere"—and jeopardize thousands of dollars of benefits. In that case the insurer, and not you, decides whether you can and should take another job.

Nuances and unfamiliar language

make disability-insurance shopping more complex than buying term life or automobile protection. Small differences in wording can lead to huge differences in whether you get benefits and how much. Fortunately, individual disability policies are usually “noncancellable” and “guaranteed renewable,” which means premiums stay fixed for the life of the coverage, which is usually to age 65. But women pay 30% to 50% more to be insured because they tend to have more claims.

●● **COVERAGE THAT KEEPS UP**

Ophthalmologist Jerry Tanner, 58, of Lincoln, Neb., didn't think much about disability insurance when he was in residency, but the subject hit close to home after he joined a medical practice in 1991 and one of the owners had a car accident and became a quadriplegic. Tanner bought a MassMutual disability policy and a disability-based business-overhead policy to pay his share of the office expenses. “I kept in the back of my mind that I probably wouldn't need this, but I had it just in case,” he says.

Tanner performed glaucoma sur-

gery, and as his practice grew, he added more coverage to keep up with his rising earnings. Good thing. “I had just turned 50 when my world caved in,” says Tanner. Just after the peak earning year of his career, he went to a doctor for tests to get a pilot's license. A calcium scan of his heart, which shows whether someone has any blockages, “was off the scale,” he says. He had heart surgery and missed several months of work. “I went into panic mode. My overhead was outrageous, and I had no income coming in,” he says.

Tanner discovered he couldn't practice ophthalmology at his former level and pace. “I could see a few patients, but I couldn't return to the operating room or take calls,” he says. “When you cut surgery out of your practice, you eliminate about 60% to 65% of your income.” Tanner goes to the office about 2½ days a week to see his patients but earns much less than he did as a surgeon. His disability insurance policy continues to make up part of the difference because of the own-occupation language. But although he raised his coverage, he didn't increase

the amount as much as he could have, and he's living on about half of his peak income.

That's much better than nothing, but there's another risk to think about. Besides lost salary, retirement shortfalls are the worst (and most overlooked) side effect of a disability. Tanner's disability benefits will stop in seven years, when he's 65. He's been unable to save much since his heart disease was diagnosed, and he is deeply worried about his financial prospects.

To address this kind of problem, you may be able to buy a rider to your policy that will make retirement savings contributions up to your 401(k) maximum while you are disabled. That adds about \$200 a year to the cost of a MassMutual policy for a 45-year-old man who buys an additional \$840 in monthly retirement coverage for his disability insurance policy. The money doesn't go to your 401(k); it goes into a trust account at the insurance company. You choose among various funds and the earnings are tax-deferred. For peace of mind, this is one of the best insurance add-ons you can buy. ■