

**- Client Information Summary -**

**Types Of Disability Insurance And  
Maximizing Your Benefits**

Until an individual has created sufficient wealth to provide adequate income for their family in the event of a disability, it is vital to *manage* the risk of loss of income.

In a perfect world it would be possible to manage this risk by *transferring* the potential loss caused by a disability to an insurance company by acquiring disability insurance. However, the amount of disability insurance one can acquire is limited.

These limitations are set out by insurance companies with the intention of encouraging people to get back to work (off claim) as soon as possible. That is, they expect every individual to suffer a degree of financial hardship as a result of their disability so that they will make every reasonable effort to get back to work.

Once you have identified the amount of disability insurance you need, making a decision as to which type of coverage best meets your specific requirements is the next task. Often an analysis of your needs in the event of disability will identify a shortfall that cannot be fully eliminated due to the maximum issue limits insurance companies set, as previously mentioned. Therefore, it's important to structure your coverage in a cost effective manner that optimizes your protection without exceeding these issue limits.

This information summary has been produced to provide a basic understanding of the various types of disability insurance and how to maximize your benefits.

It is this strategic approach that ensures that the insurance you acquire will best meet your personal needs. An overview of the various types of disability insurance follows.

### **Group Disability Insurance Benefits**

Many employers provide group benefits to their employees. Usually disability benefits under such plans are broken into two distinct plans. The following provides a brief description of these group benefits and some of the common features:

**Short Term Disability** - This benefit, sometimes called "weekly indemnity" typically will have a starting date from day 1 to 15 days. It usually has a benefit duration of 17 - 52 weeks and provides benefits of two thirds of the employee's basic weekly income.

**Long Term Disability** - Benefits for Long Term Disability almost always begin when the short term benefits end. Thus if the short term plan has a benefit duration of 17 weeks, the Long Term benefits will usually commence after 17 weeks. The benefit duration of Long Term plans is usually to age 65. However, the definition of disability is normally quite stringent, especially after 2 years of disability. Long Term benefits are typically for 50% - 75% of pre disability income with two thirds being most common. However there often will be a plan maximum that will limit coverage to a specified level (such as \$4,000 per month).

For example, "Total Disability" means the complete inability of an insured employee because of accidental bodily injury or sickness to engage in any occupation or employment for remuneration or profit for which he is reasonably suited by reason of education, training or experience.

**Plan Participation** - Most group disability plans are mandatory for all employees. It is through this mandatory arrangement that group rates are kept low since it ensures that healthy employees don't opt out of the group plan to acquire private coverage and leave the "less healthy" employees in the group plan. This mandatory participation often means that a covered employee is exposed to some risks due to the deficiencies of many group plans.

**Taxation of Benefits** - In cases where the employer pays any portion of the premium, the benefits when received by the employee are fully taxable, like regular employment income. In cases where the employer has structured their plan so that the employee pays the premium for these benefits, they will receive their benefits tax-free. It is for this reason that some employer's have elected to have their employees pay these premiums.

## Private Disability Insurance

Insurance companies have developed quite a wide variety of private disability insurance contracts. Each is designed to fill a specific situation. The following are some of the typical variations that can be found in the marketplace.

**Own Occupation Coverage** - This type of product is designed for self-employed professionals and executive employees who operate on a fee-for-service basis, where their income would stop should they become disabled.

§ **Definition of Disability:** The insured cannot perform the substantial duties of their **own occupation** to the end of the benefit period.

§ **Start Dates:** 31, 61, 91, 121, 181, 366 or 732 days

§ **Benefit Periods:** 5 years, 10 years and to age 65 (lifetime may be available)

### *Possible Built-in Features:*

§ **Own Occupation:** This feature allows you full benefits to age 65 should you be unable to return to your own occupation but you can still be employed in another occupation.

§ **Proportionate (Residual) Disability:** This feature protects the insured from a partial loss of income due to disability. If the insured is disabled, generally resulting in an income loss of at least 20%, they will be paid a percentage of their benefit based on the percentage loss of their earned income.

§ **Presumptive Disability:** This feature protects from the irrecoverable loss of sight, hearing, speech or use of two limbs.

§ **Waiver of Premium:** If a period of disability continues for more than 90 days, the premium for the policy will be waived for the remainder of the disability and the premium paid for the first 90 days of disability will be refunded.

§ **Recurrent Total & Proportionate Disability (12 months):** If the insured is disabled from the same cause within 366 days of returning to work, the relapse will be considered a continuation of the previous disability.

**Two Year Own Occupation Coverage** - This product is designed to protect business owners as well as the non-professional employee who would have 100% of their income to return to after disability.

§ **Definition of Disability:** The insured cannot perform the substantial duties of their regular occupation for 24 months and is not working in any other gainful occupation. After 24 months the definition becomes "Due directly to injury or sickness, the Insured cannot work in any gainful occupation for which they are reasonably fitted having regard for their education, training and experience."

§ **Start Dates:** 15, 31, 61, 91, 121, 181, 366 or 732 days

§ **Benefit Periods:** 24 months, 60 months, 120 months and to Age 65

### ***Built-in Features:***

- § **Presumptive Disability:** This feature generally protects the insured from the irrecoverable loss of sight, hearing, speech or use of two limbs.
- § **Waiver of Premium:** If a period of disability eligible continues for more than 90 days, the premium for the policy may be waived for the remainder of the disability and the premium paid for the first 90 days of disability could be refunded.
- § **Recurrent Total Disability (6 months):** If the insured becomes disabled from the same cause within 181 days of returning to work, the relapse may be considered a continuation of the previous disability.

## **Additional Rider Protection Under Private Disability Contracts**

The following are some valuable riders that can be added to a private disability insurance contracts that help to maximize benefits.

**Inflation Protection** —This rider helps to offset the effects of inflation on the purchasing power of the monthly income benefit during periods of disability. The monthly income benefit may automatically be adjusted according to the specifications of the company. The actual indexation is often tied to the Consumer Price Index and often has an overall maximum.

**Future Earnings Protector**—This rider provides the insured with the option to purchase additional disability income insurance in the future with no medical underwriting required, but subject to financial underwriting. This is a useful rider for the young person starting out in a new career who anticipates significant increases in their income in the future.

**Future Savings or Retirement Protector**—This rider can protect your personal strategy for achieving financial independence. During a period of disability, it's likely that your savings pattern will be interrupted due to a lack of funds. The Future Savings or Retirement Protector rider ensures that a specified amount of money will go into a savings trust for you to help minimize the negative impact of a disability on long-term retirement objectives. This rider is often used to fill shortfalls that are otherwise not possible to eliminate due to issue limits on base coverage available. This rider is also available through some companies as a freestanding contract as opposed to as a rider.

## **Association Group Disability Insurance**

Many professional associations as well as some trade organizations offer a form of group disability insurance coverage to their members. The coverage can normally be tailored to each individual's situation, similar to private disability insurance.

The premium for this type of coverage may be less than that of private disability insurance. The reason for the reduced cost is partly because the association benefits from a "group discount". However, another contributing factor to the low cost is due to a degree of uncertainty relative to whether a disabled member will actually collect benefits under the plan. This is because association coverage can usually be cancelled at the discretion of the insuring company (if claims are excessive). Also premiums are not guaranteed and thus can be increased at any time to offset bad claims experience.

Association group coverage should be viewed as a method of merely "reducing risk", in comparison with private disability insurance which "eliminates risk". One should only contemplate acquisition of Association group coverage in situations where cash flow constraints prevent the implementation of private coverage.

## **Specialty Private Disability Products**

The following specialty products and/or product enhancements enable individuals to increase their coverage beyond the constraints of insurance companies issuing limitations:

### **Critical Illness**

Critical Illness benefits are payable when the insured is diagnosed with one of a number of covered illnesses. Unlike a monthly disability benefit which is designed to replace income this type of benefit is designed to pay a lump sum in the event of a person suffering a critical illness.

The reality today is that with modern technology individuals are living longer after surviving a serious illness or accident. The costs incurred to adjust your lifestyle could result in dipping into retirement savings and even possibly result in using up equity in your home.

Types of expenses resulting from a critical illness are homecare, therapists, and home renovations (if you suffered a stroke or paralysis, wheelchair accessibility may be required). Although no one can be perfectly insured for disability, a blend of Critical Illness benefits should be acquired where any shortfall exists.

§ **Definition of Disability:** The waiting period is typically 30 days. Provided the insured is still living at the end of the waiting period a lump sum benefit will be paid

§ **Illnesses Covered by Critical Illness Policies:** Heart Attack, Stroke, Coronary artery bypass surgery, Life-threatening Cancer, Kidney failure, Major organ transplant, Paralysis, Multiple Sclerosis, Blindness, Deafness are typical covered illnesses.

§ **Benefit Periods:** Permanent level premium for life and/or 10 year renewable and convertible term to age 75.

§ **Waiver of Premium:** If a period of disability continues for more than six consecutive months, the premium for the policy will be waived for the remainder of the disability. Disability is defined as bodily injury or disease which results in:

1. The first two years of the incapacity the individual covered by Waiver of Premium is prevented from engaging in his or her regular occupation for payment or profit
2. During the remainder of the incapacity the individual covered by Waiver of Premium is prevented from engaging in any occupation for which he or she becomes qualified by training, education or experience

## Disability Group Offset

As was explained under "Group Disability Insurance Benefits", it is common for participation in group plans to be mandatory. This exposes the employee to the possibility that benefits will not be paid due to the stringent definition of disability typical under a group insurance plan. The Disability Group Offset rider provides a solution in that it allows the employee to acquire private disability insurance that will pay benefits **only if the group plan won't pay**. This eliminates any exposure to the risk that the group plan won't pay. The private coverage is issued under the group-offset arrangement regardless of normal issue limits. The premiums are slightly reduced to recognize the diminished likelihood of a claim due to the private coverage taking a second payer stance.

## Disability Waiver of Premium

This is an option purchased as a rider on a life insurance policy. With this rider, the basic premiums are waived in the event of the insured's total disability. This in effect eliminates the need for funding of these contracts during a period of disability and thus helps to reduce shortfalls in the event of disability.

## Exclusions and Coverage Limitations

Over the years some insurance companies have gone out of the Long Term disability market due to bad claims experience. In fact, it's difficult to find high quality coverage for some employment categories today. In an effort to reduce claims experience, insurance companies have resorted to a number of contract changes that limit benefits for specified types of disabilities. One of the most common exclusions today is for disabilities associated with stress related illnesses. With our fast paced stressful lives today, more disabilities are caused by mental health problems, such as depression, burnout, anxiety disorders and other such illnesses than by anything else. These types of claims in the past few decades have been the root cause of many insurance companies actually losing money on their disability business. For this reason, many contracts will have exclusions or limited coverage for these types of illnesses. Care should be taken to identify all such exclusions so that you know what you are buying.

## Disability Insurance Selection Process

Choosing the right type of disability insurance can be a complicated decision. However, the decision becomes easier when you know how much you need, the maximum amount you can buy, as well as the current and future cash flow you can allocate without having a detrimental effect on your personal financial strategy. Once these issues are resolved we can then use the chart on the previous page to help identify the products that best meet the client's needs.

Type of Coverage	Low Cash Flow Surplus	Moderate Cash Flow Surplus	High Cash Flow Surplus
<b>Group Disability</b>	Acquire maximum available Group Disability coverage where available	Acquire maximum available Group Disability coverage where available	Opt out of Group Disability coverage if possible. Otherwise acquire minimum coverage necessary through the group and top up with private coverage.
<b>Group Offset</b>	None	Consider one half of allowable Disability Group Offset	Maximum allowable Disability Group Offset in cases where group coverage is mandatory.
<b>Association Group</b>	Top up to maximum allowable coverage with Associate coverage (if available)	Top up to maximum allowable coverage with Association coverage (if available)	None
<b>Private Coverage</b>	Top up group or Association coverage to extent possible	Top up group or Association coverage to extent possible	Obtain private coverage to highest extent possible
<b>Future Savings/ Retirement Protector</b>	Acquire if shortfall exists or to protect against group plan not paying out	Acquire if shortfall exists or to protect against group plan not paying out	Acquire if shortfall exists after private coverage and group offset is in place
<b>Disability Waiver on All Life Insurance Policies</b>	Acquire when full disability coverage is not available due to issue limits	Acquire when full disability coverage is not available due to issue limits	Acquire when full disability coverage is not available due to issue limits
<b>Critical Illness</b>	Acquire Term 10 coverage if shortfall exists	Acquire a blend of Term and Permanent coverage if shortfall exists	Acquire Permanent coverage if shortfall exists
<b>Loan Protector</b>	Acquire when business loans would jeopardize financial solvency of business	Acquire when business loans would jeopardize financial solvency of business	Acquire when business loans would jeopardize financial solvency of business

Choosing the right "types" of coverage is the first step in the process of designing a personalized disability insurance portfolio. The next step is to evaluate your needs with regards to their ability to absorb an income loss. Identifying this allows the program to be developed using benefit start dates that are appropriate. The earlier the start date the more expensive the coverage. However, if the family would be in dire circumstances if they had to wait six months for benefits to commence, the price must be paid for an early start date. However, if the family has sufficient emergency cash available, it's possible that the start day could be later resulting in a lower premium. Consider the following chart which helps to identify the right start date given personal needs.

Individual Circumstances	Starting Dates Available					
	31st day	61st day	90th day	181st day	366th day	732nd day
No cashable emergency reserve; very tight cash flow	Yes	Maybe	Maybe	No	No	No
Cashable emergency reserve; significant cash flow surplus	No	No	Maybe	Yes	Yes	Yes

Identifying the right starting date as illustrated above, is an important part in designing coverage for your personal situation. Another important question is how long should benefits last. The following helps to identify the benefit duration to suit differing situations.

Individual Circumstances	Benefit Duration Periods Available				
	2 Years	5 Years	10 Years	To Age 65	Life
Less than 2 Years from Financial Independence	Yes	Maybe	No	No	No
Less than 5 Years but Greater than 2 Years from Financial Independence	No	Maybe	Maybe	No	No
Less than 10 Years but Greater than 5 Years from Financial Independence	No	No	Maybe	Maybe	No
Greater than 10 Years from Financial Independence	No	No	No	Yes	Maybe
Financial Independence would be totally impossible in the event of a long term disability due to issuing limitations	No	No	No	Yes	Yes

Using these charts it is possible to narrow down the choices when it comes to selecting the right starting date and duration for your disability program. The final step is to eliminate any "maybes". Simply put, a "maybe" should turn into either a "yes" or a "no" based on any strong personal circumstances that influence the selection towards either an improved benefit or a reduced benefit.

The actual cost of one benefit over another is a separate factor to take into consideration when making choices. For example, if an individual has significant cash reserves for emergency purposes but the cost differential between a 90 day start and a 181 day start is nominal, then it would likely be best to choose a 90 day start. Another example where cost efficiency may influence a choice is where an individual will become financially independent in approximately 7 years and the cost differential between a 5 year or 10 year benefit duration is very great. In such a case perhaps a 5-year benefit duration would be the right choice, even though a 10-year duration would be more ideal.

## In Summary

Designing a disability insurance portfolio involves selecting the right type of contract, the right company, the right optional benefits and the right amount of coverage. Integrating all of these issues into the program will result in coverage that will provide the best protection possible given issue limit restrictions. Having coverage that's right for you will deliver peace of mind in knowing that this important contingency is protected so your family is not devastated financially in the event of a disability. Having financial security in the event of disability can also help to lessen the overwhelming emotional impact at such a difficult time.