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Staying Financially Able When Physically Disabled

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Would you be financially able if you became physically disabled? If you answer "No" or "I don't know", then read on — this guide can help you work through the considerations necessary to protect family income should a family member not be able to work due to illness or injury.

In 1982, 8.9 percent of the U.S. population was considered work disabled. Our chances of becoming work disabled increase with age. In 1982, 3.3 percent of 16- to 24-year-olds were work disabled, but for those 55 years to 64 years old, this percentage increased to 24.1 percent. Being work disabled means that a person has some limiting condition that restricts the employment options available. The employment restriction may be either total or partial. A partial employment restriction means that some employment is possible if the disabled person can find a suitable job.

Occupations do exist in which a person with a disability can find employment. A disabled person able to work at some productive activity is a part of the labor force. Of work disabled 16- to 24-year-olds in 1982, 28.9 percent were employed full- or part-time, but 58.2 percent were not in the labor force; they were considered unemployable.

Unfortunately, not only do our chances of being work disabled increase with age, our chances of finding gainful employment, if work disabled, decrease with age. For work disabled people 55 to 64, 25.7 percent had found full- or part-time employment in 1982; however, 72.2 percent were unemployable due to their disability (U.S. Bureau of the Census).

Disabling illnesses and injuries may place great financial burdens on the family; however, you can reduce this impact by prudent disability insurance planning. Such planning will help ensure that the goals of the family remain attainable.

Disability income need determination

To determine your family need for disability insurance, first determine the amount of income the family would need if an income earner become disabled. This figure represents the amount the family needs after paying all income and Social Security taxes. Remember that a disability that prohibits you from working would also reduce the work related expenses: travel costs, some clothing costs, and purchased lunches, for example. Therefore, the disability income requirement would ordinarily be less than current total family after-tax earnings.

Using the worksheet at the end, enter the amount you consider to be an adequate family income on Line 1: Required monthly after-tax income. If you have been preparing a budget and keeping family expense records regularly, you can readily make adjustments to project your income need. If you have not been managing your family finances with these processes, then you will need to develop a projected expense budget to determine your income need.

Sources of disability income

Subtract the income available from sources other than disability insurance from your projected income need. These other sources are Social Security benefits, income from investments and savings, and the earnings from your spouse, if you are married and your spouse could, work outside the home.

If you become disabled before age 62, you and your dependents may qualify for payments from Social Security. To qualify as a disabled worker you must meet two requirements:

- You must be unable to perform any substantial work;
- Your disability must be expected to last for 12 months or be the probable cause of your impending death.

These requirements hold regardless of the age of the disabled person. In addition, the work-disabled person must meet work credit requirements that vary according to the age of the disabled person. Younger workers have less of a requirement because they have a shorter time in which to establish eligibility for benefits. A worker less than 24 years of age must have 1-1/2 years of work credit for the three-year period ending at the time of the disability. A worker age 24 through 31 needs credit for working half the time between age 21 and the start of the disability. The following table shows the work credit requirements for workers older than 31 years as of January 1986. (Check with the Social Security Administration for current work credit requirements.)

Table 1. Social Security work credit requirements for disability payments.

Born after 1929, become disabled at age	Born before 1930, become disabled before age 62 in	Years of work credit you need
31 through 42		5
44		5.5
46		6
48		6.5
50	1981	7
52	1982	7.5
53		7.75
54	1983	8
55	1984	8.25
56	1985	8.5
57	1986	8.75
58	1987	9
60	1989	9.5
62 or older	1991 or later	10

Three categories of individuals may qualify for payments following a worker's disability. First, the disabled person receives benefits. Secondly, the spouse of the disabled person receives payments provided that the spouse cares for the disabled person's child (age 15 or less) or that the spouse is 62 years of age or older. And, thirdly, unmarried children of the disabled worker, less than 18 years of age, may receive benefits.

The dollar amount of the benefits varies as Congress adjusts the law and as inflation causes benefits to increase. The government determines benefits primarily by the amount of your predisability earnings. In general, the more you earned in the years prior to your disability the greater will be your disability benefit. However, the percentage of predisability earnings replaced by Social Security disability benefits decreases as predisability earnings increase.

Thus, individuals with higher earnings prior to becoming disabled will have to meet a greater percentage of their disability income need through other sources. In early 1986, the average monthly benefit for a disabled worker was $483 and the average payment to a worker with a family was $899 (U.S. Department of Health and Human Services).

To determine your specific Social Security benefit, take copies of recent years' W-2 forms (wage and tax statements), or if you are self-employed, your Federal tax returns, to your Social Security office. They can tell you your potential benefits should disability occur.

Once you know your Social Security benefits, turn to the worksheet at the end and fill in Line 2a(1) for the disabled person's benefits and 2a(2) for any dependents' benefits.

If your spouse works outside the home, you should count his/her earnings as helping to meet the family's total income need. After subtracting state and federal income taxes and Social Security taxes from those earnings enter the remainder on Line 2b.

Count periodic income from savings and investment as helping to meet the family's total income need if these payments are certain. That is, if the savings and investments earn a fixed rate of interest. If the rate of interest paid is variable, be conservative in your estimate of the future income they will provide. This figure may be less than what you actually receive, but it is better to underestimate than to overestimate and have too few dollars when you need them. Once you know this figure, subtract expected state and federal taxes and record the resulting amount on Line 2c of the worksheet.

Subtract the sum of the items on Line 2 (2a(1) + 2a(2) + 2b + 2c) from the family's disability income need (Line 1). The difference is the amount of income need that remains to be met with disability insurance.

Moral hazards not allowed

The insurance industry does not want to give people an incentive to claim a disability after they have purchased a disability insurance policy. In rare instances, it might make more economic sense to claim a loss and collect your insurance than to continue working. The chance that people will do this is known as a **moral hazard.**

To prevent such a possibility, insurance companies will limit your disability income insurance so that your total disability income — insurance payments plus Social Security payments net of payments to dependents — will not exceed some percentage of your predisability income (typically 60 percent to 80 percent).

As an example, suppose your predisability income was $1,050 per month and you have a child eligible to receive disability benefits through Social Security. Social Security tells you that you will receive $483 per month and your child will receive an additional $242 per month. The child's benefit will not be counted against your allowable percent of predisability income (we'll use a 70 percent figure) and neither will any monies received in the form of interest, dividends or rents; therefore, your allowable disability income insurance benefit is:

> Allowable disability income insurance benefit = (Predisability earnings from work x 0.70) — Social Security benefit

Or

> Allowable disability income insurance benefit = (1,050 x 0.70) — $483 = $252/month

If your disability income need (see worksheet at end) is more than the allowable insurance payment, you will be unable to provide for your disability need. The greater your work-related expenses as a percentage of your predisability income, the greater the likelihood of being able to purchase adequate disability insurance coverage to meet family needs after disability, because work-related expenses do not need to be met anymore. In general, most families can purchase adequate insurance payments if they choose to do so and can afford the premiums. (You cannot get around this maximum earnings replacement by purchasing insurance from more than one company. The companies would simply pool their payments to you so that the total benefit would not exceed the allowable percentage.)

Injured on the job — a case for workers' compensation

Missouri has a no-fault compensation law that guarantees benefits to workers injured on the job. If a job injury prevents an employee from working, the state will pay medical expenses and some disability benefits to the employee. On September 28, 1986, Missouri set the maximum income compensation for workers' compensation at 75 percent of the average weekly wage of a state employee.

This law covers most working Missourians. It may not cover self-employed persons and employees of firms employing four or fewer workers. Also, the Missouri Worker's Compensation Law does not apply to farm labor, domestic servants in a private home, persons who perform occasional labor for and related to a private household, or qualified real estate agents. If you have questions about workers' compensation, ask your employer, or write the Division of Workers' Compensation, P.O. Box 58, Jefferson City, MO 65102, phone number (573) 751-4231.

Buying disability income insurance

Now that you have planned your disability insurance needs, it is time to purchase a policy. Some whole-life insurance policies have riders that allow the insured to purchase disability insurance as a percentage of the face value of the policy. Don't purchase a whole-life policy just for this reason. Instead, focus on the disability income needs of your family, and purchase disability insurance through a separate policy.

Pay particular interest to the following features of the disability insurance policy:

- **Duration of benefits.** Some disability policies make payments for a time period as short as three months, while others will make payments until you reach the age of 65. You have less chance of incurring a long-term disability than a short-term disability, but long-term disabilities have more devastating financial effects. Because of the lower likelihood of a long-term disability, the cost of coverage to age 65 is relatively modest. You should always insure against the catastrophe, so give the highest priority to the longer-term benefit period in your disability insurance plan.
  - **Definition of a disability.** Does the insurance contract define disabled as: You cannot do your present job? or
  - You cannot do any job?

  Look for a policy that uses the first, more liberal, definition. The second definition may leave you in a position of receiving no benefits if you can do even the most menial of tasks. Also, it is important to have coverage for disability from either accident or illness because family income needs will be similar in either case.

  Policies using the liberal definition will require higher premiums. Therefore, once you have established a disability insurance plan with benefits available to age 65 then, if you can afford it, choose a policy with a liberal disability definition.
- **Waiting period before benefits begin.** Disability insurance policies have a waiting period (similar to deductible features in other insurance policies) before payments begin. The low probability that a disability will last longer than the waiting period (typically 31, 61, 91 or 182 days) reduces policy premiums. The longer the waiting period, the lower the premiums.

  Choose a shorter waiting period if you do not have the financial resources necessary to handle the period of reduced income. However, a shorter waiting period will be useless unless your premium dollars have already purchased a policy with long-term benefits and a liberal definition of a disability. A short waiting period is meaningless if your disability claim is rejected or expires mid-way through an illness.

- **Renewal provisions.** Make sure you understand the renewability clause in the disability contract. The company cannot cancel "guaranteed renewable" policies, but the company can increase a person's premium at any time according to his/her class, such as age or occupation. With financially secure insurance companies premium increases rarely happen. However, to make sure the company cannot cancel your policy or raise your premium before you reach age 65, your policy must state that it is "noncancellable guaranteed renewable." The noncancellable guaranteed renewable feature is costly.
- **Coverage of pre-existing conditions.** Most policies have a two-year period of contestability. This means, if you have received treatment for an illness before you buy disability insurance, most insurance companies will not pay any benefits to you if you become disabled from that illness during the first two years of your policy. After this period of contestability, the company should pay benefits.
- **Inflation rider.** To protect the buying power of your disability benefits from inflation, you can purchase inflation riders with some policies. Make sure you understand these riders before purchasing them; they vary significantly from policy to policy. Below we offer examples of policies from two insurance companies. The inflation riders of Company A and Company B are:

  Company A: Guaranteed 7-percent simple increase annually after one year of disability until age 65. No cap on increase.

  Company B: Monthly benefit increased by a maximum of 7 percent compounded annually. The increase is tied to the Consumer Price Index (CPI) and a "catch-up" feature allows increases to exceed 7 percent if prior increases were less than 7 percent. If the CPI decreases, so do the benefits. Increases continue until original benefits double or age 65, whichever comes first.

  Company A's policy uses a 7-percent simple increase while company B's policy uses a 7-percent maximum compound increase. In the worst-case scenario, say 7 percent annual inflation, Company B's benefits would double in a little more than 10 years. Company A's policy, due to simple increases not allowing increases to be calculated on past increases, would not double the payments until 14+ years.

  If inflation continues, however, Company B's payments cannot increase beyond double their initial level; Company A, on the other hand, continues to increase payments by 7-percent simple each and every year of the policy until age 65. Also, the company guarantees the 7-percent simple and it is independent of inflation in the overall economy.

  With Company B, a deflationary economy would result in smaller monthly benefit payments. As with most financial contracts, your particular situation would determine which of these policies is preferred and at what price. In general, Company A provides the best protection because of the guaranteed increase and no cap on the allowable overall increase. However, older workers in an inflationary economy may prefer Company B's plan because of the compounding of increases, which raises payments faster until age 65, when both policies would cease payments.

- **Waiver of premium.** An acceptable disability insurance policy must waive all premiums due during periods of partial or full disability. The waiver should also apply during the waiting period prior to receipt of the first payment.
- **Treatment of recurrent disability.** Most quality disability contracts consider a disability continuous if it reoccurs within six months of the prior disability; thus, you do not have to satisfy the waiting period provision again. Of course, the disability must result in whole, or in part, from the same sickness or injury. Do not purchase a policy provision of less than six months in its definition of a recurrent disability.
- **Price.** Finally, as with any financial item, shop around and compare companies' prices and financial strength. If you have two or three policies equal in quality, choose the one with the lowest price per dollar of benefit. The money saved on your plan will help you be more financially able while you remain physically able.

Worksheet 1. Computing disability income needs.

1. Required monthly after-tax income		**$_____**
2. Subtract:		
a. Social Security benefits for: 1) Disabled person 2)Dependents' benefits	 **$_____** **$_____**	
b. Spouse's after-tax income	**$_____**	
c. Savings and investment income	**$_____**	
Sum 2a(1) + 2a(2) + 2b + 2c		**-$_____**
3. Income to be met with disability insurance		**$_____**

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