

February 20, 2024 – Wealth Planning Commentary

Do you need private long-term disability insurance?

Many people are adequately covered by life insurance to replace lost income in the event of premature death. Few workers are sufficiently covered for disability even though it's more likely to occur than premature death. In financial terms, disability can be worse than death. Disability is not limited to physical injuries. It includes terminal illnesses such as cancer, aggressive diseases, and mental disorders.

Many employers offer disability policies as part of the benefits package. A good employer plan will replace about 60-70% of salary in the event of a long-term disability. Payments are typically capped at \$12,500 per month or \$150,000 per year. For high-income earners, this may not be sufficient.

High-income earners have several options for coverage beyond the standard limits. Some employers offer non-qualified salary continuation plans, which may cover significant income for a time. Mature workers may have accumulated enough assets to self-insure. For high-income earners who have not yet accumulated enough wealth to self-insure, purchasing an individual or private policy can add extra protection beyond the employer-provided plan. Benefits can be as high as \$200,000 per month or even a \$50,000,000 lump sum. These high-limit disability policies cost between 1-4% of earnings and may require a medical assessment.

Despite the need for risk protection, only 14% of consumers have an individual long-term disability policy. The low coverage rate may be attributed to awareness; people misunderstand the likelihood of becoming disabled and don't see the need for insurance. Sometimes workers are uninsurable because of. Others object that disability coverage is "use it or lose it": if you never become disabled, then you won't benefit. Cost is also a deterrence. That said, coverage is critical if you become disabled.

Income replacement is one aspect of disability insurance and there are other considerations. Policies are based on two time horizons. Short-term disability benefits last between 3 and 6 months. Long-term disability benefits start when short-term disability benefits end and coverage is between 5-20 years or until age 65. Each policy has a definition of disability and only pays benefits if the client meets the definition. The definitions are own occupation, modified own-occupation, and any occupation. Own is the most desirable and has the greatest income potential, followed by modified, and lastly, any.

Own pays benefits if you are unable to work in a specific profession. The beneficiary may still work in another profession, for example a former surgeon may teach. Modified pays benefits if the beneficiary is unable to work and not employed – if income is earned, the benefits cease. Any pay benefits when the owner is unable to work at all, in any capacity.

Lastly, it's important to understand the tax consequences of receiving disability benefits. Like most types of insurance, if the premiums were paid with pre-tax dollars the benefits are taxable. If premiums were paid with post-tax dollars, then benefits are non-taxable.

Please reach out to your Wealth Manager with questions about private long-term disability insurance.

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