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5
DISABILITY INCOME INSURANCE

Chapter One - Introduction to Disability Income Insurance

Important Lesson Points

- The chances of an individual becoming disabled are more likely at most ages than his or her chance of death
- The principal factors that affect the probability of becoming disabled include the insured’s health status, age, occupation and lifestyle
- The likelihood of a disability occurring in a group of individuals is much greater than the probability of any individual become disabled
- The sources available to provide an income during an individual’s disability are generally limited to savings, a spouse’s employment, borrowing or disability income insurance
- Although the general level of savings in the United States is far less, if an individual saved 10% of income each year, one year of disability would wipe out almost 10 years of savings
- Spousal employment is not usually a viable source of sufficient family income during a period of disability for several reasons
- A spouse that is not currently employed outside the home is unlikely to be a source of sufficient income in the event of the other spouse’s disability
- Disability income insurance is the most economical and desirable form of income replacement during disability

THE NEED FOR PROTECTION AGAINST THE RISK OF DISABILITY

The possibility of sustaining a long-term disability from an accident or illness is something most people would rather not contemplate. However, there is a way to protect themselves and their family should they lose their ability to earn an income. A key product in the client's overall financial plan is disability income insurance. While life insurance protects the client's heirs and investment products can protect and enhance a client's assets and provide for retirement, disability insurance protects their livelihood.

The impact of a disability can result in an enormous financial burden. The disability can lead to liquidation of personal and business assets in an effort to maintain an adequate standard of living and to cover the expenses associated with a prolonged period of disability.

Protect Earning Power with Disability Income Insurance

An individual's most important asset is the ability to earn an income which enables them to acquire and retain assets. The ability to earn an income can be seriously compromised by a disability. Disability insurance is really “income replacement” insurance. It can provide the cash that needed during the period of disability.

Insurance agents must inform their clients about the potential hazards of disability and the need to protect their income earning ability.

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They may be able to “get by” for a few months on their savings, but if the disability is prolonged, they may exhaust most, or all, of their savings. Further financial hardships would be inevitable. They may miss mortgage, car, and other credit payments, and damage their credit rating. Utility bills, tuition, grocery bills, and business/professional expenses will also continue despite disability and loss of income.

Disability income insurance protects against the financial loss that occurs due to disability. The loss of income can cause the dissolution of all financial goals:

- Life insurance policies may lapse
- Retirement plan contributions will cease
- Real estate and other assets may be lost due to nonpayment

The ramifications of disability can be devastating. Disability income insurance can be a sensible solution to help protect financial security.

**Who Needs Disability Coverage?**

Every family breadwinner should be covered by disability insurance. Single people may also want to consider disability insurance since they cannot rely on a spouse’s income if a disability happens to them. Their financial burden may fall on other family members who are not equipped to handle that burden.

The need for disability coverage differs depending on the occupation of the breadwinner of the family. Some occupations are more likely to incur a disability than others, or to experience longer period of disability.

One hurdle an agent may have to overcome when explaining the need of a family to be covered by a DI policy is that if the family is covered by health insurance, they may feel a false sense of security. However disability insurance differs in one major way from health insurance.

- Health insurance pays for hospital and doctors’ costs incurred as the result of an illness or injury due to an accident.
- Disability insurance provides the insured with money to live on and pay their expenses while disabled. Both types of insurance are needed.

When individuals are considering the purchase of disability insurance, they should not overlook the fact that income will be lost if the breadwinner is in an accident. This is especially if this accident occurs outside the workplace and is not covered by worker’s compensation. If the breadwinner cannot work, the family would suffer greatly if the remaining spouse’s income could not support the family. If the remaining spouse did not have a job at the time of the disability, then no income would be coming in at all.

The agent should not scare a person into buying disability insurance, but make them aware of the benefits that disability insurance can provide in the event of such a tragedy. The way to approach a prospective client is to demonstrate the benefits of disability coverage and help the consumer come to decide if it is most logical solution for their situation.
When faced with actual potential income loss, a prospective insured can easily understand the risk disability income insurance protects against. Long-term disability is sometimes referred to as the "living death," especially when considered as a financial risk.

While most people understand the necessity and value of life insurance, many overlook the valuable role disability income insurance plays in building financial security.

Disability income insurance, like life insurance, provides for the financial welfare of those supported by the insured should the insured be unable to do so. The difference between the protection provided by disability income and that provided by life insurance is that the protection provided by disability income insurance applies during the insured's life rather than at death.

**Income Protection**

Disability Income is financial risk management. There are three primary risks to an individual's income:

- The loss of income as a result of death
- The loss of income as a result of retirement
- The loss of income as a result of disability

Life insurance protects against the first risk, pension plans, savings, and annuities against the risk of the second, and disability income insurance covers the third.

As long as a wage earner is healthy, they have the ability to provide for others and to accomplish financial goals. If a disabling sickness or accident occurs, the income earner's ability to provide financial support and accomplish their financial goals is impaired or even eliminated.

Disability income insurance coverage can help workers replace a portion of lost earnings. Disability income insurance can also help business owners safeguard their business by helping to cover business operating costs, or providing partners with the funds for small business partnership buyouts.

While corporations may provide group long-term disability (LTD) insurance coverage to employees and/or key executives, most group LTD plans:

- do not cover bonus/commission income,
- are taxable income, and,
- may not replace enough income to maintain a standard of living.

Individually owned, supplemental disability income insurance protection can enhance an existing group long-term disability benefit and maximize income protection in the event of a disability.

Disability income insurance allows income earners to obtain an appropriate level of disability income insurance based on individual income. Since it's portable, this kind of protection can follow an insured employee who changes jobs or even careers.
Insurers can provide versatile and comprehensive protection, customizing policies with riders and options and various waiting and benefit periods to help meet specific and changing needs.

**Retirement Contribution Protection**

Employees may be planning ahead for a comfortable retirement by contributing regularly to a qualified retirement plan. But if someone becomes totally disabled before reaching retirement age, he or she may not only lose his or her ability to earn an income, but may also lose the opportunity to accumulate funds for retirement.

Insurers can help protect and maintain an employee’s present retirement plan contributions, until age 65 or 67, including employee and employer contributions, with supplemental coverage. This can be offered to all or a select group of employees. While not a retirement program, nor a substitute for one, it is a way to help ensure that employees continue to make retirement contributions so funds are available when they reach the age of retirement.

**Return-to-Work Benefits**

Employees may add an optional rider to supplement a company-sponsored group long-term disability (LTD) plan. The employee would then become eligible for benefits if they return to work in either their own or another occupation on a limited basis due to a sickness or injury. They may even be able to receive a benefit if working full time at a lower income.

Whenever possible, insurers work with the policyowner, attending physician and employer to assist in returning an employee to a productive work life with rehabilitation services, such as ergonomic assistance and modifications, accommodations for assistive technology, and work schedule and task modifications, job development and placement, labor market research, retraining and other services.

**Small Business Continuation Protection**

Small business owners shoulder a lot of responsibility. In the event of an illness or injury, disability income insurance can help cover day-to-day business overhead expenses for up to two years.

Disability insurance can also help provide funds for small business partnership buy-outs in the event of total disability, while reducing the business disruption and financial burden of transitioning ownership.

**The Duration of a Disability**

The potential loss of income due to a permanent and total disability can literally be in the millions of dollars. On the average, the duration of a disability which lasts at least 90 days, will be two to four years.
The older a person is at the onset of a disability, the longer the recovery period. In addition, an older person's disability is more likely to become permanent. This table demonstrates the relationship between age and the duration of a disability.

### Duration of a Disability at Specific Ages

<table>
<thead>
<tr>
<th>At Age</th>
<th>Probability of at least One Disability Lasting 90 Days or more Prior to Age 65</th>
</tr>
</thead>
<tbody>
<tr>
<td>25</td>
<td>40%</td>
</tr>
<tr>
<td>30</td>
<td>37%</td>
</tr>
<tr>
<td>35</td>
<td>37%</td>
</tr>
<tr>
<td>40</td>
<td>33%</td>
</tr>
<tr>
<td>45</td>
<td>30%</td>
</tr>
<tr>
<td>50</td>
<td>25%</td>
</tr>
</tbody>
</table>

Source: 1985 Commissioner's Individual Disability Table A

### Likelihood of Disability

<table>
<thead>
<tr>
<th>At Age</th>
<th>Probability of a Disability Lasting at least 5 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>25</td>
<td>28%</td>
</tr>
<tr>
<td>30</td>
<td>37%</td>
</tr>
<tr>
<td>35</td>
<td>45%</td>
</tr>
<tr>
<td>40</td>
<td>52%</td>
</tr>
<tr>
<td>45</td>
<td>59%</td>
</tr>
<tr>
<td>50</td>
<td>65%</td>
</tr>
</tbody>
</table>

The table below demonstrates the possibility of a person becoming disabled during peak earning years. The risk is substantial and the probability of a disability occurring is many times greater than the probability of premature death during the same period of time. Although the risk of a disability decreases with age, the length of a disability increases at older ages.

<table>
<thead>
<tr>
<th>Age</th>
<th>Number per 1,000 Disabled</th>
<th>Number per 1,000 Dying</th>
<th>Probability of Disability Compared to Death</th>
</tr>
</thead>
<tbody>
<tr>
<td>32</td>
<td>6.87</td>
<td>1.74</td>
<td>4 to 1</td>
</tr>
<tr>
<td>37</td>
<td>7.75</td>
<td>2.27</td>
<td>3.5 to 1</td>
</tr>
<tr>
<td>42</td>
<td>9.46</td>
<td>3.39</td>
<td>2.8 to 1</td>
</tr>
<tr>
<td>47</td>
<td>12.00</td>
<td>5.00</td>
<td>2.4 to 1</td>
</tr>
<tr>
<td>52</td>
<td>15.78</td>
<td>7.36</td>
<td>2 to 1</td>
</tr>
</tbody>
</table>

Source: 1985 Commissioner's Individual Disability Table 1980 Commissioner's Standard Ordinary Mortality Table

At most ages, statistics tell us, the probability of disability occurring is from 2 to 4 times more likely than that death will occur at that age. Agents often stress the need for life insurance based on the probability of premature death, yet disability is more likely to occur than premature death.
Factors Affecting Likelihood of Disability

The likelihood of an individual’s disability is significantly affected by 3 factors:

1. Age
2. Occupation
3. Lifestyle

Age

Although the probability of disability occurring before age 65 declined as the age increased due principally to the shortening of the period being considered. While the period considered was 40 years when the individual was age 25, it diminished to only 20 years at age 45. The probability of disability actually increases as the individual ages.

Occupation

An individual’s occupation plays a major role in whether or not he or she will become disabled. This greater likelihood of disability resulting from occupation has an important bearing on both the cost of the coverage and its availability.

Lifestyle

The third principal factor in any individual’s chances of becoming disabled is their lifestyle. “Lifestyle” includes the applicant’s smoking and drinking habits as well as his or her avocations or hobbies.

Probability of Disability for Groups

The likelihood of disability during an individual’s working years is significant. It may be 4 times as likely as death at some ages.

<table>
<thead>
<tr>
<th>Age</th>
<th>Probability of One Long Term Disability Occurring in a Group of Men*</th>
</tr>
</thead>
<tbody>
<tr>
<td>25</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>36.5%</td>
</tr>
<tr>
<td></td>
<td>35.4%</td>
</tr>
<tr>
<td></td>
<td>34.2%</td>
</tr>
<tr>
<td></td>
<td>32.9%</td>
</tr>
<tr>
<td></td>
<td>31.1%</td>
</tr>
<tr>
<td></td>
<td>28.3%</td>
</tr>
<tr>
<td></td>
<td>23.4%</td>
</tr>
</tbody>
</table>

*Calculated from the Society of Actuaries’ DTS Experience Table.

As the group size increases, so does the probability of a disability.
Potential Earnings

The significance of these statistics on the potential earnings of an individual is depicted by this table detailing the potential earnings through age 65 at various ages and income levels.

<table>
<thead>
<tr>
<th>AGE</th>
<th>MONTHLY INCOME</th>
<th>$2,000</th>
<th>$4,000</th>
<th>$6,000</th>
<th>$8,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>25</td>
<td>$960,000</td>
<td>$1,920,000</td>
<td>$2,880,000</td>
<td>$3,840,000</td>
<td></td>
</tr>
<tr>
<td>26</td>
<td>936,000</td>
<td>1,872,000</td>
<td>2,808,000</td>
<td>3,744,000</td>
<td></td>
</tr>
<tr>
<td>27</td>
<td>912,000</td>
<td>1,824,000</td>
<td>2,736,000</td>
<td>3,648,000</td>
<td></td>
</tr>
<tr>
<td>28</td>
<td>888,000</td>
<td>1,776,000</td>
<td>2,664,000</td>
<td>3,596,000</td>
<td></td>
</tr>
<tr>
<td>29</td>
<td>864,000</td>
<td>1,728,000</td>
<td>2,592,000</td>
<td>3,456,000</td>
<td></td>
</tr>
<tr>
<td>30</td>
<td>840,000</td>
<td>1,680,000</td>
<td>2,520,000</td>
<td>3,360,000</td>
<td></td>
</tr>
<tr>
<td>31</td>
<td>816,000</td>
<td>1,632,000</td>
<td>2,448,000</td>
<td>3,264,000</td>
<td></td>
</tr>
<tr>
<td>32</td>
<td>792,000</td>
<td>1,584,000</td>
<td>2,376,000</td>
<td>3,168,000</td>
<td></td>
</tr>
<tr>
<td>33</td>
<td>768,000</td>
<td>1,536,000</td>
<td>2,304,000</td>
<td>3,072,000</td>
<td></td>
</tr>
<tr>
<td>34</td>
<td>744,000</td>
<td>1,488,000</td>
<td>2,232,000</td>
<td>2,976,000</td>
<td></td>
</tr>
<tr>
<td>35</td>
<td>720,000</td>
<td>1,440,000</td>
<td>2,160,000</td>
<td>2,880,000</td>
<td></td>
</tr>
<tr>
<td>36</td>
<td>696,000</td>
<td>1,392,000</td>
<td>2,088,000</td>
<td>2,784,000</td>
<td></td>
</tr>
<tr>
<td>37</td>
<td>672,000</td>
<td>1,344,000</td>
<td>2,016,000</td>
<td>2,688,000</td>
<td></td>
</tr>
<tr>
<td>38</td>
<td>648,000</td>
<td>1,296,000</td>
<td>1,944,000</td>
<td>2,592,000</td>
<td></td>
</tr>
<tr>
<td>39</td>
<td>624,000</td>
<td>1,248,000</td>
<td>1,872,000</td>
<td>2,496,000</td>
<td></td>
</tr>
<tr>
<td>40</td>
<td>600,000</td>
<td>1,200,000</td>
<td>1,800,000</td>
<td>2,400,000</td>
<td></td>
</tr>
<tr>
<td>41</td>
<td>576,000</td>
<td>1,152,000</td>
<td>1,728,000</td>
<td>2,304,000</td>
<td></td>
</tr>
<tr>
<td>42</td>
<td>552,000</td>
<td>1,104,000</td>
<td>1,656,000</td>
<td>2,208,000</td>
<td></td>
</tr>
<tr>
<td>43</td>
<td>528,000</td>
<td>1,056,000</td>
<td>1,584,000</td>
<td>2,112,000</td>
<td></td>
</tr>
<tr>
<td>44</td>
<td>504,000</td>
<td>1,008,000</td>
<td>1,512,000</td>
<td>2,016,000</td>
<td></td>
</tr>
<tr>
<td>45</td>
<td>480,000</td>
<td>960,000</td>
<td>1,440,000</td>
<td>1,920,000</td>
<td></td>
</tr>
<tr>
<td>46</td>
<td>456,000</td>
<td>912,000</td>
<td>1,368,000</td>
<td>1,824,000</td>
<td></td>
</tr>
<tr>
<td>47</td>
<td>432,000</td>
<td>864,000</td>
<td>1,296,000</td>
<td>1,728,000</td>
<td></td>
</tr>
<tr>
<td>48</td>
<td>408,000</td>
<td>816,000</td>
<td>1,224,000</td>
<td>1,632,000</td>
<td></td>
</tr>
<tr>
<td>49</td>
<td>384,000</td>
<td>768,000</td>
<td>1,152,000</td>
<td>1,536,000</td>
<td></td>
</tr>
<tr>
<td>50</td>
<td>360,000</td>
<td>720,000</td>
<td>1,080,000</td>
<td>1,440,000</td>
<td></td>
</tr>
</tbody>
</table>

Total Income through Age 65

<table>
<thead>
<tr>
<th>Annual Income</th>
<th>Starting at Age</th>
<th>50</th>
<th>40</th>
<th>30</th>
</tr>
</thead>
<tbody>
<tr>
<td>$30,000</td>
<td>$450,000</td>
<td>$750,000</td>
<td>$1,050,000</td>
<td></td>
</tr>
<tr>
<td>$40,000</td>
<td>$600,000</td>
<td>$1,000,000</td>
<td>$1,400,000</td>
<td></td>
</tr>
<tr>
<td>$50,000</td>
<td>$750,000</td>
<td>$1,250,000</td>
<td>$1,750,000</td>
<td></td>
</tr>
<tr>
<td>$60,000</td>
<td>$900,000</td>
<td>$1,500,000</td>
<td>$2,100,000</td>
<td></td>
</tr>
<tr>
<td>$70,000</td>
<td>$1,750,000</td>
<td>$1,750,000</td>
<td>$2,450,000</td>
<td></td>
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<tr>
<td>$80,000</td>
<td>$1,200,000</td>
<td>$2,000,000</td>
<td>$2,800,000</td>
<td></td>
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<tr>
<td>$90,000</td>
<td>$1,350,000</td>
<td>$2,250,000</td>
<td>$3,150,000</td>
<td></td>
</tr>
<tr>
<td>$100,000</td>
<td>$1,500,000</td>
<td>$2,500,000</td>
<td>$3,500,000</td>
<td></td>
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</tbody>
</table>
DISABILITY INCOME INSURANCE

Disability income insurance provides protection against disability due to sickness and/or accident. Generally, a disability income policy will pay income for a specified time period, or the insured’s remaining life, should a disability occur.

Policies can provide coverage for total, partial, short-term, or long-term disability. Various policy coverage features and options are available, offering a wide spectrum of coverage for the disability income customer.

AMOUNT OF INDIVIDUAL DISABILITY INSURANCE NECESSARY

To determine individual disability income insurance coverage needed, several factors must be considered:

- The amount of income needed to meet basic needs
- The amount of disability income the individual can expect to receive through federal, state, and/or group programs
- Other sources of income, such as:
  - income from a working spouse
  - investment income
  - savings
- Additional expenses due to disability
  - Transportation to and from medical and rehabilitation treatments
  - Children and housekeeping help so spouse can work

Determining the amount needed also involves a review of current and past spending, expected expenditures due to future events, such as children entering college, and expenditures that will increase or be eliminated due to disability.

Each expense and asset must be reviewed to determine the impact disability has on the expense or asset. For example, mortgage payments, installment debt, property taxes, and utilities would likely remain constant. Recreation and entertainment could be cut back or eliminated. A car or recreation vehicle may be sold. Medical expenses are likely to increase. Severe disability may even require some remodeling of a home to provide appropriate access for a wheelchair.

Coverage Calculation

The difference between the income needed and the income the individual is expecting to receive from existing sources equals the amount of disability income coverage needed.

The rule of thumb some professionals use to determine monthly disability income coverage needed is 60 to 70% of pre-disability income. However, each individual's situation can vary due to other coverages available and amount of savings and other income sources.
**Minimum and Maximum Benefits**

The minimum and maximum indemnity of the policy is normally based on the insured's income. If coverage is too high, the insured will have a disincentive to return to work. Therefore, the insurance company will place a limit on the maximum coverage amount on each case submitted.

Because disability income insurance is designed to replace lost income due to a total disability, it is important for the insurance company to be made aware of all sources of income that are available to the applicant. This is referred to as financial underwriting which takes into consideration, the applicant's current earned income (or average earned income), any unearned income, total net worth and other sources of disability income insurance.

Most states and insurers limit the amount of disability income which may be purchased. Typically, this will be some percentage, such as 70% of gross earned income. The insurer has specific issue and participation limits which are based on the applicant's earned income. As a general rule, most insurers will offer coverage equal to 60-70% of earned income. This limitation may also be adjusted (decreased) due to the occupational class of the applicant. Most insurers will offer smaller amounts of disability income coverage to applicants with the more hazardous occupations.

A third factor which serves to limit the benefit amount is the applicant's unearned income which refers to rents, royalties, interest, dividends, etc. This income is paid regardless of the individual's disability or work status. If the amounts of unearned income are substantial, the company may reduce the benefit amount applied for by the applicant. The meaning of "substantial" amounts of unearned income will vary from one insurer to another.

The underwriter's function is to protect against overinsurance. The combination of monthly disability income benefits plus unearned income may remove the incentive for the individual to want to return to work and causing malingering. The amount of disability income protection applied for may be reduced to reflect the impact of his unearned income.

Another factor which determines the amount of the benefit is the existence of any other disability income coverage in force which will cause the amount requested to be limited to the insurer's underwriting limits. These limits are referred to as the issue and participation limits.

The purpose of insurance is to make a person whole again. When an insurer's issue and participation limits are 70% of gross income, this amount is usually very close to the individual's net income. Therefore, the claimant is made whole again, but does not have an incentive to mangle.

The net worth of the applicant may also serve as a limiting factor. An extremely wealthy person may have the amount of insurance limited or the insurer may decline to provide any disability insurance.

The amount of total net worth and the liquidity of such assets will determine whether a reduced amount of disability income will be issued or possibly no coverage at all. If a person's assets are easily marketable, and/or if the total net worth reflects a large amount of unearned income, then the applicant may not be eligible for any coverage.
Disability Income Fact Finder

Needs and objectives are only determined by thorough fact finding. An agent should use a prepared format for conducting a fact finding interview designed to focus on problems, needs and objectives of your prospect. A standardized fact finding format helps prevent overlooking any relevant topic or information necessary for making a competent and professional recommendation to the client.

The essential elements of a fact finder would include the following:

- **Personal Information**: Name, address, occupation, dependent status, etc.
- **Individual Insurance**: Individually owned life, health and disability income insurance including names of insurers, amounts of coverage, and beneficiary designations
- **Statutory Benefits**: Eligibility for workers compensation, social security or other similar benefits
- **Business Information**: Business address, earned income, specific occupational duties, employee benefits, health, group life, pension, sick
- **Liabilities**: Fixed monthly expenses (rent, food, shelter, clothing, insurance premiums, etc.) and variable monthly expenses (medical, dental, home or auto repair, etc.)
- **Other Assets**: Savings, investments and unearned income

In addition to this factual type of information, the prospect's goals, objectives or special needs should be discussed, such as educational objectives for dependent children, business objectives, retirement goals, etc. Once this entire process is completed, an individual program of disability income coverage can be developed and a proposal for such coverage generated.

The precise amount of coverage needed may be hard to ascertain. A family needs to sit down and figure annual living expenses. Once a total is established, subtract all sources of income. This includes investments and Social Security that the person may be eligible for since they are disabled.

<table>
<thead>
<tr>
<th>Monthly Expenses</th>
<th>If Disabled:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mortgage/Rent:</td>
<td></td>
</tr>
<tr>
<td><em>(Include property taxes)</em></td>
<td></td>
</tr>
<tr>
<td>Utilities:</td>
<td></td>
</tr>
<tr>
<td><em>(Oil, gas, electric, water, phone)</em></td>
<td></td>
</tr>
<tr>
<td>Home Maintenance:</td>
<td></td>
</tr>
<tr>
<td>Food &amp; Clothing:</td>
<td></td>
</tr>
<tr>
<td>Insurance / Auto:</td>
<td></td>
</tr>
<tr>
<td>Home:</td>
<td></td>
</tr>
<tr>
<td>Life/Health:</td>
<td></td>
</tr>
<tr>
<td>Transportation:</td>
<td></td>
</tr>
<tr>
<td>Medical/Dental Care:</td>
<td></td>
</tr>
</tbody>
</table>

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It is important to remember all aspects of income and monthly expenses when determining how much the family needs to support them in case of an emergency. The process is not foolproof. An insurance agent must inform the family of things to consider when choosing an amount of coverage. If they decide to just cover the mortgage, the family will know what to expect if or when the disability occurs. Selling a policy with a premium that a family can live with in good and bad times is important.

### Substitute Income for Expenses When Disabled:

<table>
<thead>
<tr>
<th></th>
<th>Monthly Benefit:</th>
<th>Waiting Period:</th>
<th>Benefit Period:</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Group Disability Insurance:</strong></td>
<td>$ _____________</td>
<td>$ _____________</td>
<td>$ _____________</td>
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<tr>
<td><strong>Social Security:</strong></td>
<td>$ _____________</td>
<td>$ _____________</td>
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<tr>
<td><strong>State Plans:</strong></td>
<td>$ _____________</td>
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<tr>
<td><strong>Worker’s Comp:</strong></td>
<td>$ _____________</td>
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<tr>
<td><strong>Credit Disability:</strong></td>
<td>$ _____________</td>
<td>$ _____________</td>
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<tr>
<td><em>(In some auto or home loans)</em></td>
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<td>$ _____________</td>
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<tr>
<td><strong>Other Income:</strong></td>
<td>$ _____________</td>
<td>$ _____________</td>
<td>$ _____________</td>
</tr>
<tr>
<td><em>(Stocks, bonds, spouses income)</em></td>
<td></td>
<td>$ _____________</td>
<td>$ _____________</td>
</tr>
<tr>
<td><strong>Personally owned Disability Insurance:</strong></td>
<td>$ _____________</td>
<td>$ _____________</td>
<td>$ _____________</td>
</tr>
<tr>
<td><strong>Total Monthly Substitute Income:</strong></td>
<td>$ _____________</td>
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<td>$ _____________</td>
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</tbody>
</table>

Social security, worker's compensation and group disability benefits may be payable for a disability. A reasonable estimate can be made regarding the amount of benefits expected from each of these sources.

The amount of savings and investments should also be considered. A company retirement plan may allow withdrawals in the case of disability.

Benefits are often coordinated so that one program’s payments are reduced in recognition of benefits from another program, such as Social Security or Worker's Compensation. "Coordination of Benefits" should be considered.
The coverage does not need to replace 100 percent of the income lost. If the breadwinner is disabled, the costs of commuting to and from work would be eliminated, as well as the cost of meals eaten at restaurants for lunch. Insureds may not need to spend as much on clothes as before. Other business related expenses will be eliminated when the disability occurs.

The disabled person will be paying a lot less in taxes or possibly no taxes at all. The money received from the disability coverage may be received tax free if the insured paid for the premiums with after-tax dollars. Benefits from an employer-paid policy will usually be taxable as income to the insured.

Sources of Disability Income

In addition to disability income insurance, these resources are available to offset the devastating effects of a disability:

Savings

Although existing savings is a viable source of disability income, realize that the U.S. personal savings rate is among the lowest in the industrialized world. At a savings rate of barely 4% a year, the U.S. has fallen well behind many other nations. When Americans save money, it is generally to purchase a particular consumer item, such as a down payment for a house or a car, a new television set, a vacation or some other consumable. Even worse, people in the U.S. are more apt to be in debt than have savings.

Even if a prospect has existing savings he or she cannot be sure the savings will be sufficient—without knowing how long a disability might last. Even if someone saved 10% of his or her income each year, one year of disability can wipe out as much as 10 years of savings! Generally, most people save an amount equal to two or three month’s income or less. Statistically, if a 30-year old male is disabled for at least 90 days, the average length of the disability will be 4.7 years.

Spousal Employment

An unemployed spouse may return to the job market. The likelihood of an unemployed spouse returning to the workplace was once far greater than it is today, for several reasons:

- Dual income families
- Workforce contraction
- Technological innovation

The traditional family consisting of a working husband, a school-age child and a stay-at-home mom has generally ceased to exist. Most families today are two-income families, who depend upon both incomes to meet their basic monthly bills. In many cases there is no unemployed spouse to return to the job market.

There has also been a decline in the number of unskilled and semi-skilled jobs as many companies and industries reduce their workforce. This is known as “downsizing” or “rightsizing” and means that the market for many skills has changed or disappeared.
Prolonged absence from the job market may mean that important technological advances have occurred with which the spouse is unfamiliar, further worsening the possible chances of employment. If a spouse is not currently employed outside the home, it is extremely unlikely that appropriate employment is readily available.

In the event that a spouse can find a job to help support the family during a period of the breadwinner’s disability, it is doubtful that she can take over the job of breadwinner and still function as a parent, a spouse and a caregiver.

**Borrowing**

Borrowing and going further in debt may be another possible resource for the disabled person. However, it is hard to find anyone who would lend money to an individual who cannot work and may never work again. Without a current income source, borrowing may be difficult or impossible.

Although people may be able to borrow from existing credit cards, the 15% to 22% interest rates charged can turn a bad financial problem into a catastrophic one.

**Business Assets**

Business assets include any benefit related to a person’s employment such as pension benefits, salary continuation or possibly an ownership interest in the business. If a pension plan provides for a benefit due to the disability of the employee, this sum is normally a reduced amount from the normal retirement benefit. This could result in a very small monthly check.

If the disabled person happens to be a business owner he or she has a business asset which may be converted into cash to sustain the person through the period of disability. Unfortunately, this could mean selling or liquidating the business interest, in a forced sale which may bring only cents on the dollar.

**Personal Assets**

The disabled person has other personal assets such as automobiles, real estate, cash value life insurance, stocks, bonds, or other investments. These assets could certainly help a person through a disability depending on the severity or length of the disability and the value of the assets. Converting assets into cash will provide a limited amount of money for a limited period of time.

**Government Programs**

A person, who is disabled for five months or more, may be eligible for Social Security, if they meet all the qualifications. Even if they do, however social security will only replace an estimated 15 percent of the average monthly income. There is no guarantee that the person will be eligible for or receive Social Security benefits.

**Worker’s Compensation** covers work related injuries. This type of disability payment varies widely according to state law. The maximum is 66.6 percent of the individual’s predictability gross wages, or 80 percent of the take-home pay, up to a specified maximum. Employers buy
worker's compensation insurance for their employees. Self-employed persons may be able to buy their own coverage or in many cases they may not even be eligible for workers compensation at all.

**Disability Insurance**

The only sensible alternative is disability income insurance with annual premiums that often are as low as 4 or 5 cents for each dollar of monthly benefit provided. Disability income coverage provides income exactly when it is needed—when disability strikes. It changes the possible financial catastrophe of disability to a reasonable and budgetable monthly premium.

**Summary**

For many people, disability is the forgotten hazard—despite its being far more likely at most ages before retirement than death. Although the chances of becoming disabled are greater for someone with a history of health problems, age, occupation and lifestyle also impact the likelihood of disability. As the size of any group increases, the likelihood of a long-term disability among members of the group also increases.

After considering the alternative income sources during disability—savings, borrowing or spousal employment—the best choice is disability income insurance.
Chapter One Quiz

1. The probability of disability is _____ times more likely than death.
   a. 3 to 5
   b. 2 to 4
   c. 2 to 3
   d. 5 to 6

2. Which of these is NOT a factor in the likelihood of an individual’s disability?
   a. Net worth
   b. Age
   c. Occupation
   d. Lifestyle
Chapter Two Disability Policy Definitions & Provisions

Important Lesson Points

- A disability income policy's **renewability** provision determines the policy's guarantees with respect to the insurer's right to cancel coverage or raise premiums.
- The term **total disability** in a typical disability income policy is defined in terms of the insured's inability to work and makes no mention of income loss.
- An **income replacement contract**, which is an alternative to a traditional disability income policy, generally contains no definition of disability; it pays a benefit based solely on loss of income resulting from sickness or accident.
- An **elimination period** is the period following the onset of disability before benefits are payable and may be as short as zero days or as long as several years.
- **Split elimination periods** may be used to enable an underwriter to provide needed coverage without exposing the insurer to undue risk.
- Policy **benefit periods** may provide benefits for as short a period as two years or for as long as the insured's entire lifetime.
- **Exclusions and limitations** in a disability insurance policy serve to limit the insurer's liability for disability arising from certain conditions or to eliminate that liability entirely.
- The exclusions and limitations in disability insurance policies are generally limited to pre-existing conditions, acts of war and service in the armed forces.

BASIC DISABILITY INCOME CONCEPTS

The purpose of disability income insurance is to provide income replacement. If a person is totally disabled due to accident or sickness, the policy will provide income to replace part of the insured's lost wages.

Once the insured is totally disabled, the elimination period must be satisfied. Upon completing the elimination period, benefits begin to accrue, with a claims check mailed to the insured at the end of a month. The insured must remain totally disabled to receive benefits. If he or she returns to work in any capacity (part time, a few hours per week, etc.), then benefits will cease as the insured can no longer fulfill the definition of total disability.

There are basically two important periods of time associated with a disability income policy - the elimination period and the benefit period. The EP is the period of time that the insured must be totally disabled before disability benefits are payable. Once benefits begin following the elimination period, they will be paid up to a specified period of time (such as two years) known as the benefit period.

POLICY PROVISIONS

This section will describe the principal provisions of a disability income contract. The four principal elements to consider when developing an individual plan of disability income protection for a client are:

- The length of the elimination period.
• The length of the benefit period
• The amount of monthly benefit required
• Optional benefits which may be included

All of the factors should be considered with regard to the client’s total financial needs (other insurance, investments, etc.) and the ability to qualify and pay for the insurance.

Disability Income Insurance: Features

Disability, as that term relates to the disability income products, means *meeting a specific definition in a particular policy*. Those definitions are quite different from each other. The impact of those differing definitions is that a policyholder may be considered disabled or not depending upon the disability income policy under which he or she is insured.

When prospects consider what it means to be disabled, they seldom think of disability in terms of meeting—or failing to meet—a particular definition. Instead, they think in terms of an illness or injury that causes them to lose their income. Their mortgage or rent payments continue to be due and their children still need to be fed, but their income to make those payments has stopped.

Prospective insurance buyers are often confused about disability income insurance because the features and benefits vary widely from one policy to another. There are a few key elements that make a big difference.

Portable Coverage policies that allow insureds to carry their coverage from one job to another have an obvious advantage. Coverage from a professional association could be an example of portable coverage as well as an individual disability income policy that they might buy on their own.

**Mandatory Provisions**

The Uniform Individual Accident and Sickness Policy Provision Model Law drafted by the National Association of Insurance Commissioners (NAIC) in 1950 and passed by all states except Louisiana, mandates that certain provisions must be included in every individual disability income policy as well as in every health insurance policy.

The Mandatory Policy Provision section consists of 12 provisions found in all health insurance policies.

1. Change of Beneficiary
2. Notice of Claim
3. Claim Forms
4. Entire contract and changes
5. Premium grace period
6. Legal Actions
7. Payment of Claims
8. Physical Exam & autopsy
9. Proof of Loss
10. Policy Reinstatement

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11. Time limit for Paying Claims
12. Time limit on Certain Defenses

The uniform law does not require verbatim language by the insurers, nor must the provisions appear in a set order. The provisions must be followed in substance only, and most insurers use language that is more favorable to the policyholder than the law demands.

Change of Beneficiary

This mandatory provision provides that the policyowner (usually the insured) has the right to name or change a beneficiary. A policy that allows the insured to change the beneficiary is called revocable. Since a disability income policy may include an accidental death benefit, this provision is relevant. The revocable beneficiary has no right to the proceeds until the death of the insured.

The only time the policyowner may not change a beneficiary is if the beneficiary is irrevocable. An irrevocable beneficiary cannot be changed by the insured. The irrevocable beneficiary has a vested right in the contract; however, if the irrevocable beneficiary dies before the insured, the insured may name a new beneficiary.

Notice of Claim

Notice of claim sets the time parameters during which the claim must be filed. The insured has 20 days to notify the insurer of a claim. Notification of a claim may be a written communication or a telephone call to the insurer or the agent. Notifying the agent is considered notification to the company by law.

If the insured was seriously injured and unable to notify the insurer within 20 days, then notification of the claim may occur later than the 20-day period.

If the laws in the state where the policyholder resides require more notice than the insurance company normally allows, the insurance company must comply with that state's requirements.

Claim Forms

Upon receipt of the notification of claim, the insurance company has 15 days to provide the claimant with the necessary claims forms. Frequently, the company includes claims forms along with the policy.

If the insurer does not comply with this 15 day requirement, the company must allow the insured to submit the claim in any manner as long as all the information required is provided.

Entire Contract

The Entire Contract and Changes provision dictates that the insurance contract between the insured and the insurance company is contained in the insurance policy, including the application, endorsements, and any riders attached to the policy. There are no verbal agreements or other documents which change or alter the contract. The agent cannot change or
alter any policy provision or benefit. *No changes* can be made to the contract unless it is agreed upon in writing by both the insured and the insurer and must be attached to the policy.

**Grace Period**

A grace period is a specified number of days following the premium due date during which the policyholder may pay unpaid premium without losing their insurance. Depending on the type of insurance in question, the length of grace period can be anywhere from seven to 31 days. During this grace period, the policy stays in force, and claims will be valid.

**Legal Action**

A policyowner cannot bring legal action against the insurer, regarding a claim, sooner than 60 days after the insurer has received the proof of loss. Most states will also specify a maximum time limit for initiating legal action, such as three to five years after the insurer has received the proof of loss. The intent of the provision is to establish a fair and reasonable time period for resolving claim problems and disputes between the insurer and the insured.

**Payment of Claims**

This provision identifies to whom benefits will be paid. Typically, a disability income claim will be paid directly to the insured. It is possible for policy benefits to be paid to a third party if the policyowner/insured executes a proper assignment form which authorizes the insurer to pay benefits directly to another party such as a doctor or hospital, or upon the insured’s death.

**Physical Exam and Autopsy**

This provision permits the insurer to request physical exams of a claimant as continued proof of a disability. The exam is conducted by an insurer’s doctor at the insurance company’s expense. This provision may be invoked if the insurer has reason to believe that the claimant is not really disabled or is malingering.

If the policy includes an accidental death benefit but the cause of death cannot be determined accurately, then the insurer may request an autopsy be performed as long as such a request does not conflict with state law.

**Proof of Loss**

The claimant has 90 days to file proof of loss, which includes the following types of information: the time, date, and nature of the accident or sickness; and the names and addresses of doctors or hospitals providing treatment. In addition, a statement from the attending physician is usually required indicating the anticipated duration of the disability.

Subsequent claims forms usually must be submitted to the insurer at regular intervals (every two or three months) to prove the claimant is still eligible for benefits.
Reinstatement

Should the policy lapse for nonpayment of the premium, this provision explains the policyowner’s right to request reinstatement of the policy. Typically, the reinstatement process consists of submitting an application for reinstatement, proving insurability and paying all back premiums plus interest. Some insurers may permit reinstatement without a formal application depending on the length of time which has elapsed since the policy lapsed. In this situation, usually a signed statement of continued good health and the premiums in arrears plus interest are the only requirements.

The insurer has the right to ask the insured to fill out an application for reinstatement before the policy can be activated again. If the insured has submitted all required documentation to the insurer and they do not notify the insured to the contrary within 45 days, the policy is reinstated.

A reinstated policy covers losses due to accidents immediately. However, it usually contains a 10-day probationary period for sickness benefits only to prevent adverse selection.

Time Payment of Claims

The time of payment of claims provision outlines when the insurer will pay the insured for a submitted claim. This is subject to the insured sending in the required documentation, or proof of loss. DI benefits are paid monthly.

Time Limit on Certain Defenses

The insurer may not contest or challenge any statement on the application or deny a claim after the policy has been in force for a certain time period after the effective date of coverage. Two years is the standard period after which the policy becomes incontestable.

The purpose of this provision is to provide the insurer with a reasonable amount of time to investigate the applicant and statements made on the application. This provision also protects the policyowner since the insurer cannot deny a claim based on a misstatement on the application after the policy becomes incontestable (except for fraud). There is usually no time limit if the insured has engaged in fraud.

Optional Provisions

In addition to the mandated provisions, most insurers provide the option of additional provisions that may be unique to that insurance company. There may be an additional premium charged for adding these provisions to a disability income insurance policy.

These provisions are optional on the part of the insurer and by law do not have to be included in the contract. These are provisions which primarily protect the insurer from certain activities or practices of the insured. The 11 optional provisions are:

1. occupation change
2. age misstatement
3. other insurance with the same insurer
4. expense insurance with other insurers

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5. income insurance with other insurers
6. relation of earnings to insurance
7. unpaid premiums
8. cancellation
9. conformity with state statutes
10. illegal occupation
11. intoxicants and narcotics

Change of Occupation

The change in occupation provision allows the insurer to raise or lower premiums or benefits since the insured's new occupation that may be more or less hazardous. Failure to notify the company will result in the insurer adjusting benefits should the insured file a claim. The insured will receive the benefit which the premium would purchase for the more hazardous occupation.

Misstatement of Age or Sex

Age is also a factor in DI policies when determining the premium cost. The younger an insured starts coverage, the lower the premium will be. This optional provision permits the insurer to adjust benefits or premiums if the insured's age or sex has been misstated. If age or sex has been misstated, then the premium and/or the policy benefits will be adjusted according to the correct premium or benefit for the actual age or sex of the insured.

Income Insurers with Other Insurers

The “income insurance with other insurers” provision deals with DI policies as well as other types of insurance. It states that each insurance company will share in the benefit payments in proportion to the benefit amounts each insurance company provides under their own policy. When each insurance company pays less than its total limit, the insured may have paid premiums for coverage they will not receive, which means those premiums will typically be refunded.

Other Insurance with This Insurer

Insurance companies have developed this provision to alleviate the possibility of paying a claim twice, even if the insured has another policy with the same insurer. This provision is called the other insurance in this insurer provision, also called the duplicate coverage provision. The insurer has two methods of assuring this: first the insurer specifies a maximum dollar amount for which the insurer is liable. Under this method the insurer agrees to return any excess premiums paid by the insured. The second method used by the insurers is to have the insured choose which policy will pay benefits and the insurer then returns the premiums paid for the other unused policy.

Expense Insurance with Other Insurers

The next provision allows the insurance company to either exercise or not exercise it. It is called the expense insurance with other insurers’ provision. Expense insurance deals with benefits paid for expense related services. This type of coverage includes medical plans. This type of provision is encountered in just about all fields of health policies, including health insurance.
coverage, disability coverage and even Medigap policies. The primary insurance would cover first, or both may pay a portion of the bill.

**Relation of Earning To Insurance**

The insurance company will establish a limit as to the amount of disability income coverage which may be purchased. This may be a dollar amount relative to the person's earned income or a percentage of earned income such as 70% or 75%.

The relation of earnings to insurance provision prevents the insured from actually profiting financially from a disability, and restricts total benefits paid from all policies to no more than either the insured's monthly earnings at the time of the disability occurring or the insured's average monthly earnings for the two years prior to the disability. The insurer pays only their proportionate amount of benefits and any excess premiums are refunded to the insured.

**Unpaid Premium**

This provision allows the insurer to deduct any unpaid premium from any disability income claim payment. If the insured made a claim, and there are unpaid premiums, this provision allows the insurer to deduct such premiums from the benefit amount.

**Cancellation**

The cancellation provision requires the insurer to notify the insured at least five days in advance of canceling the policy. This provision is not allowed in some states. Upon cancellation, the insured would receive a refund of any unused premium.

**Conformity with State Statutes**

As a legal contract, the insurance policy must comply with state laws. This optional provision avoids problems if a particular contract is issued which fails to comply with some state requirement or law. Whenever the policy is in conflict, it will automatically be amended to conform to all state laws.

**Illegal Occupation**

The purpose of this provision is to protect the insurance company from losses, such as injury, which are the result of the insured's involvement in criminal activities. The Illegal Occupation provision allows the insurer to deny coverage for an injury or sickness that occurs as the result of, or while the insured was engaged in, an illegal occupation or action.

**Intoxicants and Narcotics**

This provision is similar in purpose to the illegal occupation provision. It permits the insurer to deny a claim if the cause of the sickness or injury is due to the consumption of alcohol or the use of narcotics. The exception to this provision is a prescribed drug or a drug administered by a physician.
Additional Provisions

The Uniform Individual Accident and Sickness Policy Provision Law includes other health insurance requirements, in addition to the mandatory and optional provisions. Some of the other requirements are:

1. The entire monetary and other considerations must be expressed in the policy
2. The type used in the policy must be at least ten point font
3. It must not give undue prominence to any portion of the text
4. General exceptions and reductions shall be grouped under a descriptive head
5. A policy in violation of the act shall be construed to conform to the act
6. No policy provision can restrict or modify the provisions of the act
7. Supplying claims forms, acknowledgment of notice of claim, the investigation of a claim are not waiver of defense against the claim
8. The policy remains in force for any part of a policy term that exceeds the age limit, and acceptance of a premium after that term keeps the policy in force, subject to any cancellation provisions in the policy
9. If misstatement of age leads the insurer to accept premiums beyond the age limit, liability is limited to a premium refund
10. The act does not apply to workers’ compensation, reinsurance, blanket or group coverage and life insurance or annuity riders covering total disability

DISABILITY INCOME INSURANCE RENEWABILITY PROVISIONS

Renewability refers to the right of the policyowner to renew the policy. It is important because it defines if, and under what conditions, the insurance company can change or cancel the policy or increase its premium.

These are the different renewability provisions that may be contained in disability income insurance policies:

Cancelable

A cancelable policy is one which may be cancelled or the premiums increased, at any time, by the insurer, as long as the policyowner is given proper written notice (usually 5 or 10 days). This type of renewability is extremely undesirable and is not allowed in disability income policies by most state laws.

Guaranteed Renewable

A guaranteed renewable policy is one in which the insurer guarantees to renew the contract, but it does not guarantee the premium. The premium may be increased on the policy anniversary but the policy cannot be cancelled except for non-payment of the premium.

The insurer can increase the premium for all of the policyowners in a class, but not for an individual insured. The Guaranteed Renewable provision normally contains language stating that the insurer:

*retains the right to increase premiums on a class basis.*
Many disability income policies are issued as guaranteed renewable. Guaranteed renewable coverage normally has a lower premium than otherwise identical noncancellable coverage.

**Non-Cancelable**

The insurance company cannot cancel or change the policy or increase premiums before they reach age 65 as long as premiums are paid on time.

A non-cancelable contract is one in which the insurer guarantees both the premium and the renewability of the policy. This type of renewability assures the policyowner that the premium cannot be increased nor can the policy be cancelled by the insurer, except for nonpayment of the premium. This gives a person the right to renew the policy continuously without an increase in the premium or a reduction in benefits.

**Noncancellable & Guaranteed Renewable**

Disability income insurance coverage that is Noncancellable & Guaranteed Renewable provides the greatest amount of protection to the insured and is the most expensive. Disability income insurance policies issued on a noncancellable and guaranteed renewable basis generally provide these premium and renewability guarantees only until the insured’s age 65.

Coverage under early noncancellable & guaranteed renewable disability income policies generally terminated completely at the insured’s age 65—the age at which workers were usually thought to retire. As many individuals, especially professionals, continue to work well past age 65 this is changing.

More recently issued disability income policies enable the insured to continue coverage beyond his or her age 65 on a modified basis, provided the insured certifies annually that he or she is working for at least 30 hours each week. The coverage that continues beyond age 65 is, however, modified, usually in two areas:

1. Policy premiums
2. Duration of coverage

This type of disability income insurance is usually available only on disability income insurance policies issued to applicants in the professional or managerial occupation classes.

**Conditionally Renewable**

In a Conditionally Renewable policy, the insurer retains the right to refuse to renew the policies and increase rates.

A typical conditionally renewable provision contains language as follows:

*The insured may not change his or her occupation to one considered more hazardous.*

Policies issued with this type of renewability provision generally have significantly lower premiums than either noncancellable or guaranteed renewable coverage.

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A conditionally renewable provision is generally offered to insureds in high-risk occupations and is frequently found in group or association type coverage.

**Optionally Renewable**

The renewability provision that offers the least security for the insured is known as optionally renewable coverage. A policy which is issued as optionally renewable is one which may be non-renewed or the premium increased only on the policy's anniversary or at the next premium due date.

Conditionally renewable and optionally renewable provisions are seldom found in disability income policies.

**Optionally - Renewable After Age 65**

This provision indicates that the company can refuse to renew the policy after age 65. Or, the policy may be renewable only if certain health and/or financial conditions are met.

It is assumed that the insured will retire and no longer be employed or have any earned income to protect after age 65.

However, in the event that the insured does not retire at age 65 and continues to work and earn an income, the disability income policy may be conditionally renewable past age 65. The policy may be continued for subsequent one year periods on the condition that the insured continues to work (full time) and earn an income. This period of conditional renewability will continue to the insured's age 70 or 72. On each annual renewal date, the premium will be increased.

**Annually Renewable**

This form of policy is similar to annually renewable term life policies in that premium increases annually based on age. Annually renewable disability income policies are typically convertible to level term disability income policies.

**Definitions of Disability**

**Definition of “Total Disability.”**

Prior to initiating a claim, the insured must be totally disabled as the policy defines total disability. A policy that refers to their “own occupation” generally pays benefits if they cannot return to work in their own field. A policy that refers to “any occupation” generally would pay benefits only if they were unable to perform any job, either their own, a lower paying job, or a job in a new occupation.

The policy’s definition of disability determines whether or not benefits are payable. Various definitions of disability are used in disability income insurance policies. Except in rare cases, the various definitions of total disability in many disability income insurance policies do not require a loss of income for benefits to be payable.
Understanding a policy's definition of disability is critical to determine the application of that policy to a particular client's situation. The client may be interested in protection from partial or temporary disability as well as permanent disability. Not all policies provide benefits for all types of disability.

Another important definition in the policy is the definition of income. Many contracts base claim payments on loss of income. Income may be derived from a variety of sources such as salary, commissions, bonuses, net earnings, and accounts receivable. The policy must define what items comprise income in order to determine loss of income.

**DISABILITY DEFINED BY OCCUPATION**

Some contracts treat the insured as disabled if unable to perform duties of his or her regular occupation. Other policies treat the insured as disabled only if no gainful employment can be accomplished.

Some policies pay benefits if the insured is unable to perform any job suitable for their education and experience. Some policies define disability in terms of their own occupation for an initial period of two or three years and then continue to pay benefits only if they are unable to perform any occupation.

**Own Occupation**

The definition of disability that provides the greatest protection for the insured—and is the one under which it is easiest to obtain a total disability benefit—is the own occupation definition. Under this definition, the insured is considered disabled when he or she is:

*unable to perform the duties of his or her own occupation*

Under a pure own occupation definition of total disability, the insured is considered totally disabled if, as a result of accident or sickness, he or she can't perform the substantial and material duties of his or her regular occupation—even if employed doing something else.

This pure own occupation definition of disability is often limited to insureds in those occupation classes that are very narrow in scope and that are generally deemed to involve very low disability risk by the industry. For example, a cardio-vascular surgeon is an occupation that is well defined and performs very specialized skills in a controlled environment. On the other hand, a manager may be totally inside behind a desk, in a factory or warehouse, traveling frequently by car or plane, and subject to various levels of exposure from one day to the next.

**Modified Own Occupation**

A variation of the pure own occupation definition of disability, known as a modified own occupation definition, states that the insured will be considered totally disabled if he or she is:

*unable to perform his or her own occupation and not engaged in any other occupation.*
Generally, for the insured’s benefit to cease, the insured must have entered an occupation that is considered reasonable in light of his or her education, training or experience with due regard to prior income.

The benefit of a modified own occupation definition to the insured is somewhat lower premiums.

**Limited Own Occupation**

Under a limited own occupation definition of total disability, the definition of total disability changes with the duration of the disability from a pure own occupation definition of disability to any occupation definition. As the disability continues, its definition becomes more restrictive.

The language of a typical limited own occupation definition of total disability is normally similar to the following terms:

*The insured is disabled if unable to perform the duties of his or her own occupation for the first 24 months of disability; following such 24-month period, the insured will be considered totally disabled if unable to perform any occupation for which he or she is fitted by education, training or experience.*

This limited own occupation definition of total disability is inferior to the pure own occupation definitions, and usually appears on policies designed for sale to applicants in the higher risk occupation classes.

**Any Occupation**

The total disability definition providing the least protection for the insured is the any occupation definition. Under the any occupation definition of total disability, the insured must be unable to engage in any occupation in order to be considered totally disabled.

The language of an early any occupation definition of total disability was as follows:

*The insured is disabled when, as a result of sickness or accident, he or she is unable to engage in any occupation for remuneration or profit.*

Under this definition, an insured would be considered disabled only if he or she was unable to engage in any occupation for remuneration or profit, would lose his benefits.

Over time, the courts have added important qualifying language to this definition that avoids some of its harsher consequences. As a result, the any occupation definition of total disability has changed to the following:

*The insured is disabled when, as a result of sickness or accident, he or she is unable to engage in any occupation for remuneration or profit for which he or she is fitted by education, training or experience.*

The any occupation definition of total disability is ordinarily reserved for policies designed for sale to insureds involved in high risk occupations. Although an insurer could certainly design a
disability income policy for sale to professional or managerial occupation class applicants with this definition of total disability, it would be unlikely to do so.

**Any Gainful Occupation**

Other disability insurance policies are structured to pay income only if the client is unable to work in "any gainful occupation." This policy is generally less expensive than an "own occupation" policy. Traditionally, "any gainful occupation" policies are more commonly marketed to the middle-income earner than to the higher income market.

**Income Replacement**

Income replacement policies base benefits payable on amount of income lost. "Income" can be defined as income from a particular occupation or may include income from all sources.

This product, which provides a benefit only if the insured suffers an income loss—resolves the concern about the possible abuse of the own occupation product. When the insured suffered no continuing income loss but continued to receive disability income benefits.

The typical income replacement policy pays a monthly income benefit that is equal to the percentage of income lost by the insured as a result of sickness or accident multiplied by the maximum monthly income benefit.

Example, an applicant with a monthly income of $10,000 might qualify for a $6,000 per month income replacement benefit. If, as a result of sickness or accident, the insured's income reduced in a particular month to $7,000, he or she would have sustained a 30% income loss. The $6,000 maximum monthly benefit would be multiplied by 30%, and the benefit paid for that month would be the result—$1,800.

Each month, the benefit that is payable under the income replacement policy is recalculated based upon the insured's income in the previous month. The required minimum income loss that must be sustained by the insured in order to qualify for a benefit is 20%.

If the insured suffered a complete income loss in a particular month, a benefit equal to 100% of the maximum monthly benefit would be payable. In some income replacement policies, an income loss greater than 80% is considered total, and the maximum monthly benefit is paid.

This income replacement benefit calculation is very similar to the calculation of the residual disability benefit under many disability income policies. The primary difference between the residual benefit and an income replacement policy is that the insured need suffer no loss of time or duties to receive a benefit in an income replacement design. All that is required is that the insured suffer an income loss as a result of an accident or sickness. Income replacement policies are generally a less expensive alternative to provide for the devastating effects of income loss.

**Preexisting Conditions Provision**

A DI policy excludes coverage for preexisting conditions. The exclusion normally disappears after a certain amount of time has passed. If the insured experiences a disability relating to the
preexisting condition, after the required time has passed, the disability will be covered by the policy.

In most disability income insurance policies, a pre-existing condition is defined as a sickness or physical condition for which:

- Medical advice or treatment was recommended by or received from a physician, (or)
- Symptoms existed which would cause a prudent person to seek diagnosis or treatment

in the two-year period preceding the effective date of the policy.

Disability income insurance policies generally do not pay benefits for disabilities resulting from pre-existing conditions during the first two years that the policy is in force unless two conditions are met:

1. The pre-existing condition was disclosed in the application for the policy and
2. The insurance company did not specifically exclude the pre-existing condition.

After the policy has been in force for 2 years, undisclosed, pre-existing conditions are covered just like any other condition.

**Elimination or Waiting Periods**

The waiting or “elimination” period is the amount of time insureds must wait before disability benefits can start. Shorter waiting periods involve higher premiums and vice versa. The waiting period is determined when a policy is issued, not when disability commences. Waiting periods in disability income insurance policies vary. Typical waiting periods are 90 or 180 days. Consider liquidity, sick pay, and any money owed, so they can decide how long a waiting period they could reasonably afford.

The elimination period is similar to a deductible but it is a “time deductible” instead of a dollar deductible. The longer the period of time that the insured can go without the need to collect disability benefits, the smaller the premium, as shown below:

<table>
<thead>
<tr>
<th>Premium and the Elimination Period</th>
<th>Male, Age 45, $1,000 Monthly Benefit Payable to Age 65</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ELIMINATION PERIOD</strong></td>
<td><strong>ANNUAL PREMIUM</strong></td>
</tr>
<tr>
<td>30 Days</td>
<td>$690</td>
</tr>
<tr>
<td>60 Days</td>
<td>$550</td>
</tr>
<tr>
<td>90 Days</td>
<td>$495</td>
</tr>
</tbody>
</table>

A 60-day EP is approximately 20% less in cost than a plan with a 30-day EP. Most companies will offer elimination periods from 30 days to as long as two years. The savings in premium must be balanced against the client’s best interest.

The insurer will not issue a claim check until the end of the month following the end of the elimination period. Therefore, with a 90-day elimination period, the insured must wait 120 days or 4 months from the onset of the disability before any benefit is actually received.

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When determining which elimination period to elect, the client must determine how long they can go without any income from the disability income plan. This will depend on the following factors:

- **Fixed Obligations**: Such expenses as mortgage or rent payments, car payments, utilities, food, installment purchases, insurance premiums, etc., must be itemized. The total fixed expenses must be paid from some source.

- **Other Expenses**: These are the unexpected, non-fixed expenses which occur from month-to-month, such as the automobile repair, medical expenses, prescriptions, monthly obligations must be determined and the source from which they will be paid.

In addition, there are added expenses incurred relative to the disabling injury or sickness such as additional medication, doctor's bills, the need for prosthetic appliances such as braces and hospital bills which are not fully covered by health insurance.

The function of elimination periods in a disability income policy is to avoid administratively costly but relatively insignificant claims. The benefit for insurance companies is lower administrative costs. The benefit to insureds is lower premiums.

Elimination periods are also useful to resolve underwriting issues. A disability income policy may be structured in a way that provides the needed coverage to the insured while protecting the insurer from increased risks through the use of special elimination periods.

The solution to that underwriting problem may be to offer a split elimination period. A split elimination period will give the proposed insured the coverage he or she needs for most disabilities, but it will adequately protect the company against the likelihood of frequent claims.

The common elimination periods today are 30 days, 60 days, 90 days, 180 days and 365 days. The insured should have an emergency fund large enough to cover the elimination period. Much longer elimination periods, however, are found in a disability buyout policy, used to fund the buyout of a disabled partner or stockholder, typically have an elimination period of 1 1/2 to 2 years.

**Benefit Period**

**The Benefit Period (BP)** is the length of time benefits will be paid for each disability following the elimination period. The benefit period is usually expressed in years. Disability policies can be designed to pay benefits from one to five years, or until the insured is 65 or even lifetime. Total disability benefits will be paid for up to that number of years for each claim or disability sustained by the insured. Benefits are paid for each day of a disability after the elimination period has been satisfied. The shorter the length of the benefit period, the cheaper the policy.

**Duration of Benefits**

Disability Income policies are available that offer benefits only for a limited period, for example, a maximum of two or five years, and the nature of the occupation may affect the duration of coverage. Even if they have to choose a smaller benefit amount to keep the premiums affordable, they should look for coverage that protects them until age 65.
Benefits payable until age 65

Most companies offer benefits payable to age 65 or 67. Many policies offer the ability to continue a policy after age 65 on a conditionally renewable basis. Some companies offer lifetime benefits.

Some occupations, like blue-collar workers, may not have the option of benefits to age 65 because of the line of work they are in. Their length may be limited to five years. White-collar jobs normally do not have these limitations on benefit periods.

Lifetime Benefits

Disability policies with lifetime benefits are not always available and when they are they may be prohibitively expensive. Some coverage is better than none and it is important to sell coverage that clients will be able to afford to keep in force.

- The longer benefit periods are typically found in policies for the professional and high-income markets.
- The shorter benefit periods of two to five years are typically for the blue-collar markets.
- The benefit periods that are selected by the policy owner directly impact premium cost.

Benefit periods for specialty disability policies are designed to enable those policies to meet the objectives for which they were designed. Overhead Expense policies may have benefit periods of 18 or 24 months while Disability Buyout policies may have lump-sum payouts or periodic payouts over 24 months.

The deciding factor may well be the cost of the policy. An individual with a limited amount of money to pay the premium may have to choose between a shorter elimination period and a longer benefit period.

<table>
<thead>
<tr>
<th>Male, Age 45, $1,000 Monthly Benefit</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>BENEFIT PERIOD</td>
<td>ANNUAL PREMIUM</td>
</tr>
<tr>
<td>1 Year</td>
<td>$255</td>
</tr>
<tr>
<td>2 Years</td>
<td>$330</td>
</tr>
<tr>
<td>5 Years</td>
<td>$510</td>
</tr>
<tr>
<td>To Age 65</td>
<td>$690</td>
</tr>
<tr>
<td>Lifetime</td>
<td>$830</td>
</tr>
</tbody>
</table>

Amount of Coverage

To avoid malingering, false claims, and to encourage a claimant to return to work following a period of disability, insurers will limit the amount of disability income insurance which may be purchased to some percentage of a person's gross, earned income. This usually results in a disability benefit which will not be greater than a claimant's net pay, or possibly less. Most plans set a limit on the percentage of income a person can insure—usually 50% to 60% of their total gross earnings.
**Sickness vs. Accident**

To determine how liberal or restrictive the policy may be review are the definitions of accident and sickness.

The benefit period may vary by disability type. Disability income insurance policies may be purchased with split benefit periods. Split benefit periods are benefit periods in the same policy that are different for disabilities arising out of a sickness than for those arising out of an accident. Individuals disabled due to an accident often survive longer than those disabled from sickness.

Disability income insurance policies often specify lifetime benefits for sickness are payable only if the disability due to sickness commences prior to age 50 or 55 (age 45 in certain policies). Disabilities due to sickness that begin after that limiting age on these lifetime benefit policies have their benefit period reduced to age 65.

Most individual disability insurance policies today cover disability whether due to accident or sickness.

**Disability Due To Sickness**

Disability policies define what sicknesses are covered and excluded, whether the sickness must manifest after the policy is in force for benefits to apply, whether undisclosed pre-existing sicknesses are covered, and the difference between an accident and a sickness.

Sickness is usually defined as a disease or illness which first manifests itself while the policy is in force. The definition of sickness in the policy may also include a reference to preexisting conditions. Generally, a preexisting condition is any sickness which exists prior to the effective date of the policy. Accordingly, sickness may be defined as:

"any illness which first manifests itself while the policy is in force or a sickness which began prior to the effective date of coverage if it was mentioned on the application for insurance."

Some disability policies protect only against a specific illness or disability, such as cancer. Because the coverage is so limited, these are not suited for most clients overall disability needs.

**Disability Due To Accidents**

The definition of disability due to accident includes whether the accident must be intentional or unintentional for coverage to apply. The definition also includes what sorts of injuries are covered.

**Accidental Bodily Injury**

The term accident is usually defined as an unintended and unforeseen event which results in bodily injury. This definition "accidental bodily injury" is very liberal. As long as the accident is not predictable and not due to a self-inflicted injury, it will normally be a covered loss.
Accidental Means

A more restrictive definition of accident is the “accidental means” definition. In this case, accident may be defined as any injury caused by accidental means. This definition attempts to determine whether the cause of a loss and whether that cause was accidental or intentional. If the cause was accidental, then benefits would be payable. If it was intentional, the claim would be denied.

Many people, especially young people, feel that if they are ever killed or disabled, it will be as a result of an accident. The reality however, is that death or disability more often results from sickness. An accident-only policy is less expensive but does not provide adequate protection. Ideally, both accident and illness coverage should be purchased.

DISABILITY TYPES

The way in which a policy distinguishes between the types of disability is another key aspect in determining the applicability of a policy to client needs. The disability definition may relate to a number of disability types, such as:

- Total disability
- Partial disability
- Permanent disability
- Temporary disability

It is also critical in terms of understanding policy benefits and weighing premium costs against the benefits provided.

Temporary Disability

This benefit is paid out after a waiting period. The benefit is typically paid monthly for a maximum number of years.

Total Disability

Most policies contain a definition of what constitutes total disability and have certain payment provisions based on the insured's total disability. Total disability may be permanent or temporary and the policy will define the difference and any applicable difference in coverage.

Partial Disability

Not every disability is total. In fact, most disabilities are partial. Benefit payments from policies that cover partial disability are derived from either an inability to perform the same duties as those performed prior to the disability, an inability to work the number of hours normally worked prior to disability, and/or the applicable loss of income due to partial disability. Like total disabilities, partial disabilities may be permanent or temporary.
Partial disability benefits require that the insured be unable to perform one or more of the duties of his or her regular occupation as a result of accident or sickness, but there is no requirement that the insured suffer any income loss.

The benefit payable under a partial disability benefit is usually a fixed percentage of the total disability benefit for the duration of the partial disability up to a maximum period. The maximum benefit period is usually 6 months, and the maximum benefit is typically 50% of the policy’s total disability benefit.

**Permanent Disability**

A permanent disability is one that is irreversible. It could be the loss of both eyes, the hearing in both ears, a loss of limbs, or a loss of speech.

**Transition Benefits**

Offered by some companies, it can offset financial loss during a post-disability period of rebuilding a business or professional practice.

**Recurrent Disability**

This is also referred to as the "relapse provision." Recurrence is an unfortunate characteristic of many serious disabilities. Fortunately, disability income insurance policies contain a recurrent disability provision to deal with that problem.

The typical recurrent disability provision provides that a subsequent disability occurring within a specified period—usually 6 months—following a prior disability from the same or a related cause is considered a recurrence and a continuation of the earlier disability. For the disability to be recurrent the subsequent period of disability must:

- begin again within 6 months following a prior period of disability and
- be from the same or a related cause.

Disabilities that are deemed to be recurrent disabilities:

- Do not require that the insured meet a new elimination period
- Continue the earlier benefit period.

The recurrent provision usually works to the benefit of the disabled insured. Since the elimination period doesn’t apply to these recurrent periods of disability, benefits begin again immediately. However, since the earlier benefit period is resumed, the insured is limited only to the remaining months of benefits. If the disability was not considered recurrent, but was considered a new disability, the benefit period would start over completely rather than only for the remaining time, however, a new waiting period would apply.

When does a temporary disability become permanent? What distinguishes partial disability from total disability? What types of disability is the client most concerned about?
**Combination TTD and PTD**

This type of policy provides a monthly benefit after a waiting period. If the disability continues through the waiting period plus twelve month period, the lump sum is paid.

**Exclusions and Limitations**

It is just as important to know what a policy won’t cover as it is to know what it will cover. The contract identifies losses which are either not covered or are limited in some way. Common exclusions are disability due to or resulting from war or acts of war, abuse of alcohol or drugs, suicide attempts, undisclosed pre-existing conditions, commission of a felony, normal pregnancy, or disabilities incurred while incarcerated, or while the insured is on active duty in the Armed Forces.

**War and Act of War**

Losses due to war, declared or undeclared, are excluded.

**Self-Inflicted Injury**

A self-inflicted injury, such as an attempted suicide, would be contrary to the policy’s definition of accident (unintentional or unforeseen).

**Aviation**

This exclusion normally pertains to commercial airline pilots and those who fly private aircraft. It may also apply to passengers in a private aircraft as well. Most insurers will not cover pilots for disability income due to the fact that a relatively minor change in health could leave the pilot totally disabled. Generally, these minor impairments would not disable most other people.

**Insuring Clause**

The insuring clause is basically a statement of the contract between the insured and the insurer. It generally defines the scope or extent of the policy’s benefits. Specific information regarding policy coverages will be found in other sections of the policy.

**Consideration**

This provision applies to both the insured and the insurer. By definition, the consideration is the value exchanged by the parties to the insurance contract. The consideration provided by the insured is the statements on the application and the payment of the premium. In return, the insurer’s consideration is the promise to pay the benefits stated in the policy.

**Free Look Provision**

The free look provision permits the insured the opportunity to review the policy upon receipt and return it to the insurer within 10 days for a refund of all premium paid if not satisfied for any reason.
Waiver-Of-Premium Provision

Most policies offer the option to waive premiums while benefits are paid. Many also refund premiums paid during the waiting period. Some continue to waive premiums up to three months after benefits cease.

In most disability income insurance policies, the waiver of premium benefit requires that the insured be disabled for a period of at least 90 days, after which the insurance company will waive all future premiums during the continuation of disability and refund those premiums paid during the 90-day period. The waiver of premium benefit in a disability policy may be either total disability or residual disability.

Conclusion and Summary

Disability insurance policy renewability provisions govern the insurer’s ability to cancel coverage or increase its premium. The most insured protection is provided by coverage that is noncancellable and guaranteed renewable. Disability definitions may vary greatly from insurer to insurer and may consider the insured totally disabled when unable to do his or her own job or may require that the insured be unable to perform the duties of any job.

The principal disability insurance exclusions and limitations refer to pre-existing conditions, acts of war and the insured’s service in the armed forces. These provisions may limit the insurer’s liability for the insured’s disability or may eliminate it altogether.

Insurance policies, including disability income contracts, are all legal binding contracts between the insurer and the policyowner.
Chapter Two Quiz

1. The younger a person is when they become disabled
   a. The higher their total potential earning
   b. The lower their total potential earnings
   c. The amount of their potential
   d. There is no relationship between their age at the time of disability and the amount of their potential earnings

2. The amount of disability income coverage which can be purchased is limited for all of the following reasons EXCEPT:
   a. To provide an incentive to return to work and reduce malingering
   b. To replace after-tax income
   c. To protect against over-insurance
   d. To protect against under-insurance
Chapter Three - Principal Disability Rider Benefits

**Important Lesson Points**

- **Riders** available for use on disability income policies can add substantially to insured benefits.
- **Social Insurance Benefit** riders permit the policyowner to have greater levels of disability coverage at generally lower cost.
- A **Purchase Option Rider** protects an insured’s insurability by making additional disability income coverage available in the future despite any deterioration of the insured’s health.
- **Cost of Living riders** combat the problem of reduced purchasing power caused by inflation by increasing the monthly disability benefit based on a guaranteed minimum increase, the change in the CPI or both.
- **Return of Premium riders** substantially increase the policy premium but provide a return of premium, less the aggregate claims paid, on specified dates, at death or upon surrender.
- A **Hospital Income Rider** may be designed to provide a non-disability benefit for each day the insured is in the hospital or may be designed to waive the elimination period in the event of hospitalization so that disability benefits begin immediately.

**Disability Income Insurance Riders**

Like many other types of insurance policies, disability income insurance policies offer a variety of riders.

The following riders or options may be available to the insured:

- Waiver of premium
- Increased benefits adjusted for cost of living
- Automatic increase of benefits
- Social Security supplemental rider
- First day hospital rider
- Return of premium rider
- Accidental medical reimbursement rider
- Business overhead expense rider

There may be substantial differences among companies, however, so the selling agent must investigate each one and explain it to the insured carefully.

**OPTIONAL POLICY BENEFITS**

Optional policy benefits may be added disability contracts. The purpose of these optional benefits is to enhance overall protection and to help meet specific needs of the insured.
Some insurers include certain optional benefits as standard policy benefits. Most often these would include the presumptive disability benefit, transplant and cosmetic surgical benefit and the rehabilitation benefit.

The inclusion of optional policy benefits is dependent on both the client's needs and ability to pay the extra premium for these options. The additional premium charged for most optional benefits is relatively low. The options which generally appeal to most buyers include:

- Future Increase Options
- Cost of Living Rider
- Lifetime Accident and Sickness Benefit

Not all of the provisions are offered by all insurers, thus there is a need for an agent to be familiar with the options for the policy they are selling. Some of the provisions may reduce or increase premiums.

**Nonoccupational Provision**

A non-occupational provision states that the Disability Income policy will not pay any benefits if workers’ compensation or similar compulsory benefits for employed people are payable for a condition otherwise covered by the Disability Income policy. Some insurers offer benefits for vocational rehabilitation, and in such cases where the insured has lost a limb, and may even pay for prosthesis.

**Nondisabling Injury Provision**

This benefit pays a benefit for medical expenses incurred due to injury which does not result in disability. The purpose of this provision is to encourage the insured to seek prompt medical attention, thus preventing a minor injury from worsening resulting in a disability payout.

Under the provisions of a non-disabling injuries benefit, an insurer will typically pay for the medical treatment prescribed by a physician required within 90 days of, and as a result of, an accident. Generally the benefit is limited to no more than 50% of the monthly benefit for total disability.

**Survivor Benefits**

Many policies continue to pay disability income upon the death of the insured to policy beneficiaries for one to three months.

**Hospital Income Rider**

This rider provides for the commencement of income payments immediately upon admission into a hospital. The normal policy waiting or elimination period does not have to be met in order for payments from this rider to commence. The income payments may be equal to, less than, or even greater than the normal policy benefit payments.
This optional benefit results in the elimination period being waived when the insured is hospitalized as an inpatient. The factor which triggers the payment of the benefit is any period of hospitalization during the elimination period. Benefits will only be paid for as long as the insured is hospitalized.

The Hospital Income Rider might provide a specific dollar amount per day for each day the insured is in the hospital, payable after the elimination period.

**Automatic Increase of Benefits (Inflation Protection)**

Most people can expect their income to rise over time and therefore want disability income coverage, which will match expected income increases. The automatic increase of benefits rider meets this need.

The automatic update feature is typically renewable on a five-year basis and has an average benefit increase of 5% annually. Some automatic increase riders give the purchaser the option of selecting the benefit increase amount. These increases may be allowed by some insurance companies without medical or financial underwriting.

It is most common to find automatic increase riders in policies marketed to the higher income client.

**Future Purchase Options/Guaranteed Insurability**

The Future Increase Option (FIO) protects future insurability by providing the guaranteed right to purchase additional amounts of disability income in subsequent years. Normally, the rider is not available past age 40 although some insurers may offer it up to age 50.

The future purchase option, also known as the guaranteed insurability rider, allows an insured to buy more coverage as they get older, or at the onset of some event, such a birth of a child or marriage. The insured’s income must increase significantly in order to be eligible for this rider and the insurer will require proof of the increased income to prevent overinsurance. This rider is also expensive.

Statistically the odds are greater for a person to be disabled as they grow older. A person’s income will probably increase as they grow older. However, as they grow older their odds of becoming uninsurable increase. The rider allows them to increase coverage without proving insurability. The option periods which allow the insured to increase their benefits differs from insurer to insurer.

To guard against overinsurance, the insurer will usually limit the amount of additional coverage on each option date. The insured must still meet the insurer’s limit on the amount of disability income insurance it will issue, based on income.

The company will also limit the number of option dates on which the insured may purchase additional coverage. Usually, these option dates will be every two or three years from ages 25 to 40 or possibly age 50. The premium on the increased coverage is based on the insured’s attained age.
In a variation on this approach, the future purchase option rider is issued for an aggregate option amount rather than a maximum monthly amount that may be purchased on each option date. The aggregate option amount is usually limited to no more than the amount of monthly income that is provided by the original policy.

The aggregate approach permits the insured, on each policy anniversary, to exercise an option for the entire remaining aggregate amount or some portion of it. Exercise of the option is subject only to his or her ability to meet the earned income requirements for the opted amount. The aggregate disability purchase option design is particularly useful when working with a client whose income is likely to increase dramatically over a short period.

**Lifetime Benefits**

This relatively expensive option extends the benefit period from age 65 to lifetime. This extension may apply to accident only benefits or to accident and sickness benefits. Normally, if the total disability is due to an accident which occurs prior to age 65, benefits will be paid for the lifetime of the insured provided he or she remains totally disabled.

For the lifetime sickness benefit, the disabling sickness must begin prior to a specified age such as 50, 55 or 60. A policy providing lifetime sickness benefits may stipulate that the sickness must begin by a certain age or earlier for 100% of the total disability benefit to be provided for the lifetime of the insured. However, if the disability begins after that age, but before age 65, a reduced benefit will be paid for life, subject to a schedule such as:

If total disability, due to sickness, begins at age 55 or earlier, total disability benefits will be paid for the lifetime of the insured. If total disability benefits begin at age:

- 56 - total benefits are paid to age 65; then 90% of the benefit for the lifetime of the insured;
- 57 - total benefits are paid to age 65; then 80% of the benefit for the lifetime of the insured;
- 58 - total benefits are paid to age 65; then 70% of the benefit for the lifetime of the insured;
- 59 - total benefits are paid to age 65; then 60% of the benefit for the lifetime of the insured;
- 60 - total benefits are paid to age 65; then 50% of the benefit for the lifetime of the insured.

This progression of benefits would continue in this manner until age 65. If the total disability began at age 65, then the payment of total disability benefits would be limited to one or two years.

**Presumptive Disability**

Certain disabilities are automatically considered to be total disability in terms of policy benefits. These disabilities are called presumptive disabilities because the insured is presumed totally disabled if one of these disabilities occurs. Presumptive disabilities commonly found in disability contracts provides for total disability benefits if the injury or sickness causes the insured to totally and irrecoverably lose:

- The ability to **speak**
- **Hearing** in both ears
- **Sight** in both eyes
- Loss of use of **both hands**

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- Loss of use of **both feet** or
- Loss of use of **one hand and one foot**

Although most disability policies specify that the insured must be under the care of a physician during the period of total disability, this requirement is waived.

This benefit is somewhat similar to the accidental death and dismemberment benefit. The principal distinction here is that the presumptive benefit is provided for loss of use as opposed to actual severance of a member as with the AD&D benefit. In addition, the presumptive benefit is paid if the loss of use results from a sickness as well as an accident.

**Transplant and Cosmetic Surgery Benefit**

Cosmetic surgery to improve one's appearance is a voluntary decision if there is no underlying medical reason for having the surgery. The same concept applies to a person who voluntarily donates a body organ as part of transplant surgery. Normally disability income benefits are paid due to accident or sickness. Voluntary surgical procedures are usually not covered. However, some disability income contracts will include a benefit for transplant or cosmetic surgery.

If, as a result of the transplant or cosmetic surgery, the insured becomes totally disabled, and satisfies the elimination period, disability income benefits will be paid. The amount received by the insured will be as much as it would be for a total disability benefit.

**Rehabilitation Provision**

This provision is aimed at helping a disabled insured to return to work. Insurers often pay this provision in the hope that it will save them money in the long run. As a result of a disability, the insured may not be able to return to his or her occupation, but may still be able to work in another field. Moving to a new job or career may necessitate some vocational training.

If, while totally disabled and receiving benefits, the insured participates in vocational rehabilitation which is approved by the insurer, total disability benefits will be continued as long as the insured is actively participating and remains totally disabled. Some insurers provide a lump sum benefit for vocational training.

Insurance companies that issue disability income insurance are also increasingly encouraging or even requiring rehabilitation programs. Employers who encourage rehabilitation generally receive better insurance rates than those who do not include a rehabilitation program in conjunction with a disability insurance plan.

Rehabilitation is becoming a more significant part of disability policies as claim rates continue to rise. Not only is rehabilitation a benefit to the insured, but many insurers believe it to be an effective method of managing costs.

Almost all disability income insurance policies provide some type of rehabilitation benefit. There are two parts to the typical rehabilitation benefit:
1. The first part of the benefit guarantees that participation in a rehabilitation program will not be considered a recovery from total disability that would reduce or eliminate benefits.
2. The second part of the benefit pays some or all of the costs of the rehabilitation program that are not covered by other means.

**Coordination of Benefits**

The amount of benefits received from the insurance company is dependent on other benefits received because of the disability. The policy specifies a maximum amount that can be received from all the policies combined, so this policy will make up the difference not paid by other policies.

**Cost Of Living Benefit**

Inflation has a devastating effect on buying power. The problem of inflation is even greater for someone who is disabled, however, since they cannot increase their income to compensate for it. A solution to the problem of inflation for disabled individuals is the Cost of Living Adjustment rider (COLA).

Cost of living benefits are offered by most insurers. Once an individual goes on claim, the insurer will automatically increase the amount of the benefit to reflect changes in the cost of living.

The purchasing power of fixed disability benefits may be eroded due to inflation and increases in the cost of living. To protect against inflation, most insurers offer an optional cost of living benefit. The COLA increases disability benefits over time based on the increased cost of living measured by the Consumer Price Index. Clients will pay a higher premium if they select the COLA.

Under the provisions of this option, the insured's monthly disability benefit (total or residual) will be automatically increased once a year while the insured is on claim. The first adjustment is made on the 13th month of disability. The adjustment in the monthly benefit depends upon the way the rider is designed. There are three types.

1. The most common type of adjustment is based on the Consumer Price Index for urban consumers (CPI-U). The benefit can never fall below the monthly amount that was purchased.
2. A second type increases benefits each year by a certain percentage—regardless of the direction of the CPI. The typical percentage increases in the COLA riders are 3% and 5%.
3. The final type combines a benefit increase based on the CPI coupled with a minimum guaranteed increase, usually 3%.

The increase is almost always limited to some maximum amount. COLA riders with an annual limit on the increase often contain a “catch-up” provision which allows a monthly disability benefit to increase based on previous CPI increases that were in excess of the permitted annual COLA increase.
The COLA rider may also affect the residual disability benefit payable due to the action of the COLA on pre-disability earnings. Under the residual disability benefit, the amount payable is the percentage of income lost multiplied by the monthly benefit for total disability.

**Residual Disability**

After a serious disability, many people are able to return to work only on a part-time basis. The policy will pay benefits in proportion to their loss of earnings if they are partially disabled and return to work at a job that pays less than their former salary. Partial or “residual” benefits allow insureds to receive partial disability benefits, as well as part-time income, until they fully recover. Without this feature, benefits may stop as soon as they return to work, and provide an incentive for malingering.

Residual disability policies pay a monthly disability income benefit that is generally equal to a percentage of insured’s lost income multiplied by the policy’s benefit for total disability.

Residual policies offer an incentive for the claimant to attempt a return to work since the policy benefits will be continued in proportion to the person's loss of income. With traditional disability income policies, benefits cease when the claimant returns to work even if on a part-time basis.

**Key Provisions Of Residual Disability Benefits**

Residual benefits are a portion of the benefits that would be paid for total disability.

Typically, a period of total disability will be followed by a period of partial disability where the insured is able to perform some, but not all, of the duties of his or her occupation.

Although some earlier policy forms required that the insured experience a period of total disability before residual disability benefits were payable, this requirement has been eliminated in most policies now being offered.

Residual disability benefits are generally triggered by loss of income. The residual disability policy provides a long term partial benefit related to the loss of pre-disability earnings.

The definition of disability may include a definition for residual disability benefits.

"following a period of total disability, the insured may be eligible for residual benefits if, due to disability, there is a loss of at least 20% of pre-disability income."

Or in a pure residual policy, residual disability may be defined as:

"the ability to perform some, but not all, the duties of one's occupation and as a result of disability, the insured's earned income is reduced by at least 20% of pre-disability income."

With this definition, a proportionate benefit is paid relative to the amount of income lost due to disability.
Most residual policies require a minimum loss of at least 20% of pre-disability income. Therefore if an insured experienced a loss of 5 or 10% of pre-disability income, no residual benefit would be paid. Many companies will pay 100% of the total disability benefit if the insured suffers more than an 80% loss of pre-disability earnings.

Pre-disability earnings are the basis for any claim. Most policies will define such earnings as the average earnings received by the insured over a two- or three-year period. Pre-disability earnings may also simply be defined as the earned income received during the 12-month period preceding the disability.

A short-term, partial disability rider will pay a portion of benefits for a specified period, such as six months. The rider will pay if the insured can return to work, but is not able to resume normal duties.

Some policies define total disability in terms of working full time and residual disability, in terms of working part time.

The Qualification Period is the amount of time the insured must be totally disabled before becoming eligible for residual benefits in addition to the elimination period. Some insurers offer residual policies without any Qualification Period. In such cases, the elimination period may be satisfied by days of total or partial disability.

Many companies offer residual policies without qualification periods. Satisfying the elimination period makes the insured eligible for total or residual benefits.

**Return of Premium Rider**

This option appeals to people who feel they will never be disabled, and don’t want to “lose” the money spent on premium.

The Return of Premium rider promises to return a portion of the premium, minus claims paid, at a future date. The policy must be in force for the full term. The full percentage of return will only be received if no claims have been made.

To fund the Return of Premium rider, the policyowner pays a premium in addition to that required for the disability benefit. That additional premium creates a cash value that is payable to the policyowner, less the total of any claims previously paid, on dates specified in the policy.

Some riders provide for a return of premium that pays at age 65, others will refund premiums at the end of a certain number of years. The rider will not allow payment if claims exceed a certain amount of percentage of premiums paid. This rider is relatively expensive and should not be purchased if the client is unable to afford adequate benefit levels.

**Accidental Medical Reimbursement Rider**

This rider will pay income if the insured incurs medical expenses due to an accident that does not cause benefit payments under the disability provisions in a policy. If benefit payments later are payable, some companies will deduct the accident medical reimbursement income received
from the total benefits payable. The idea is that by id medical benefits are available, the insured is more likely to get medical attention and prevent or lessen claims for disability.

**Accidental Death and Dismemberment Rider**

This rider provides for a specified face amount to be paid upon accidental death. A portion of this amount is typically paid for dismemberment according to a schedule of benefits.

This rider provides for the payment of lump sums for the loss of sight or limbs instead of the weekly or monthly income benefits, but only if the disability is caused by an accident.

The accidental death benefit is usually payable if death occurs:

1. before the insured's 70th birthday,
2. directly & independently of all other causes,
3. as a result of accidental bodily injuries, and
4. within 90 days from the date of the accident.

Most policies exclude suicides while sane or insane, death resulting in war, death resulting from disease, or if the death occurs while outside the Earth's atmosphere.

The Accidental Death & Dismemberment Rider may appeal to people who feel their insurance program is inadequate or want high limit accident protection. This rider affords extra insurance protection but only on a limited basis. When considering this rider, clients should remember that the cause of death has nothing to do with the needs of the dependents and the accidental death rider may give the family a false sense of security. It may make more sense to use premium dollars to buy a higher benefit amount for both sickness and accident, or a longer benefit period.

**Social Security Riders**

One of the sources of disability income available to wage earners is Social Security disability. Although the likelihood of obtaining Social Security disability benefits is generally small because its definition of disability is difficult to meet, Social Security disability payments, nonetheless, could create overinsurance if the insured buys a sufficient amount of DI coverage. The Social Insurance Benefit rider is designed to overcome that overinsurance problem.

Most insurers offer short term riders to provide additional benefits during the first year of a claim while the insured is presumably waiting for Social Security benefits to begin. Chances are that the insured may never be able to collect disability benefits through the Social Security Administration.

The Social Security Administration has a very rigid and ultra-conservative definition of total disability. Annually, the Social Security Administration denies about two-thirds of all disability claims presented to them.

A Social Security supplement rider will pay a specific amount, in addition to the normal policy amount, until the insured qualifies for Social Security disability payments. A Social Insurance Benefit rider pays a monthly disability income benefit only if Social Security does not pay. If and
when Social Security disability benefits are payable, some or all of the benefits under these riders cease.

Social Insurance Benefit riders enable policyholders to purchase disability income benefits that are a high percentage of the insured’s current income without the concern about overinsurance that could be caused by the possible payment of Social Security disability benefits.

Two approaches have been taken by insurers in the development of Social Insurance Benefit riders.

1. **Social Insurance Substitute Rider**

In the Social Insurance Substitute rider, benefits are payable only if no Social Security disability income benefits are payable. If any Social Security benefits are payable—no matter how small—no rider benefit is payable.

2. **Social Insurance Supplement rider**

Also Called an Offset Rider, the benefit provided by the social security rider will be reduced, or offset, by the amount of any benefit provided by Social Security. The rider benefit supplements, and is payable in addition to, the Social Security disability benefits.

According to typical Social Insurance Benefit rider provisions, the insured must satisfy two criteria in order to receive a disability benefit under one of these riders:

1. The insured must file a claim for Social Security disability and
2. The Social Security disability claim must be denied

If Social Security disability benefits are initially denied, the insured is usually required to appeal. Often, the cost of the appeal will be paid by the insurer.

The Social Security Administration sometimes reverses its position with respect to benefit awards. As a result, a Social Security disability income claim that was previously denied may be paid and may include back payments. In the case of most Social Insurance Supplement riders, no repayment of previously-received rider benefits is required. Any subsequent rider benefits, however, would be reduced or eliminated depending upon the type of Social Insurance Supplement rider if Social Security disability benefits continued to be paid.

**Family Income Rider**

The insured could receive a stipulated amount of additional monthly income from the end of the elimination period to the end of a stipulated period of time that begins on the date of issue. This rider can be used for specific limited term financial obligation such as a mortgage or college funding for a dependent.
Summary

Riders attached to disability income policies can greatly expand the policy coverage. Social Insurance Benefit riders can be added to increase the overall coverage while still enabling the insurer to avoid the problems associated with overinsurance in the event Social Security benefits are payable. Available as supplements and substitutes, Social Insurance Benefits also permit policyowners to reduce the premiums for needed coverage.

Purchase Option and COLA riders both help to overcome the tendency of benefits to become eroded over time. The Purchase Option Rider enables an insured to purchase additional coverage while COLA riders increase benefits while on disability. Return of Premium riders offer disability income policyowners the opportunity to recover some or all of their disability income policy premiums.
Chapter 3 Quiz

1. The difference between AD & D and Presumptive Disability is which of the following?
   a. Presumptive disability is provided for loss of use whereas AD & D is provided only if the appendage is actually lost
   b. Presumptive disability pays benefit for disability due to accidents but not for sickness
   c. AD & D only covers disabilities that result in death
   d. Presumptive disability applies to partial as well as total disability

2. Which of the following is true about Residual Disability benefits?
   a. Residual Disability is based upon the percent of disability determined by a doctor
   b. Allow the insured to receive partial benefits if they return to work after serious disability
   c. Most Residual Disability policies require a minimum loss of at least 50% of pre-disability income
   d. Residual Disability is only available in policies with an “own occupation” definition of disability
Chapter Four - Disability Income Underwriting

Important Lesson Points

- Disability insurance underwriting generally focuses on three important factors: occupation, health history and overinsurance
- The classification of occupations according to the disability hazards they represent results in occupation classes
- A proposed insured’s occupation class has a significant effect on the amount of disability income coverage available, the availability of favorable provisions and the premium charged
- Although occupation classification may differ from insurer to insurer, occupations are generally divided into five or six categories that differ principally in their manual work content
- Financial underwriting for disability insurance is concerned primarily with ensuring that the disability income insured has sufficient financial motivation to seek to return to work following a period of disability
- Medical underwriting focuses on the proposed insured’s health history and the likelihood that it will increase morbidity
- Underwriting the impaired risk is generally accomplished through three approaches: rejection, increased premiums and/or exclusions and limitations

UNDERWRITING DISABILITY INCOME POLICIES

Underwriting is the process of selection, classification and rating of risks. The underwriter is the person working in the home office of the insurer who receives, reviews and evaluates all underwriting information to accept or reject an applicant for insurance.

Underwriting includes both preselection and postselection of risks. Preselection involves gathering pertinent information concerning the risk and deciding to accept or reject the risk of the prospective insured. Once this risk is accepted, the insurer must then practice postselection. Postselection is the process of reviewing insureds and dropping those that are no longer desirable. Postselection is available only if the policy is cancelable, not guaranteed renewable or state law permits the insurer to cancel the policy.

Companies are strengthening the underwriting process. Verification of income, close scrutiny of applicants, and tough standards for agents are all the result of the increase in claims. Underwriting is the place to begin to control future claims expenses.

As current claims experience demonstrates, there are unique claims considerations with regard to stress, mental and nervous disorders which warrant serious underwriting considerations. Any history of these problems needs to be closely reviewed.

The Need for Underwriting

The main purpose of underwriting is to maximize earnings by accepting a profitable distribution of risk. Adverse selection can occur if these risks are not properly balanced out.
Underwriting for disability income insurance has become more extensive as has claims processing. Insurers want to ensure that only appropriate cases are written and that no fraudulent claims are made against the company. By taking the time for complete underwriting and performing a thorough claims process, the insurer is not only protecting itself from financial harm, but also helping to keep disability income insurance affordable.

If an insurer accepted applicants that did not meet the standards contemplated in the rate, the insureds would have to pay higher premiums for the insurance company to remain solvent. Prospective insureds with loss expectancies that are substantially higher than provided for in the rate should either:

- Be charged a higher rate, premium, or
- Be declined coverage.

Underwriting helps achieve equity in premium rates since insureds are charged an amount commiserate with their loss expectancy. With Disability Income policies, classifications are made to differentiate among exposures that are used for rating purposes.

Insurance companies must develop a process to classify acceptable exposures accurately and to maintain enough insureds with loss expectancies low enough to offset the insureds with higher loss expectancies. The insurers must set a limit for the degree to which an applicant’s loss expectancy can exceed the average without rejection or assigning to a higher premium classification. The primary purpose of this risk selection by the insurance companies is to obtain a profitable distribution of policyholders.

**The Agent's Role in Underwriting**

The agent is usually the only person from the insurer who actually sees the person to be insured. As such the agent is in a position to offer valuable information regarding the risk to be insured. This information is reported on the application which subsequently becomes part of the policy of insurance.

Agents perform only a limited underwriting function. As with any type of insurance, the agent asks preliminary questions to appraise the risk exposure of the prospective insured.

When taking an application, if the agent learns of a health condition or, an occupational risk that is too high for the insurer to accept, the agent has a couple of choices:

- Turn the application in with a check from the prospective insured. The insurer’s underwriting department then has the decision to issue the policy with different terms or premiums.
- Turn the application in on a COD basis and wait to see if the insurer accepts the risk. If the risk is accepted, the agent will collect premium upon delivery of the policy.

The agent can advise the applicant that he or she may be viewed as high risk by the company underwriters. Some companies issue guidebooks for the agents and prospective applicants that outline specifically which health conditions or occupations are not acceptable for policy issue or which may be uprated.
**The Underwriting Process**

Once the agent has submitted an application to the insurer, it is given to the underwriter who obtains additional information about the prospective insured to make an equitable and profitable decision. Some applicants show a higher probability of loss than other applicants. The additional information may help identify cases of possible adverse selection. The underwriter must deny or approve an application based on this information. The most important types of information are:

- The applicant's past loss experience
- The financial standing of the applicant
- The applicant's living habits
- The physical condition of the applicant
- The character of the person requesting insurance

**Information Sources Used For Underwriting**

Underwriting in Disability Income insurance can be a very detailed process, especially if a high-benefit, own-occupation policy is applied for. In all cases, the application and underwriting process require complete and accurate information. Incorrect or incomplete information could lead to a denial. It could cause an insurer to issue a disability income insurance policy to a bad risk or provide insurance at a higher or lower premium than the risk actually merits.

To gather this information, the underwriter relies on the sources available to them, including:

**The Agent**

Agents provide underwriters with valuable information beginning with the application of the applicant. Agents may also be required to submit a report with the application, answering questions regarding the risk and giving their recommendation of risk. An underwriter relies heavily on the agent's recommendation.

The application contains personal, occupational, avocational, financial and medical information regarding the applicant. All of the information is important for purposes of evaluating a risk and arriving at an underwriting decision. The most important elements of the application with regard to underwriting disability income coverage include the applicant's occupation and duties, other disability income coverage in force, earned and unearned income, medical history and current physical condition.

**Medical/Non-Medical**

An applicant for disability income may have to have a physical examination performed by a doctor or paramedical facility in lieu of simply answering medical questions posed by the agent. This would normally be referred to as a 'medical application.'

**Non-Medical Application**

If the agent obtains medical information by recording answers to questions on the application, it is generally referred to as a ‘non-medical application.’ Depending on the medical problem, an applicant's personal physician may be requested to complete an Attending Physician's
Statement (APS) to provide more detailed information about an applicant’s medical history or current physical condition. Normally, the amount at risk, age of the applicant, and occupation which determine whether or not a physical exam is necessary. The table below reflects this type of criteria.

**NONMEDICAL LIMITS**

<table>
<thead>
<tr>
<th>Occupational Class</th>
<th>Age</th>
<th>5 Years or Less</th>
<th>More Than 5 Years</th>
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</thead>
<tbody>
<tr>
<td>1 and 2</td>
<td>18-40</td>
<td>$3,500</td>
<td>$2,000</td>
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<tr>
<td></td>
<td>41-50</td>
<td>$2,500</td>
<td>$1,500</td>
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<tr>
<td></td>
<td>51-60</td>
<td>$1,000</td>
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<td>3 and 4</td>
<td>18-40</td>
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<td>51-60</td>
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</tbody>
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**Medical Exams and Information**

Medical information and attending physicians reports a paramedical exam, where weight and blood pressure are checked and a blood test is taken, is used for smaller cases. A full medical exam is required when larger cases are written or if there is something in the medical history that makes a full medical examination mandatory.

Insurance companies can request specific testing or medical examination related to a particular condition the applicant disclosed on the application. The application has basic medical questions that the applicant answers. This can prompt the underwriter to request an attending physician statement (APS) from physicians the applicant has consulted in the past and present.

**Attending Physician Statement**

An APS is a questionnaire sent to the applicant's doctor, who must complete the questionnaire in order for the underwriters to complete the underwriting process. The proposed insured must give his or her permission on the application for the attending physician to provide this information.

- The agent, also known as a "field underwriter"
- The application including the agent's statement
- Inspection reports
- Other information such as occupational or avocational questionnaires

**Inspection Reports**

An inspection company provides underwriters with valuable information. These companies provide insurers with reports concerning an applicant. A federal statute, the *Fair Credit Reporting Act*, became effective in 1971 allowing the consumer to require disclosure of information on file and the sources of the information. If the consumer disputes some data in the report, the credit bureau must reinvestigate. The law also requires insurers to notify applicants on whom reports have been requested, and to specify if the insurer uses the report as a basis.
for denying the coverage or even charging a higher premium. The insurer must notify the applicant of this and provide them with the name and address of the reporting agency. The Gramm Leach Bliley Privacy Act and subsequent state privacy laws also restrict the procurement and use of private information about applicants by insurance companies.

**Consumer Reports**

For large cases or if there is a discrepancy between the application and the MIB report or attending physician statement, a "consumer report" may be required. Various consumer-reporting agencies provide this service. The report may include credit information, verification of employment, residence address, health information, and information found in public records. If more information is required, an "investigative report" may be generated. Actual interviews with neighbors, an employer, or business associates are conducted to ascertain or verify information.

- Generally, a **consumer report** is defined by the Act as any written, oral or other communication of any information by a consumer reporting agency which has a bearing on a consumer's credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living and which is collected for the purpose of serving as a factor in establishing eligibility for insurance, credit, employment purposes and other uses found in the Act. The Act distinguishes between a consumer report and an "investigative consumer report."
- An **investigative consumer report** is a consumer report or portion thereof in which information on a consumer's character, general reputation, personal characteristics, or mode of living is obtained through personal interviews with neighbors, friends, or associates of the consumer reported on or with others with whom he or she is acquainted or who may have knowledge concerning any such items of information.

Some information must be excluded from consumer reports, including:

- information that pertains to any bankruptcy which is over ten years old,
- suits and judgments that are over seven years old,
- paid tax liens that are over seven years old,
- accounts placed on collection that are over seven years old,
- crimes that are over seven years old, or
- any other adverse information that is over seven years old.

The applicant must be asked for permission to obtain a report from a "consumer reporting agency" during the application process. Consumer reporting agencies must provide the information reported and the source of information to the proposed insured if he or she so requests. The information may be disputed by the applicant and must be substantiated or deleted by the consumer-reporting agency. If the consumer reporting agency substantiates the data, but the proposed insured still disagrees, the applicant can file a statement which must accompany consumer rating agency reports from the time the statement is filed.

Consumer reports are regulated by the Fair Credit Reporting Act of 1971, which was amended in October 1997. The amendments had the purpose of providing increased consumer protection when consumer reports are used.

The purpose of the Fair Credit Reporting Act is to require that consumer reporting agencies adopt reasonable procedures for meeting the needs of commerce for consumer credit,
personnel, insurance, and other information in a manner which is fair and equitable to the consumer, with regard to the confidentiality, accuracy, relevancy, and proper utilization of such information in accordance with the requirements of this law.

**Medical Information Bureau (MIB)**

The MIB is a cooperative organization of life insurers formed to centralize information about physical condition of previous applicants for life insurance in a member company. The files do not record the action taken by the insurer on the application. One of the services provided by the MIB is the **Disability Income Record System (DIRS)**, a record of applications for DI coverage that request lengthy benefit periods and/or monthly benefits that exceed a specified amount. The purpose of this program avoiding overinsurance. The MIB data cannot be used alone to make underwriting decisions.

If an applicant disagrees with the information on the MIB, the applicant has the right to request the MIB to correct it, under the Fair Credit Reporting Act. This information is disclosed to the applicant on the application. States have varying requirements in addition to the federal rules for disclosing the use of MIB data, so the information given proposed insured's on the application may vary from state to state.

**Underwriting Factors**

The application is the principal tool of the underwriter as it contains important information about the risk including:

- The age, gender and occupation of the applicant
- Past medical history and current physical condition
- Moral habits
- Information regarding other insurance owned
- Family history information
- Unusual hobbies or avocations

**Age and Gender**

Age is an important factor in disability income insurance underwriting. Age is considered in conjunction with the gender of the applicant in underwriting of disability income insurance because, unlike most other insurance types, females at younger ages (30's to early 50's) are generally charged higher premium rates than males of the same age. As females grow older, premium rates are lower than males of the same age. The rates charged are based on actual industry claims experience, which shows that younger females are more likely to file claims than males of the same age.

The types of benefits in the policies affect the age and gender premium rate factors used. For example, long-term disability risk increases significantly due to age. If a policy offers broad long-term disability benefits, the age of the applicant will have a greater impact on rates than on a policy with limited short term disability benefits.

Statistically, females become disabled more frequently than males, therefore they present a higher risk. Accordingly, the disability income premium for females will be higher than for males.
Ironically, women tend to take care of themselves better than men. They use health insurance more frequently than their male counterparts. This contributes to their longer life expectancy and lower life insurance rates but higher rates for disability income.

**Occupation**

The occupation in which the insured is employed is probably the most important factor in disability income insurance underwriting and rating. Generally, occupations are categorized into four to six classes based on the risk of disability associated with each occupation. Higher rates are charged for higher-risk occupations. Some of the highest risk occupations are only insurable through group plans or through policies with limited benefits, if at all.

It is important that the underwriter know the specific duties of the applicant's occupation. A person working in an office presents a totally different risk than a person with the same job who travels thousands of miles per year in automobiles and airplanes.

Also due to the specific nature of a particular occupation, an accident or sickness may result in the total disability of the insured, while the same sickness or injury does not disable a person in another occupation.

**Avocations**

Similar to hazardous occupations is the risk factor of hazardous avocation. Hobbies, such as scuba diving, sky diving and auto racing are certainly more hazardous than golf or tennis. As such, the underwriter must be made aware of these high risk hobbies when considering the applicant for disability income. If an applicant is engaged in a hazardous hobby, an avocation questionnaire may be required whereby more specific information is provided concerning the hobby.

**Medical History**

Another factor in disability income insurance underwriting is medical history, particularly the likelihood of a medical condition that might cause disability. Like other health insurance

- the type of condition,
- its frequency and severity,
- the likelihood of recurrence, and
- the length of time since the condition occurred,

An applicant's medical profile will normally consist of past medical history and current physical condition. Family medical history may also be a factor.

**Current Health**

If an applicant has a current medical condition, a pre-existing condition provision may apply which will exclude coverage for a certain time period or the condition may be excluded from coverage altogether when the policy is issued. Weight, blood pressure, and other health indicators are also assessed in the underwriting process may exacerbate other medical conditions, making disability more likely.
Mental or Emotional Stress

Underwriters are interested in how likely an applicant is to make a claim. Underwriters today take a hard look at those who have had psychological counseling or even marriage counseling. The underwriters look for signs of emotional or mental stress that will increase the likelihood of a disability claim. Illegal drug use and alcohol abuse are also underwriting concerns.

Moral & Morale Hazards

Moral hazard is the possibility that an insured will deliberately cause or exacerbate a loss. Moral hazard usually arises from a combination of moral weakness and financial difficulty. The underwriter must determine if the applicant presents a moral hazard. Underwriters can often uncover the presence of moral hazards by looking at an applicant's credit report; excessive inventories, large unpaid bills, working capital deficiencies, etc.

Malingering and fraudulent claims can result from moral hazard. Overinsurance often leads to the temptation to extend periods of disability that would be shorter without insurance.

In addition to moral hazards, the health insurance underwriter must also protect the company from any morale hazards. A morale hazard is an indifferent attitude or carelessness displayed by a person which increases the risk of loss. Many feel that the presence of insurance often causes or increases this hazard.

Financial Status

Disability income insurance was created to replace or partially replace income. Financial status is important to determine the appropriate benefit amount. The insurer has to be careful not to give the insured an incentive to claim disability by allowing benefits that are not commensurate with the applicant's income.

Underwriters also review the applicant's unearned income and net worth. These factors are important when analyzing the insurance need and the motivation of the insured to return to work should a disability occur.

The Underwriting Decision

Once all the underwriting information has been reviewed, a decision is made as to acceptance of the risk. After obtaining the relevant facts, the underwriters analyze the information to make a decision. The reliability of the information and whether it is subjective or objective are important factors that the underwriter must weigh on their decision. At this point the underwriter has three options:

1. Accept the prospective applicant as applied for (standard risk),
2. Offer the applicant modified coverage or premium (substandard risk), or
3. Deny coverage all together (uninsurable risk).
Classification and Rating of Risks

Most applicants are classified as standard risks, which basically means they are an average risk and the policy will be issued as applied for by the applicant. The rate or premium charged will be the standard premium relative to the individual's age, sex, occupation, benefit amount, elimination and benefit periods selected.

Substandard Risks

If, after underwriting, it is determined that an applicant does not qualify for standard rates, the insurer may offer the policy with higher rates, modified policy benefits or exclusions of coverage.

When an applicant is classified as substandard, the insurer has several alternatives available for issuance of a substandard disability income policy.

- An **extra premium** may be charged whereby the coverage is issued as applied for and the higher premium is used to compensate for the higher risk involved.
- A rider may be attached to the policy **modifying the coverage**. A full exclusion rider is used when the nature of the condition is likely to result in recurrent disabilities.
- A qualified condition **exclusion rider** may be used to exclude coverage for a specified medical problem for a specified period of time. This is normally accomplished by altering the elimination period or benefit period for the particular medical condition.
- Depending on the medical condition, the insurer may **increase the elimination period** or **shorten the benefit period** to compensate for the medical disorder.

According to disability income underwriting statistics, approximately 75% of disability income policies are issued as applied for.

All parties generally try to avoid rejection of the risk since everybody loses. The agent loses commission, the insurer loses potential profit and the applicant loses important coverage. Not surprisingly, most insurers will try to find another alternative except in the most uninsurable situations.

Charging Higher Rates

Insurers can generally charge an applicant higher rates if the application and accompanying documents demonstrate that the case contains risks that merit using higher rate factors. States may regulate the maximum rates or rate factors allowed for certain risk factors. Within any state regulated bounds, the insurer can charge increased rates as long as the rates are not discriminatory.

The alternative of charging an additional premium to account for the increased risk is the one that is generally the most favorable for the proposed insured. By paying an increased premium the insured receives full coverage.
Exclusion Riders

Exclusion riders are also used as an underwriting tool in disability income insurance. The insurer may offer to cover the applicant for disability as stated in the policy, excluding disability resulting from a specified condition or circumstance stated in the exclusion rider.

A different approach would exclude only those injuries to the specific condition that presents the problem for the underwriter.

Limiting Benefits

Benefits may be limited to decrease the moral hazard related to the motivation to file a claim or because the applicant's medical profile warrants limiting benefits. Limitations may be placed on certain benefit amounts or all benefits in the policy may be limited.

Split elimination periods are sometimes used to resolve underwriting concerns. A split elimination period is simply an elimination period that is longer for disabilities resulting from a specific cause—the cause that is a concern for the underwriter.

As a result, the disability income policy would be issued with a split elimination period: one elimination period for the condition causing the underwriting concern and another elimination period for everything else.

Other Insurance

To prevent overinsurance, it is necessary for the insurer to be aware of any other disability income coverage in force. The agent must obtain accurate information regarding the amount of other coverage, elimination and benefit periods.

The number of Disability Income policies that an insured obtains or the total amount payable under all policies can be limited. Insurance companies developed provisions in the contract to protect against this. Overinsurance creates a continuing moral hazard in the disability income insurance field. If overinsurance was allowed to continue, an insured may be tempted to prolong a disability.

Avoiding overinsurance is best achieved if the disability income policy pays no more than the net take-home pay, after taxes and expenses of the insured are considered. Underwriters may limit the amount of disability income insurance written to approximately 80 percent of the insured's gross income and may also use the average earnings clause to prevent overinsurance.

Under the average earnings provision, the amount payable at any time is typically reduced if the insurance in force under all policies exceeds a specified percentage, such as 85 percent, of the gross earned income of the insured at the time of the disability, or their average monthly earnings for the two year period preceding disability, whichever is greater. The reduction is proportionate and a minimum monthly benefit may be included.
**Group Underwriting**

Most group underwriting is non-medical, however insurers will require that a certain number of employees participate in a group plan (such as 10, 25, etc.) which is issued without evidence of insurability. Generally, the employee is required to provide information regarding his or her address, social security number and certain work related information.

The underwriter will thus concentrate on group factors such as occupational duties, the industry and the amounts of disability income being offered. Due to the nature or risk of an occupation, the insurer may limit or refuse to write group disability income coverage for certain occupational groups such as coal miners, the lumber industry, the entertainment industry, etc. Coverages written will usually be limited to not more than 70% of the employee's wages subject to a maximum such as $1,000 or $2,000 per month.

Because there is no medical underwriting involved with group cases, the underwriter's primary job is to protect against adverse selection against the insurer. The underwriter may limit the amount of coverage offered, decline to write the group at all or offer the coverage on a non-occupational basis. Non-occupational coverage does not pay benefits for work-related disabilities since they are usually covered by worker's compensation.

**Association Underwriting**

Association coverage has some of the same underwriting characteristics of group coverage. It might be described as individual policies administered as group insurance. If the association offers a guaranteed issue plan, then there will be no medical underwriting.

However, most association plans require limited medical underwriting commonly referred to as "simplified underwriting." Association underwriting may take the form of three or four medical questions asked of the individual. Due to the size of the association membership, policies for applicants with relatively minor medical problems may be issued. Nevertheless, even with simplified underwriting, it is possible for a member to be declined for the insurance.

The underwriting procedure is further simplified by the limitations placed on the amount of coverage that may be issued as well as the length of the elimination and benefit periods. There is also no need to occupationally classify association members as they all have essentially the same occupation which is normally low risk. Premiums for association coverage are normally banded by ages and amounts.

Another underwriting consideration with regard to association coverages pertains to the place where the association member conducts his or her business. Normally, individuals who work out of their homes cannot qualify for disability income coverage because it is difficult to determine if or when in fact they become disabled. Their workplace is also their recovery place and thus a conflict arises. Often the underwriter may simply decline to offer this type of association any coverage at all.

**OCCUPATIONAL CLASSIFICATIONS**

There is a relationship between occupational class and the amount of coverage available. The lower the occupation class, the lower the amount of disability income which may be purchased.
Conversely, the better the occupational class, the higher the amount of disability income which can be purchased. This relationship is due to the degree of risk involved in the lower occupational classes. Accordingly, the insurer will limit its exposure to that risk by limiting the amount of coverage and/or the benefit periods.

Occupations are classified into different groups according to the degree of hazardous duties involved. This may be one of the most important parts of underwriting a prospective insured. The underwriter of the Disability Income policy must assess not only the proposed insured's occupational title, but also the nature of the duties performed in that occupation.

If an individual is applying for Disability Income coverage and their occupation requires them to perform several different duties, the occupational classification is based upon the most hazardous duty performed.

The primary role of occupation classes is to provide a sound and equitable basis for providing disability income insurance protection that takes into account two important considerations:

1. The likelihood of the insured’s becoming disabled because of the risks imposed by his or her occupation and
2. The probability of the insured’s returning to his or her own occupation following a period of disability

Unlike the risk of death, which is principally a function of age, an applicant’s occupation is an extremely important factor in the likelihood of his or her becoming disabled. A significant reason for the difference is that the determination of the applicant’s continued disability often rests on whether he or she is able to perform the duties of that job.

Once the various occupations are assigned to their appropriate classification, these classifications play an important role in determining the:

- Maximum monthly disability benefit amount available
- Maximum benefit period available
- Premium rate category

The insurer’s Occupation Guide lists the occupation classes into which an applicant might fall based on the principal duties of his or her occupation. The information in the guide is usually presented in two ways:

1. An alphabetical listing of the most common occupations, followed by a designation of the class to which that occupation belongs
2. A broad definition of each occupation class providing general guidelines as to class placement, based on typical duties of an occupation

**Occupation Guide—General Guidelines**

<table>
<thead>
<tr>
<th>General Description of Occupation Class</th>
<th>Occupation Class</th>
</tr>
</thead>
<tbody>
<tr>
<td>Select professionals and managers with most favorable underwriting and claims experience</td>
<td>5A</td>
</tr>
</tbody>
</table>

Copyright © Sandi Kruise Inc 2008 - 2015, All rights reserved.
• Most professionals and managers — office duties only; no extensive traveling  4A
• Same as occupation class 4A, but with travel  3A
• Persons engaged in social service, medical support, clerical, selected commission sales or office or retail setting; light manual duties  2A
• Certain skilled trades & supervision (foreman) and some medical support personnel. Work is often performed in a shop, medical facility, retail establishment or outdoors using light machinery; direct supervision of personnel performing manual duties; chiropractors  A
• Personnel engaged in heavy manual duties; skilled and unskilled occupations (laborer)  B

In the general occupation class guidelines, occupation classes are characterized in this second method. In addition, however, these guidelines generally describe the limits of manual involvement permitted within each class. As the occupation classes move down the list from 5A to B that the description of duties includes increasing amounts of manual work.

Although any individual insurer may change the language of the occupation classification chart, it is a composite of the way a number of companies approach the general classification of occupations. Not unexpectedly, perhaps, there are consequences to an applicant of being placed in a particular occupation class.

There are certain benefit limitations normally imposed by insurers on the basis of the insured’s occupation class. Often, applicants considered to present the least risk—those that fall into occupation class 5A, 4A or 3A—may purchase a lifetime benefit period while those applicants in the more hazardous occupations cannot. Typically, those applicants that fall into classes A or B may be limited to 5 year or 2 year maximum benefit periods.

The limitations that insurers impose based on occupation class don’t apply only to the maximum benefit periods available. The amount of maximum monthly benefit available may also be based on occupation classes. While an applicant that is a 5A risk may be able to obtain $15,000 of monthly income benefit, a bricklayer—a B risk—may be limited to $2,000 of maximum monthly disability income benefit.

### BENEFIT LIMITATIONS BASED ON OCCUPATION CLASS

<table>
<thead>
<tr>
<th>Occupation Class</th>
<th>Maximum Benefit Period</th>
<th>Maximum Monthly Benefit</th>
<th>Definition of Disability</th>
</tr>
</thead>
<tbody>
<tr>
<td>5A</td>
<td>Lifetime</td>
<td>$15,000</td>
<td>Own occupation for entire benefit period</td>
</tr>
<tr>
<td>4A</td>
<td>Lifetime</td>
<td>$10,000</td>
<td>Own occupation to age 65</td>
</tr>
<tr>
<td>3A</td>
<td>Lifetime</td>
<td>$10,000</td>
<td>Own occupation to age 65</td>
</tr>
<tr>
<td>2A</td>
<td>Age 65</td>
<td>$5,000</td>
<td>Own occupation (not engaged in any other occupation)</td>
</tr>
<tr>
<td>A</td>
<td>5 Years</td>
<td>$3,000</td>
<td>Limited own occupation (2 years)</td>
</tr>
<tr>
<td>B</td>
<td>2 Years</td>
<td>$2,000</td>
<td>Any occupation</td>
</tr>
</tbody>
</table>
It isn’t only the available amounts and benefit periods that are limited based on occupation class, occupation class also affects the actual definition of disability. It is undeniably more difficult for an insured in a lower occupation class to meet the definition of disability than for an insured in a higher occupation class because the definition is often considerably more stringent at the lower occupation classes that present the higher risk.

An insured in the B occupation class often must be unable to engage in any occupation in order to be considered disabled.

Although the differences based on the insured’s occupation class are certainly important ones, the difference in the treatment of occupation classes that is usually most visible to the applicant is the difference in premium. The premium for the insured B risk, per $1 of benefit, may easily be double that charged the 5A risk.

It is the difference in the probability and severity of the disabilities to which people in different occupations are exposed that justify the difference in the available benefits and their cost. The nature of the industry, as well as the specific duties of a particular occupation, often impacts on the severity of the disability. For example, an industry in which employment tends to be cyclical or sporadic incurs the greatest number of disability claims during periods of unemployment. If disabled workers have no job to which to return, their motivation to recover may be adversely affected.

**Ineligible or Severely Limited**

**Government Employees** (Federal civil service) are not eligible for disability insurance because of the accumulating sick leave and disability benefits automatically available with their jobs.

**State, county and municipal employees**, including public school teachers, are ineligible for the disability insurance because potential substantial benefits available in their pension plans. Individual underwriting consideration may be given for limited coverage amounts, provided full information including the retirement plan booklet is submitted preliminary to determine eligibility.

Disability Insurance coverage is not generally available to individuals who work at their residences. People who have **Businesses at Residence** may be given exception in cases where some duties are performed at the residence, but a significant amount of outside activity is required. Normally, exceptions of this type will be granted only with a 60 or 90-day waiting period. This situation does not apply to doctors, dentists and attorneys who have established offices at their residence, nor to manufacturers’ representatives who use their residence as business addresses but whose duties require them to spend almost all of their time calling on clients.

Those occupations in which the insured works at home may involve significant claims administration problems. The reason for those problems is simple: it is extremely difficult to objectively determine if the insured is unable to engage in his or her occupation. As a result of that claims administration difficulty, many insurers choose not to make their disability income insurance products available to individuals that work at home.

There are also occupations that are usually uninsurable in most companies and which are characterized by:
• Extreme hazard
• Employment instability
• Significant claims administration problems

Disability Income coverage is not available for some occupations. This list may change and some insurers may allow occupations that other insurers do not. Some of the professions not covered are used car salesmen and dealers, authors, actors, singers, entertainers, air traffic controllers, acupuncturists, bartenders, barbers, bus drivers, butchers, cooks/chefs, flight attendants, musicians, guards, detectives, policemen, janitors, bartenders and cocktail waitresses.

**Financial Underwriting**

One of the key issues of disability insurance underwriting is financial underwriting. The principal underwriting concern in the area of financial underwriting is whether the insured will be financially motivated to return to work after a period of disability. A central reason why a disabled individual might not be motivated to return to work is if doing so would result in his or her losing income. That situation would result if the insured were over-insured.

To avoid the problem of overinsurance, insurers limit the amount of monthly disability insurance they will consider for an applicant.

The benefits that are available to an insured on an individually-purchased disability income insurance policy are not usually a rigid percentage of earned income. Instead, they range from approximately 65% of earned income at the lower income levels to about 40% of income at income levels above $200,000.

In the same fashion, the benefits available to an insured on an employer-pay-all disability income policy usually range from about 75% of earned income at the lower income levels to about 50% of income at income levels above $200,000.

Limiting the amount of monthly benefits that are available to no more than a fraction of current earned income gives the insured some financial incentive to return to work. In most cases, however, the benefit provided is still a meaningful one that will enable insureds to meet basic financial obligations.

The possibility still exists that a disability income insured may be overinsured at the time that he or she becomes disabled, despite the care with which issue and participation limits are drawn. That overinsurance possibility exists because benefits may be paid by Social Security. The use of the social insurance benefit riders generally resolves that concern.

In the process of underwriting a disability income application, existing disability income coverage on the proposed insured needs to be considered. If a proposed insured has existing disability income insurance that will not be replaced, the amount of that coverage is subtracted from the available maximum to determine the amount that may be purchased.
**Unearned Income**

In addition to existing disability income coverage, another overinsurance concern is caused by the existence of a large unearned income. For the purposes of current disability income insurance underwriting, more than $12,000 per year of unearned income will usually reduce the amount of disability income insurance available. The amount of monthly disability income coverage available is usually reduced by $.50 for each $1.00 of monthly unearned income in excess of $1,000 per month.

The effect of unearned income on the financial underwriting of a disability income policy is generally a reduction of the amounts otherwise available. A proposed insured whose earned income would qualify for $5,000 of monthly benefit but who had $24,000 of annual unearned income would be eligible for $4,500 of monthly benefit, as shown below:

<table>
<thead>
<tr>
<th>Available disability income coverage from Issue &amp; Participation limit chart</th>
<th>$5,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual unearned income</td>
<td>$24,000</td>
</tr>
<tr>
<td>Allowable annual unearned income</td>
<td>$12,000</td>
</tr>
<tr>
<td>Excess annual unearned income</td>
<td>$12,000</td>
</tr>
<tr>
<td>Excess monthly unearned income ($12,000 ÷ 12)</td>
<td>$1,000</td>
</tr>
<tr>
<td>Reduction in available monthly benefit ($1,000 ÷ 2)</td>
<td>$500</td>
</tr>
<tr>
<td>Reduced monthly benefit available ($5,000 – 500)</td>
<td>$4,500</td>
</tr>
</tbody>
</table>

**Summary**

Underwriting the disability insurance risk involves a consideration of the proposed insured's occupation, medical history and the financial aspects of the proposed risk. Occupations are generally classified by their manual content and the hazard that they present. Financial underwriting is concerned primarily with ensuring that claimants are financially motivated to return to their occupation, if possible, following a period of disability. The foremost concern with respect to financial underwriting is the possibility of overinsurance.

Underwriters generally take one of three approaches to underwriting the impaired disability risk: rejecting the risk, charging an increased premium and excluding or limiting coverage for certain conditions.
INSURANCE COMPANY RATINGS

A. M. Best Company Rating System

One source of public information is the A.M. Best Company of Oldwick, New Jersey. This is the oldest insurance industry rating service. Alfred M. Best began in 1899 what was known as an "independent watchdog" for the insurance industry. A.M. Best provides information regarding various insurance companies' financial condition, a brief history of the company in question, information on its management, operating comments, and lists the states in which the company is allowed to write and sell business. A.M. Best also grants its own ratings to companies, designed to reflect strength and weaknesses in four areas:

- underwriting
- expense control
- reserve adequacy and
- investments

In most cases, a policyholder would be wise to place their trust in a company rated A or A+ by A.M. Best. As with all insurance products, due diligence is essential when recommending a product to a client. The history of a company's investment portfolio should be considered before recommending a company. A.M. Best gives the agent a source for obtaining this information.

A.M. Best is only one source that company information can be found. There are other sources that can be utilized regarding the ability of an insurance company to make good on their promises. A.M. Best Company can be contracted directly at:

Ambest Road
Oldwick, NJ 08858
(800) 424-BEST (there will be a charge for the call)

The following is a list of the A.M. Best ratings and what they mean, how they can be modified and how the "not assigned" ratings can be interpreted. Only the most current book should be consulted. Summaries from A.M. Best reports may be available through the insurance companies themselves.

A+ (Superior)

Assigned to companies which A.M. Best thinks has achieved superior overall performance when compared to the norms of the life/health insurance industry. The A+ rated insurance companies generally have demonstrated the strongest ability to meet their respective policyholder and other contractual obligations.

A (Excellent)

Assigned to companies which A.M. Best thinks has achieved excellent overall performance when compared to the norms of the life/health insurance industry. A rated insurance companies generally demonstrate a strong ability to meet their respective policyholder and other contractual obligations.
B+ (Very Good)

Assigned to companies which A.M. Best thinks has achieved a very good overall performance when compared to the norms of the life/health insurance industry. B+ rated insurance companies generally demonstrate a very good ability to meet their policyholder and other contractual obligations.

B (Good)

Assigned to companies which A.M. Best thinks has achieved good overall performance when compared to the norms of the life/health insurance industry. B rated insurance companies generally demonstrate a good ability to meet their policyholder and other contractual obligations.

C+ (Fairly Good)

Assigned to which A.M. Best thinks has achieved fairly good overall performance when compared to the norms of the life/health insurance industry. C+ rated insurance companies generally demonstrate a fairly good ability to meet their policyholder and other contractual obligations.

C (Fair)

Assigned to companies which A.M. Best thinks has achieved fair overall performance when compared to the norms of the life/health insurance industry. C rated insurance companies demonstrate a fair ability to meet their policyholder and other contractual obligations.

A.M. Best's Rating Modifiers

The following rating modifiers may be attached to an A.M. Best's rating classification of A+ through C. The modifiers are used to qualify the status of the assigned rating. The modifier will appear as a lower case suffix to the rating.

C - Contingent Rating

This rating modifier is temporarily assigned to an insurance company when there has been a decline in performance in its profitability, leverage and/or liquidity results, but the decline has not been significant enough to warrant an actual reduction in the company's previously assigned rating. A.M. Best's evaluation may be based on the availability of more current information and/or contingent on the successful execution by management of a program to bring about corrective action.

E - Parent Rating

This refers to a company which met A.M. Best's minimum size requirement and is a wholly owned subsidiary of a rated life/health insurance company, but has not accumulated at least five consecutive years of operating experience for rating purposes. The parent company's rating is referenced for companies which meet this criteria until such time as the subsidiary is assigned an A. M. Best's Rating of its own.
P - Pooled Rating

This is assigned to companies under common management or ownership which pool 100 percent of their net business. All premiums, expenses, and losses are prorated in accordance with specified percentages that reasonably relate to the distribution of policyholders' surplus of each member of the group. All members participating in the pooling arrangement will be assigned the same rating and financial size category, based on the consolidated performance of the group.

R - Reinsured Rating

This indicates that the rating and financial size category assigned to the company is that of an affiliated carrier which reinsures 100 percent of the company's business.

Ratings "Not Assigned" Classification

Companies not receiving an A.M. Best's Rating (A+ to C) are assigned to a rating class of "not assigned" which is abbreviated NA. This is divided into ten classifications to identify the reasons why the company was not eligible or assigned an A.M. Best Rating. The primary reason is identified by the appropriate numeric suffix.

Na-1 Inactive

This is assigned to a company which has no net insurance business in force or is virtually dormant and is not 100 percent reinsured by another company. Normally, A.M. Best will continue to report on an inactive company if it is associated with a group or is an unaffiliated stock company pending sale to a new owner.

Na-2 Less than Minimum Size

This is assigned to a company whose annual net premiums written do not meet A.M. Best's minimum size requirement of $1,000,000. The exceptions are:

- The company is 100 percent reinsured by a rated company,
- The company is a member of a group participating in a business pooling arrangement, or
- The company was formerly assigned a rating and is expected to meet the minimum size requirement within a reasonable period of time.

Na-3 Insufficient Experience

This is assigned to a company which meets A.M. Best's minimum size requirement, but has not accumulated at least five consecutive years of representative operating experience. For most companies, the year that A.M. Best anticipates assigning a rating is referred to in the report on the company as set forth in A.M. Best's Insurance Reports, Life/Health Edition. For all life/health companies in this category which are wholly owned subsidiaries of a rated life/health insurance company, the rating of the parent company will also be shown for reference purposes in A.M.
Best's Insurance Reports, Life/Health Edition, until such time as the subsidiary is assigned a rating.

**Na-4 Rating Procedure Inapplicable**

This is assigned to a company when the nature of its business and/or operations are such that A.M. Best's normal rating procedure for life/health insurance companies do not properly apply. Those companies writing lines of business uncommon to the life/health field; or companies not soliciting business in the United States; or companies which are not actively soliciting new business and are in a run-off position; or companies whose sole insurance operation is the acceptance of business written directly by a parent, subsidiary or affiliated insurance company or those writing predominantly property/casualty insurance under a dual charter would be assigned to this classification.

**Na-5 Significant Change**

This is assigned to a previously rated company whose representative operating experience has been or is expected to be significantly interrupted or changed. This may be the result of change in ownership and/or management whereby the existing book of business is sold or reinsured; or a significant revision in the portfolio of coverage offered; or any other relevant event(s) which has or may affect the general trend of a company's operations. Depending on the nature of the change, A.M. Best's rating procedure may require the company be eligible for a rating.

**Na-6 Reinsured by Unrated Reinsurer**

This is assigned to a company which has reinsured a substantial portion of its book of business or maintains considerable amounts of reinsurance recoverable in relation to the policyholder's surplus with reinsurers which have not been assigned an A.M. Best Rating.

**Na-7 Below Minimum Standards**

This is assigned to a company that meets minimum size and experience requirements, but does not meet the minimum standards for A.M. Best's Rating of "C."

**Na-8 Incomplete Financial Information**

This is assigned to a company which fails to submit, prior to the rating deadline, complete financial information for any year in the current five year period of review. This requirement also includes all domestic life/health subsidiaries in which the company's ownership exceeds 50 percent.

**Na-9 Company Request**

This is assigned when a company is eligible for a rating but disputes the A.M. Best's rating assignment or procedure. If a company subsequently requests a rating assignment, A.M. Best's policy normally requires a minimum period of three years to elapse before the company is eligible for a rating.

**NA-10 Under State Supervision**

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This is assigned when a company is under conservatorship, rehabilitation, receivership or any other form of supervision, control or restraint by state regulatory authorities.

**Standard & Poor's Corporation Rating System**

Standard & Poor's rating system is along the same lines as A.M. Best's. Standard & Poor's insurance claims-paying ability rating is an opinion of an operating insurance company's financial capacity to meet the obligations of its insurance policies in accordance with their terms. The claims-paying ability ratings are based on current information furnished by the insurance company or obtained by Standard and Poor's from other sources it considers reliable. They do not perform an audit in connection with any rating and may, on occasion, rely on unaudited financial information. The ratings listed below may be modified by adding a plus or minus sign to show relative standings within the major rating categories.

These reports are generally not available to the public unless the insurance company which purchases the report chooses to make it available to the policyholders. Standard & Poor's Corporation is located at:

25 Broadway  
New York, NY 10004  
(212) 208-8000

AAA - Extremely strong capacity to meet contractual policy obligations.

AA - A very strong capacity to meet contractual policy obligations.

A - Strong capacity to meet contractual policy obligations.

BBB - Adequate capacity to meet contractual policy obligations.

BB, B, or CCC - Uncertain or weak capacity to meet contractual policy obligations, with CCC assigned to those with the weakest or most uncertain capacity.

D - Default. Terms of the obligation will not be met.

**Moody's Rating System**

Moody's concentrates a little more on the quality of the company's investment portfolio. The Moody's Investor Service ratings may be divided into three subcategories.

Moody's Investors Service entered the bond-rating business in 1904. They have been evaluating life insurance companies since the 1970s. In 1986 Moody's introduced insurance financial strength ratings to provide guaranteed investment contract (GIC) investors with objective, independent credit opinions. In April 1991, the firm revised several elements of its benchmark capital ratio to reflect the changing nature of risk in the life insurance industry and to improve the accuracy of the ratio. Moody's offers financial strength ratings on nearly 80 life insurance companies, and the list continues to grow. The rated companies represent more than 60 percent of the life insurance industry's assets and more than 90 percent of total GIC assets.
Insurance companies pay approximately $25,000 for the rating services. Moody's sees its real clients as financial intermediaries such as brokers, pension plan sponsors, structured settlement advisors and agents. Much of their attention has been given to companies involved in group pensions and individual annuity business. In recent times, coverage has expanded from initial focus on companies selling GICs to annuity providers, universal life writers, and providers of other life products.

Like Standard & Poor's rating service, Moody's ratings are not generally available to the public unless the insurance company chooses to make them available to the policyholder. For an annual fee of $125, Moody's quarterly *Life Insurance Handbook* gives ratings, explains rationale, and provides executive summaries for all life insurance companies. The company can be contacted at:

99 Church Street  
New York, NY 10007

**Aaa**

Insurance companies which are rated Aaa are considered to be the best quality. Their policy obligations carry the smallest degree of credit risk. While financial strength of these companies is likely to change, such changes as can be visualized are most likely to impair their fundamentally strong position.

**Aa**

Insurance companies which are rated Aa are judged to be of high quality by all standards. Together with the Aaa group they comprise what is generally known as high-grade companies. They are rated lower than the best companies because long-term risks appear somewhat larger.

**A**

Insurance companies which are rated A possess many favorable attributes and are to be considered upper-medium grade. Factors giving security to punctual payment of policyholder obligations are considered adequate but elements may be present which suggest a susceptibility to impairment sometime in the future.

**Baa**

Insurance companies which are rated Baa are considered as medium-grade, i.e., their policyholder obligations are neither highly protected nor poorly secured. Factors giving security to punctual payments to policyholder obligations are considered adequate for the present but certain protective elements may be lacking or may be characteristically unreliable over any great length of time. These companies' policy obligations lack outstanding investment characteristics and, in fact, have speculative elements as well.
Ba

Insurance companies which are rated Ba are judged to have speculative elements; their future cannot be considered as well assured. Often the ability of these companies to discharge policyholder obligations may be very moderate and thereby not well safeguarded during other good and bad times in the future. Uncertainty of position characterizes policyholder obligations of insurance companies in this class.

B

Policyholder obligations of insurance companies which are rated B generally lack characteristics of the desirable insurance policy. Assurance of punctual payment of policyholder obligations over any long period of time is small.

Caa

Insurance companies which are rated Caa are of poor standing. They may be in default on their policyholder obligations or there may be present elements of danger with respect to punctual payments of policyholder obligations and claims.

Ca

Insurance companies which are rated Ca are speculative in a high degree. Such companies are often in default on their policyholder obligations or have other marketed shortcomings.

C

Insurance companies which are rated C are the lowest rated class of insurance companies and can be regarded as having extremely poor prospects of ever attaining real investment standing.

Duff & Phelps Rating System

Duff & Phelps provides an overall approach in its credit ratings and has a reputation of quality and integrity. The Duff & Phelps ratings apply to:

- Corporate debt
- Preferred stock
- Real estate
- Asset backed financing and
- Claims-paying ability

Its rating services include insurance company management interview, quantitative analysis and a view of the company's future. The ratings are updated quarterly in an effort to make the material more timely. The Duff & Phelps ratings probably will only be obtainable from the insurance companies that have contracted for their services.

The Duff & Phelps rating process, which costs an insurance company around $20,000, was first introduced in 1986. It is divided into four parts.
1. Duff & Phelps requests the company's financial reports.
2. Representatives travel to the insurance company for an initial on-site interview after the reports have been received. During the meeting, the rater meets in groups and individually with key management personnel, including the chief executive officer, chief financial officer, chief investment officer and product managers.
3. Duff & Phelps invites a group of executives from the insurance company to their Chicago headquarters to confer with members of the rating committee. This meeting gives the insurance company the opportunity to meet its evaluators and get a better sense of the rating process.
4. The rating committee convenes to establish a rating. It presents the grade and an analysis to the insurance company. The insurance company can choose either to publish or discard the company's results.

As part of the contract, the insurance company agrees to provide relevant financial information quarterly, for rating updates. There is also an annual review meeting at the start of each new rating year. They can be contacted at:

55 East Monroe Street
Chicago, IL 60603

AAA -- Highest claims paying ability. Risk factors are negligible.

AA+, AA, or AA- -- Very high claims paying ability. Protection factors are strong. Risk is modest, but may vary slightly over time due to economic and/or underwriting conditions.

A+, A, or A- -- High claims paying ability. Protection factors are average and there is an expectation of variability in risk over time due to economic and/or underwriting conditions.

BBB+, BBB, or BBB- -- Below average claims paying ability. Protection factors are average. However, there is considerable variability in risk over time due to economic and/or underwriting conditions.

BB+, BB, or BB- -- Uncertain claims paying ability and less than investment grade quality. However, the company is deemed likely to meet these obligations when due. Protection factors will vary widely with changes in economic and/or underwriting conditions.

B+, B, or B- -- Possessing risk that policyholder and contract holder obligations will not be paid when due. Protection factors will vary widely with changes in economic and underwriting conditions, or company fortunes.

CCC -- There is substantial risk that policyholder and contract holder obligations will not be paid when due. Company has been or is likely to be placed under state insurance department supervision.

**Weiss Research, Inc. Rating System**

Weiss developed a proprietary computer model that uses some 200 ratios derived from 750 pieces of data to determine an insurer's rating. They do not meet with managers or other executives for the rating. Data for these calculations come from the statutory reports insurance
companies submit to the insurance commissioners, plus supplemental data from the companies themselves. Weiss Research receives quarterly reports from the insurance companies. New information is added to the analytical process and is reported in quarterly updates.

The results of the analysis and the ratings are sent to the companies with a request that the data be examined and verified. Some insurance companies do not respond to these requests. Others object to the rating received. Weiss Research may be contacted at:

P.O. Box 109665
Palm Beach Garden, FL 33410
(800) 289-9222

Each rating may be given a (+) or (-) sign. The plus sign is an indication that, with new data, there is a modest possibility that this company could be upgraded. The A+ rating is an exception since no higher grade exists. The minus sign is an indication that, with new data, there is the modest possibility that this company could be downgraded.

**A (Excellent)**

Those receiving this rating offer excellent financial security. The company has maintained a conservative stance in its investment strategies, business operations and underwriting commitments. While the financial position of any company is subject to change, Weiss believes that this company has the resources necessary to deal with severe economic conditions.

**B (Good)**

This company rating indicates good financial security and has the resources to deal with a variety of adverse economic conditions. However, in the event of a severe recession or major crisis, we feel that this assessment should be reviewed to make sure that the firm is still maintaining adequate financial strength.

Important Note: Carriers with a rating of B+ or higher are included on their Recommended List.

**C (Fair)**

This rating indicates the carrier offers fair financial security and is currently stable. But during an economic downturn or other financial pressures, Weiss feels it may encounter difficulties in maintaining its financial stability.

**D (Weak)**

This company currently demonstrates what Weiss considers to be significant weaknesses which could negatively impact policyholders. In an unfavorable economic environment, these weaknesses could be magnified.

**E (Very Weak)**

This rating indicates the company currently demonstrates what Weiss considers to be significant weaknesses and has also failed some of the basic tests that they use to identify fiscal stability.
Therefore, even in a favorable economic environment, it is their opinion that policyholders could incur significant risks.

**F (Failed)**

Company is under the supervision of state insurance commissioners.

**Additional Notations**

**Sa Sb Sc Sd Se (Smaller Companies)**

The S designates companies with less than $25 million in capital and surplus, excluding companies with more than $500 million in admitted assets regardless of the capital and surplus levels. It does not reduce or diminish the letter grades A through E. The S is simply a reminder that consumers may want to limit the size of their policy with this company so that the policy’s maximum benefits per risk do not exceed one percent of the company’s capital and surplus.

**U (Unrated Companies)**

This company is unrated for one or more of the following reasons:

- total assets are less than $1 million,
- premium income for the current year was less than $100 thousand, or
- the company functions almost exclusively as a holding company rather than as an underwriter.

**State Ratings**

Agents and prospective policyholders may also check the quality of the insurance company with the department of insurance in their state. Insurance companies are primarily regulated by the individual states. Each company must be registered with the state and approved by the state prior to writing business there. In spite of the state regulations insurance companies have failed financially and caused economic harm to their clients.

The state collects information about the different insurance companies doing business within the state that can be of value to both the agents and the policyholders which should be available upon request.

A review of an insurance company's financial statements and annual reports is also in order. These annual reports are readily available from each insurance company.

**REINSURANCE**

The underwriting process is closely related to reinsurance and the underwriter must know how their ability to accept risks is both broadened and limited by reinsurance available to the insurance company themselves. Reinsurance is the transfer of insurance from one insurer to another. It is the insurance purchased by insurers. The amount of business placed with the reinsurer is called the ceded amount. The placing of business with a reinsurer is called cession.
Reinsurance shifts part of that risk to many others. Catastrophic losses are thus shared, and excessive losses in one occurrence do not cause financial instability of individual insurers. Without reinsurance, each insurer would be limited to its own financial ability to pay losses. With reinsurance, financial strength is enhanced by the spreading of losses throughout the entire insurance business.

Reinsurance allows insurers to accept more business than their underwriting capacity otherwise would support. There are reserve requirements for insurers on insurance policies that, if a disaster were to occur, could cause a drain on surplus and restrict growth, particularly for newer and smaller companies. Reinsurance allows for more rapid growth by having a reinsurer take over from the insurer part of the requirement for maintaining reserves, thus permitting the insurer to write more policies.

Reinsurance is classified in several ways:

**Treaty vs. Facultative**

- **Treaty Reinsurance**: the insurer must cede the amount of insurance required under the contract agreement and the reinsurer must accept the amount offered. Treaties may cover a range of perils and they avoid the time-consuming negotiations necessary when reinsurance has to be arranged for each contract.
- **Facultative Reinsurance**: the insurer determines for each case whether reinsurance is desired. The reinsurer retains the right to accept or reject each proposal on its merits. A new contract must be negotiated for each case.

**Proportional (pro-rata) vs. Nonproportional.**

- Under proportional reinsurance an insurer shares with a reinsurer on a proportional basis both the premiums and the losses.

Within the proportional or pro rata reinsurance are:

- **Quota share** reinsurance is shared with the reinsurer, having the same proportion of every policy - large and small.
- **Surplus share** reinsurance has the participation calculated separately for each policy.

Nonproportional reinsurance can be classified into two major categories:

- excess loss, and
- stop loss.

Under excess loss reinsurance the reinsurer is required to bear only those losses in excess of the ceding insurer's retention limit. This leaves the ceding insurer responsible for losses in full up to the retention amount. Excess loss reinsurance may be written as individual per-risk reinsurance (the reinsurer agrees to pay losses on a single risk in excess of the ceding insurer's net retention limit) or catastrophe risks reinsurance (the reinsurer agrees to reimburse the reinsured, up to a stated maximum, for catastrophe losses in excess of a given retention amount per disaster).
The ceding insurer uses stop loss reinsurance to control their loss ratio (the ratio of incurred losses to earned premiums). This plan has a stop-loss limit. The limit is the higher of a given percentage of the ceding insurer's net earned premium or a specified dollar amount. The reinsurer is liable only for the insurer's aggregate losses exceeding the applicable stop loss limit up to a specified maximum. This maximum is either a predetermined percentage of the insurer's net earned premium or a fixed dollar amount - whichever is less.

A special type of reinsurer is the reinsurance pool. This is an association for the exchange of reinsurance among two or more insurers according to an automatic agreement. Each of the insurers receives a certain portion of the risks or losses of the other reinsurers. Each gives to all the others a predetermined part of its risks or losses. These pools are also used for spreading infrequent catastrophic types of risks among insurers of a company group or fleet.
Chapter 4 Quiz

1. The increase in loss potential due to the applicants' indifferent attitude or carelessness about risk is called which of the following?
   a. Morale Hazard
   b. Fraud
   c. Overinsurance
   d. Moral Hazard

2. According to the information in the book, which of the following applicants would probably be offered the most liberal DI policy?
   a. Barry, who is a dentist
   b. John, who is an office manager
   c. Susie, who is a chiropractor
   d. Mary, who is a LUN at a nursing home

3. Which of the following is NOT a reason for reinsurance?
   a. Additional Underwriting capacity
   b. Protection against catastrophic losses
   c. Allows the insurer to charge additional premium for the same policies
   d. Help to maintain the supply of insurance in the marketplace
Chapter Five - Primary Sources of Disability Income Benefits

Important Lesson Points

- Disability income benefit sources include government programs, such as Social Security as well as non-governmental sources, such as employer-sponsored group insurance plans.
- **Workers Compensation** plans provide disability benefits to covered workers disabled through job-related activities.
- In addition to Workers Compensation, six jurisdictions provide non-occupational disability income coverage.
- Employer-sponsored sources of disability income coverage include group insurance, association/franchise insurance and sick-pay plans.

TYPES OF DISABILITY INCOME COVERAGE

Several types of coverage are available under Disability Income insurance. For instance, Disability Income coverage may be available from employers, auto insurance, or life insurance riders.

There are several different places to look for Disability Income benefits including:

- Company provided Disability Income coverage
- Group coverage
- Individual coverage
- Riders on already existing insurance coverage
- Social Security Disability Benefits

An insurance agent is usually most interested in individual policies since this is the way they make their commissions. However, a family may be able to qualify for coverage through a company-provided plan or group plans which agents may be able to coordinate with an individual Disability Income plan.

Government Programs

There are a number of sources of income for the disabled individual, not the least of which are government sources. Both the federal government and the states sponsor programs that may provide disability income.

Insurance agents should be familiar with their state's programs (if any) and disability benefits provided through Social Security.

The social insurance plans include:

- Federal Old-Age, Survivors, Disability, and Health Insurance (OASDHI)
- State Workers' Compensation, several of them federal
- Federal & state systems of unemployment compensation

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State sponsored temporary disability income insurance (not provided in all states) and
Health insurance Medicare and Medicaid

Federal Government Disability Compensation Programs

The federal disability programs covering military, civil service, and railroad personnel provide
replacement of a high percentage of income should disability occur.

Workers compensation and Social Security are the two principal statutory disability programs
which cover most people. Depending on an individual's employment, he or she may be eligible
for other disability benefits. Most federal Civil Service workers who began working for the
government prior to 1984 are not covered by Social Security. They have their own Civil Service
program which provides disability benefits. The Veteran's Administration (VA) provides disability
benefits for disabilities incurred while an individual is on duty with any of the military branches.
The VA benefits are paid as long as the veteran remains totally or partially disabled even after
discharge from the military service.

There are two different disability benefit programs under Social Security:

- Social Security Disability Insurance (SSDI), and
- Supplemental Security Income Program (SSI)

SOCIAL SECURITY DISABILITY INSURANCE (SSDI)

Another hurdle an agent may have to overcome is the misconception that Social Security (or
Worker's Compensation) will cover the family adequately without the need to purchase disability
insurance. To overcome this hurdle, an agent needs to understand some complexities of Social
Security.

Of the federal government disability benefit programs, Social Security covers the most people.
Social Security disability benefits were first introduced in the 1950s, with benefit coverage
expanding greatly in the 1970s.

The first social security disability benefits paid only for disabilities expected to be permanent and
total, incurred over the age of fifty, and which lasted over twelve months. In the 1960's,
coverage expanded to all workers covered by social security; in the 1970's, benefit levels
increased.

Currently, social security disability benefits are payable to eligible workers who, due to a
disability, are unable to engage in any substantial gainful work or employment. The disability
must be expected to last, or have lasted, at least twelve months, and must last five months
before any benefits begin to accrue.

The amount of benefits payable through social security disability benefits is based on the
average earnings of the disabled party in the years prior to disability. If too little income has
been earned by an individual, he or she would be unable to receive social security disability
benefits. The amount of income necessary to qualify for benefits is quite low, so most wage
earners will meet income requirements.
Dependents of a worker, such as a spouse and children, are eligible for social security disability benefits as well. A widow or widower of an eligible worker may also receive disability benefits under certain circumstances.

The rejection rate for Social Security disability income benefits usually ranges between 60% and 70%. It is the definition of disability that results in this extremely high rejection rate.

The most common disability benefits program for which working adults qualify is SSDI. Under this program, monthly installments are based on the amount of income earned in the 40 quarters prior to when the disability occurred. A quarter is defined as a period of three months ending March 31, June 30, September 31, and December 31 of any year. If a person applies for benefits, a representative from the Social Security Administration (SSA) will conduct a telephone interview to review the earnings and generate a report that informs them if they have enough income earned to qualify for an insured status. Insured Status means a sufficient amount of income was made to enable the person to apply for SSDI benefits. If the person reviewed is not found to be of insured status, which means not enough income was earned to qualify for SSDI benefits. The person then could apply for SSI disability benefits instead.

**Eligibility for SSDI**

Eligibility for Social Security disability benefits requires that the worker be both fully and “disability” insured. Fully insured status means that the person has at least 40 calendar quarters of covered employment during which Social Security taxes have been paid. These quarters of coverage need not be consecutive. Generally, if a person has worked for 10 years, he or she is usually “fully insured.”

In addition, the worker must be “disability insured” which means that Social Security taxes have been paid in at least 20 of the preceding 40 calendar quarters, ending with the quarter in which a disability claim is filed. For all practical purposes an individual who continues to be employed will “automatically” achieve disability insured status concurrently with attainment of fully insured status. However, a person who has prolonged breaks in employment might have some difficulty achieving disability insured status, for example a person who worked 10 years (40 quarters) from ages 18 to 28 then married and stopped working to raise a family then at age 50 becomes disabled. Even though they are fully insured, they would not be eligible for social security disability benefits.

The amount of work required in order to qualify for Social Security disability benefits is based on a ‘quarters system’. Individuals may earn up to four quarters per year based on the amount of earnings for the year. The amount of earnings required for each quarter increases based on the general wage level.

The number of quarters necessary to qualify for Social Security disability payments vary based on the age of the individual to receive the benefits.

**SSI**

The basic purpose of the SSI program is assure a minimum level of income for people who are age 65 or over, blind, or disabled and who do not have sufficient income or resources to
maintain a standard of living at the established federal minimum income level. SSI is also available to blind and disabled children.

Eligibility for SSI

To be eligible for SSI benefits a person must meet all of the following requirements:

1. Age 65 or older, blind or disabled
2. A resident of the United States and one of the following:
   a) A citizen or national of the U.S.
   b) An alien lawfully admitted for permanent residency in the U.S.
   c) An alien permanently residing in the U.S. under color of law. This group includes aliens residing in the U.S. with the knowledge and permission of the INS and whose departure INS does not contemplate enforcing. It also includes certain aliens who are residents of long duration. It does not include immigrants.
   d) A child of armed-forces personnel living overseas.
3. Not have more income or resources than is permitted

Application for Social Security Benefits

A claim must be filed with the Social Security Administration and the disability must commence prior to age 65 since, at age 65, the claimant is eligible for retirement benefits instead. If a person is receiving disability benefits prior to age 65, benefits will still be received by the claimant at age 65. However, at that point, they become a retirement benefit, rather than a disability benefit.

To apply for Social Security Disability Benefits (SSDI) a person must first contact their local office. SSA will ask some preliminary questions and then forward Disability and Vocational Reports for the individual to complete. The individual must complete these forms with both a financial and medical history. SSA will use this to determine the individual's case type. Once SSA has received the forms, the local SSA office will set a date for a telephone interview. Once that is completed, a copy of everything discussed is sent to the individual to sign and return it along with any other requested information.

Determination of Disability

A person may be able to apply for both SSI and SSDI if they have worked long enough to be insured under Social Security, even though they may not have sufficient amount of income or resources. When a person is eligible for both it is called a concurrent case. A person who is married with a spouse who makes a substantial amount of income will not qualify for SSI.

The determination process and medical requirements needed to prove an individual's disability are the same for both SSI and SSDI. The main difference between the two programs is that SSDI's eligibility is based on the amount of income accumulated from prior work, while SSI's eligibility is based on financial need. Beside eligibility, some other differences between SSDI and SSI are:
Unlike SSDI, no disability waiting period is required under SSI. This is because SSI payments are based on financial need; the presumption that a person has resources to handle short-term health problems does not exist.

Under SSI, a person may qualify for an immediate disability payment if the condition is obviously disabling and they meet the SSI income and resource limits.

Those people qualifying for SSI benefits usually qualify for food stamps and Medicaid, which helps pay doctor and hospital bills.

SSI recipients fall under different work incentive rules. One difference is that cash benefits and Medicaid continues as long as the SSI income limits are not exceeded. With SSDI, a person who earns more than a certain amount per month will lose both eligibility and monthly cash payments.

Each state has a "Disability Determination Service" office or DDS office, which reviews Social Security disability applications and required accompanying documentation to determine that the individual qualifies as disabled under Social Security law. A physician or psychologist and a disability evaluation specialist look at medical evidence, as well as information related to the individual's age and work record, if any.

The health care providers who have prescribed treatment for the individual must complete medical report forms for Social Security. These reports include information related to the medical history of the individual, a description of the individual's condition, how the individual is disabled, the result of medical exams and tests, and the activities the individual can and cannot do.

If the DDS office cannot determine whether the individual qualifies as disabled from the information submitted by the individual and by health providers, the individual will be required to undergo a "consultative examination." Social Security pays for this examination, and the individual's own physician may give the exam.

The factors used to determine disability include whether the:

- Individual is working
- Individual's condition is severe
- Individual's condition matches with one found on Social Security's list of impairments
- Individual can do work performed prior to the disability
- Individual can do any type of work

A claimant must be alive at the time an application is filed, with a few exceptions.

If the claim is denied, the individual will be contacted in writing. The paperwork regarding the claim is returned to the local SSA office and held for 60 days or until a request for a reconsideration appeal. If the individual does decide to appeal the case, they have 60 days from the date of the denial letter to submit an appeal form.

Once SSA has received the completed appeal forms, they send the case back to DDS where it is assigned to a different claims examiner. The new claims examiner will reevaluate the case and can request additional medical reports if the person did visit any new doctors since the submission of the initial application. If the claim is denied, it will be denied in writing. The person then has 60 days to file an administrative law judge (ALJ) appeal.
The Administrative Law Judge (ALJ) is usually a face-to-face hearing with a judge. At this level of the appeal, the person can represent themselves, hire an attorney, or use an authorized representative who can be a friend or relative. After the hearing has been held, the judge has 90 days to issue a decision. The process can take longer if new medical evidence is presented or if the judge feels more evidence is needed before making his or her decision.

If the claim is denied again, the only avenue left is to hire an attorney and take the claim to the Appeals Council level for review.

If an individual finds that their disability is going to last more than 12 months or that it is permanent, they should immediately apply for SSDI or SSI disability benefits even if they are receiving worker's compensation or state disability benefits. It is not wise to wait until the benefits end to apply since it will take at least six months for the initial SSDI or SSI paperwork to be processed. If the individual does qualify for Social Security disability benefits, SSA will take into account any funds that have been received under either of these two programs when calculating the retroactive payments.

**SSA Definition of Disability**

Before a properly insured worker can collect benefits, he or she will also have to satisfy the Social Security definition of total disability. Compared to such definitions found in disability income policies, total disability under Social Security is much more restrictive.

SSA defines a disability as:

"the inability to do any substantial gainful activity by reason of any medical determinable physical or mental impairment (or combination of impairments) which can be expected to result in death or has lasted or can be expected to last for a continuous period of not less than 12 months. The impairment must be so severe that the individual is unable to engage in substantial gainful work that exists in the national economy regardless of whether or not such work exists in the immediate area in which the applicant lives, a specific job vacancy exists, or the applicant would be hired."

After reading this definition it is no wonder that two out of three disability claims are rejected by the SSA.

This qualification rules out all short term and non-life threatening disabilities. There is also a five month elimination period associated with Social Security disability benefits which means that after 5 months of total disability, the individual may file a claim for benefits. If the claimant qualifies for benefits, generally the first benefit check will often not be received before the end of the first year of the person's disability. This sort of statistic should be used to help a family to realize that it is not prudent to rely on Social Security benefits for disability coverage.

The Social Security Administration maintains a listing of Impairments that it considers severe enough to prevent a person from performing any substantial gainful activity and that fall under their rules of disability. The impairments are permanent or are expected to result in death. Impairments that are not expected to end in death must have lasted or be expected to last for a continuous period of at least 12 months.
The Definition of Substantial Gainful Activity (SGA)

The Social Security Administration defines substantial gainful activity (SGA) as work that involves performing significant and productive physical or mental duties for pay. Any SGA requires that the individual have the ability to:

- Walk, stand, sit, lift, push, pull, reach, carry or handle
- See, hear and speak
- Understand, carry out and remember simple instructions
- Use their own judgment
- Respond to supervision, co-workers, and usual work situations
- Deal with changes in a routine work setting

The Social Security Administration also considers the individual's age, education, work experience, and residual functional capacity when evaluating the disability. A disability, either physical or mental, must be proved by medical evidence consisting of signs, symptoms, and laboratory findings.

Residual Functional Capacity (RFC)

Residual functional capacity (RFC) is composed of activities that a person is still able to perform in a work setting despite their impairment. SSA uses the RFC assessment to determine if other types of work can be done. A limited ability to perform certain physical activities such as sitting, standing, walking, lifting, carrying, pushing, pulling, reaching, handling, stooping or crouching reduces the individual's ability to do past work and other work. A limited ability to perform certain mental activities such as understanding, remembering, carrying out instructions, and responding to supervision, co-workers, and work pressures also reduces the individual's ability to do past work and other work.

Disability Condition Periodic Review

Once an individual is receiving disability payments through Social Security, the individual's condition will be reviewed regularly. If medical improvement is expected, the review will occur after every six to eighteen months.

Ending Disability Benefits

Social Security disability benefits will end if the individual is able to earn a "substantial" amount on a monthly basis. Earnings of $940 per month (2008) generally cause the end of disability benefit payments. Disability payments also end under the Social Security program if the individual no longer qualifies as disabled under the Social Security rules.

If an individual receiving Social Security disability benefits returns to work, there will be no change in disability benefits paid for the first nine months in which the individual earns more than $670. Once the individual is able to earn $940 per month, benefits will continue for three months before being discontinued. If an individual meets requirements, the individual can receive benefits during any month in which earnings are less than $940 (2008).
How SS Benefits Affect Disability Insurance

Each policy may treat this differently. This is where agent knowledge of the product is crucial for the policyholder. The policyholder needs to be aware that the Disability Income payment will be reduced if other income is being earned by the same disability. If the family does not receive accurate information, and much more important, all the information about benefits, it can have serious consequences for the family financially if the breadwinner becomes disabled.

The policyholder needs to be aware of statements made in their policy that can be overlooked or ignored. For instance, an insurance company may state: "We will provide the social disability amount shown on the policy schedule, reduced by an amount equal to any monthly legislative disability benefits received."

Each policy may treat this differently. This is where agent knowledge of the product is crucial for the policyholder. The policyholder needs to be aware if the Disability Income payment will be reduced if other benefits are paid for the same disability.

Comparing Social Security Disability to Disability Income Insurance

Although payments available through Social Security may provide some relief to a disabled individual, its benefits will generally be insufficient to meet the needs of most people. The strict definition of disability and six-month waiting period within the Social Security disability program result in the disqualification of many applicants.

A disability income policy, on the other hand, can be constructed to meet the needs of individual purchasers and can be designed to include a sufficient benefit amount, a definition of disability that suits the individual's profession and income level, and an elimination period that is more flexible than that offered through Social Security.

Several groups of employees are not included in Social Security coverage:

- Federal employees covered under a separate plan
- Police covered under municipal plans
- Railroad employees covered under the Railroad Retirement Act.

Railroad Retirement Act

Two types of disability benefits are offered by the Railroad Retirement Act. These disability benefits are called disability annuities and are available to employees who have at least 10 years of railroad service. The two disability annuities under the Railroad Retirement Act are:

1. The occupational disability annuity and
2. The total disability annuity

The Railroad Retirement Act’s occupational disability annuity applies if the employee’s disability prevents him or her from working in his or her regular railroad occupation. It is available if the employee meets three criteria. The employee has:
1. Not attained retirement age
2. A current connection with the railroad industry
3. Completed 20 years of service (or 10 years of service and is at least 60 years old)

The **Railroad Retirement Act's total disability annuity** applies if the disability prevents the employee from working in any regular employment. It is available if the following criteria are met. The employee:

1. Is under retirement age; and
2. Has completed at least 10 years of service

Before payments can begin, a five month waiting period that begins the month after the month in which the disability began is required. Benefits can vary significantly between employees since they are based on months of service and earnings credits.

**State Programs**

In addition to the federal programs providing Social Security and Railroad Retirement Act benefits, the states also provide certain disability benefits. The two principal state programs that provide disability income benefits are:

1. Workers Compensation and
2. Non-occupational Disability programs

**Worker's Compensation Disability Benefits**

Workers compensation provides benefits to workers who have occupational or job-related disabilities. Prior to the enactment of workers compensation laws, an injured worker had to sue their employer and prove that he or she was negligent in order to be compensated for a job related disability.

Today, all 50 states have enacted workers compensation laws. Under these laws, an employer must assume the expenses of occupational disabilities without regard to any fault being proved. In order to have the necessary funds to provide benefits, most states mandate that an employer carry worker’s comp insurance, however not all states require the employer to carry insurance.

Although Workers Compensation is normally considered a state program, certain classes of workers, whose jobs defy state boundaries—seamen, railroad workers and federal government employees—are covered under various federal Workers Compensation laws rather than state laws.

Workers Compensation provides an array of benefits in the form of:

- Cash payments and
- Medical and hospital services
- Vocational rehabilitation

These benefits are provided to workers that sustain job-connected injuries or illnesses and are available to every worker.
Workers Compensation benefits are established by law and may be paid by the employer or by its Workers Compensation insurance carrier. The benefits provided may be scheduled or non-scheduled.

Scheduled benefits are so called because the amount of benefit is set forth in a schedule that indicates the percentage of loss of use and portion of the body affected. Scheduled losses may involve disabilities to:

- Arms, hands or fingers
- Eyes, ears or teeth
- Legs, feet or toes

Non-scheduled benefits are benefits for injuries or illnesses to parts of the body other than those defined under scheduled losses. Payment of non-scheduled benefits is based on a percentage of the maximum weekly benefit available and is determined by the extent of the worker's disability.

Workers compensation benefits are usually expressed as a percentage of the worker's wage before disability - usually 66 and 2/3% is the figure used. In addition, each state has a cap on the amount to be paid. This maximum weekly figure will vary widely from state to state.

How Workers Compensation Affects Disability Insurance

How worker's comp affects the disability coverage will depend on the policy. A policy may exclude coverage for an injury covered under worker's compensation. Worker's compensation may not replace enough income if the breadwinner earns over $30,000 a year, and worker's compensation only covers on the job injuries. Therefore there is still the need for disability insurance to cover that person to and from work as well as on the weekends.

If the worker's compensation benefits are not adequate, additional benefits from the DI policy can be paid to provide up to 80 percent of the individual's average earnings. Worker's compensation would be considered the primary, paying the maximum allowed amount and SS would be supplementing the income to raise the percentage to 80 percent of the earnings.

State Disability Benefits

Disability coverage for job-related disabilities is required in all states. However, only six jurisdictions have compulsory non-occupational disability insurance programs. These non-occupational disability programs provide short-term financial assistance for disabilities occurring off the job. Their maximum benefit periods are limited to 6 months.

These six jurisdictions are

- California
- Hawaii
- New Jersey
- New York
- Puerto Rico
- Rhode Island

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There are four basic characteristics shared by each of the non-occupational disability programs, although the programs otherwise differ to some extent:

1. Coverage is partly financed by employee contributions
2. Program benefits are coordinated with other benefits to which the recipient is eligible
3. The individual must have a work record to be eligible to receive benefits; the definition of “work record” varies among jurisdictions
4. The coverage is short-term

Each of these programs provides benefits for a maximum period of 26 weeks following a 7-day waiting period. Since these are state programs, the benefits are mandated by the state and vary widely. In some cases, they can be as much as two-thirds of the recipient’s average weekly salary to a stated maximum dollar amount.

Non-occupational disability benefits are usually coordinated with other benefits received.

**No-Fault Auto Coverage**

Another source of disability benefits is no-fault auto coverage. Some states have enacted "no-fault" automobile insurance laws that provide the insured with certain minimum benefits, regardless of who was at fault in an accident. These provisions generally include payment for injury or disability incurred in the accident. Automobile accidents make up a small percentage of total disability cases, so the need for disability coverage is not filled by "no-fault" auto insurance.

**Non-Governmental Disability Programs**

**Employer-Paid Disability Insurance**

Most employers provide some short-term sick leave. Many larger employers provide long-term disability coverage as well, typically with benefits of up to 60 percent of salary lasting from five years to age 65, and in some cases extended for life.

**Sick Pay Plans**

A tax favored sick pay plan is a formal program for continuing the compensation of key employees of a business including the owner and other stockholder employees. This plan may be funded with disability income policies. If the plan is unfunded, a disabled employee’s benefits would be paid from corporate income.

If a sick pay plan is not established in accordance with the requirements contained in Section 105 of the Internal Revenue Code, then it will lose its tax advantages. For a sick pay plan to be valid and thus tax deductible to the corporation, it must be:

- Effective before the disability commences
- In writing (as part of the Corporate minutes)
- Communicated (in writing) to the employees
By establishing a formal plan in accordance with Section 105 of the IRS Code, any payments made are necessary business expenses and tax deductible. Naturally, such payments would be taxable to the employee. If the corporation funds the sick pay plan with disability income contracts and pays the premiums, the benefits received by the employee are taxable. The premiums paid are tax deductible to the corporation. If the employee paid part of the premiums for the disability insurance, then that portion of the plan benefit would be received tax free by the employee.

**Advantages and Disadvantages of a Formal Sick Pay Plan**

The principal advantage to the corporation is the fact that payments made to a disabled key employee under a formal salary continuation agreement are tax deductible for the company. However, an unfunded plan has some drawbacks.

When a disability occurs, the company will be required to make payments in accordance with the agreement. This becomes a fixed liability of the corporation. It is difficult to budget for the contingency of a disability since the employer doesn't know when it may occur. If the disability does strike, it may happen at a time when corporate income or profits are down and providing the required payments to a nonproductive employee can become a financial burden.

The best way to avoid these problems is to fund the plan with disability income contracts. The corporation pays a specified tax deductible premium which is relatively small compared to the benefits to be paid. There is little uncertainty as the premium to be paid is predictable. In addition, if a disability occurs, the corporation is relieved of the responsibility to provide benefit payments. The insurance company assumes the responsibility of providing payments in accordance with the policy. Any potential problems in terms of budgeting or timing of a disability are eliminated when the plan is funded by disability income contracts. The only liability of the employer is to pay the premiums and comply with the IRS requirements that the plan be in existence prior to any disability, be in writing and communicated to the employees.

A formal sick pay plan can increase employee loyalty. The implementation of a formal sick pay plan by the employer is evidence of the employer's concern for the employees. Employees who feel financially secure will usually do better work. Better work performance usually means more profits for the business.

A formal sick pay plan can also help to attract and help keep key employees.

**Group Disability Income Plans**

Several different kinds of groups are eligible for Disability Income coverage. The most familiar kind of group is the single employer group. The employer offers the employees group coverage. The size of an eligible group is governed by law and the employer may be too small to offer coverage to their employees. The smaller employers can band together to have the same Disability Income benefits as the larger companies through a Multiple Employer Trusts (METS). When a firm implements a formal salary continuation program for the key executives, it is customary that a similar program be installed for the benefit of all employees. Most often this will take the form of group disability income. A plan of group disability income may be in lieu of a formal salary continuation program and thus cover all employees including the key employees or it may be for those employees not covered by a formal sick pay plan.
Group disability was initiated largely by unions and spread to the non-union workforce. Prior to the 1970s, short-term disability policies were much more prevalent than the long-term policies so prevalent today. The influence of union bargaining had much to do with the increased availability of these policies, beginning in the 1970s and continuing today.

Statistically, few people own a disability policy. This is especially true with group coverage. Two big selling points of group plans that may be overlooked is that there is lower individual cost and less strict underwriting. Many businesses, unions, etc. have group health and/or life coverage, but few include Disability Income coverage. This translates into an opportunity to sell coverage to people who more than likely do not have it. The tax advantages to the employer may be enough incentive to go ahead and add a Disability Income package for their employees.

The two broad categories of group disability coverage are:

1. Short term and
2. Long term

A common approach is for an employer to provide short term coverage of 26 weeks with a 7 day elimination period for all employees and a long term disability plan providing long-term coverage with a 6 month elimination period for all salaried employees. It is a two-level program in which everyone gets some benefit.

**Group Short Term Disability**

Short-term group disability coverage is characterized by:

- Short elimination periods, that generally range from 0 days to 30 days and
- Limited benefit periods that normally are 13, 26 or 52 weeks

Short-term group policies typically have a waiting period of 0 to 14 days with a maximum benefit period no longer than two years. Most group short term policies provide for short elimination periods (usually 30 days or less) and short benefit periods. The benefit period is normally for 6 months but not longer than one year. The benefit amount is limited to a percentage of compensation, such as 60 or 70%.

Typically, short-term disability coverage pays benefits for disabilities, which prevent working in the insured's normal or regular occupation. Benefits may be payable immediately if the disability occurs as a result of an accident.

One of the rationales for short term disability has been that the worker presumably is eligible for Social Security disability benefits after the five-month Social Security waiting period. In reality, this may or may not be true depending on whether the worker can qualify for Social Security disability benefits. In addition, if the person does qualify for benefits, the first benefit check will likely not be received before one year from the onset of disability. In any event, short term disability benefits were designed to fill the gap until Social Security began paying benefits to the claimant.
Group Long Term Disability

Group Disability Long-Term coverage has longer elimination periods and longer benefit periods. A typical long-term group disability plan may have:

- Benefit periods of 5 years, to age 65 or for lifetime and
- Elimination periods that are as short as 30 days to as long as 6 months, or longer.

The waiting period on a group long-term disability policy is typically from three weeks to one year. Benefits may be payable to age 65 or retirement age, although LTD policies for "blue collar" occupations may limit benefits to from two to ten years. The more conservative group policies pay benefits for two years if the insured is unable to work in his or her own regular occupation, and continue if the insured is unable to work after this period in any occupation. More liberal policies pay benefits regardless of whether the insured is able to work outside his or her regular occupation, as long as the insured is not able to work in his or her own occupation. Benefits payable are based on income earned and typically fall between fifty to seventy percent of income earned prior to the disability.

Additionally, LTD policies usually provide for integration of plan benefits with other disability income benefits payable to the insured. The LTD benefit may be offset by any of the following:

- Any benefits provided by another formal employer plan
- Benefits payable under workers compensation or any similar statutory program
- Any benefits payable under Social Security

The purpose for having integration with these other sources of disability income is to prevent overinsurance on the part of the insured. Again, the purpose of insurance is to make an insured whole again. Insurance cannot result in an insured "making money" while disabled.

Advantages of Group Disability Coverage

Many of the advantages common to the sick pay plan for key employees are applicable to group disability plans. These would include the factor of increased employee loyalty, improved work performance and the element of attracting and retaining good employees. In addition, the employer also enjoys a tax deductible premium. Benefits paid to employees are taxable. The employees experienced a degree of financial security should they be struck with the economic death of total disability.

Because this is a group disability contract, there is normally no requirement to prove insurability. This enables the substandard risk to acquire disability income protection regardless of his or her health history or current physical condition. If the plan is written as an employee pay-all, payroll deduction, most often, individual policies would be issued. When this occurs, there would naturally be underwriting and the need to show evidence of insurability.

Generally, group coverage will be less costly for the employee than individual coverage. For some occupational classes, this is a valuable consideration as normally higher individual costs due to the occupation may be negated to some degree through the group purchase.
An advantage of employer group disability income insurance is that normally it is at a lower cost to the employee and their family. Another advantage is that the employer is working as an advocate in dealing with the insurance company. If the insurance company, though, finds that providing benefits for the employer has become too high of a risk, the insurance company (insurer) may decide to cancel coverage of the employees.

**Disadvantages of Group Disability Coverage**

One of the biggest disadvantages of company provided Disability Income plans is that the employee does not have sufficient control over their benefits. The employer-provided Disability Income plan may not cover the employee’s income adequately. The employee may only receive 40 to 60 percent of their income but before taxes. After tax, the employee would net much less. Employees in such a situation could purchase additional coverage so the percentage goes up to 60 to 70 percent of their after-tax income coverage.

Group disability plans can also be inadequate due to weak definitions of disability. A person may not be considered disabled under circumstances where a disability made the person unable to do the simplest of jobs. Another disadvantage is that many plans offer benefits only in the event of an accident and/or only for a very limited period of time. This translates into problems if the family experiences a disability and is not covered for the full term of the disability. Yet another disadvantage is that a person has no control over what happens to such a plan. A person may be canceled without any control over the matter. A person may be left with no Disability Income coverage at all, if the insurance company decides to terminate the offering of the coverage for their organization. Under a worst-case scenario, a person may be disabled or in ill health looking for Disability Income coverage that they will not be able to attain with their current health conditions.

Under Group Disability Insurance Plans, a person may be canceled without any control over the matter. There are several different kinds of eligible groups for Disability Income coverage. The most familiar type of group is the singular employer group. The employer offers the employees group coverage.

Since the minimum size of an eligible group (usually ten), is governed by law, the employer may be too small to offer coverage to their employees without assistance. Smaller employers can band together to have the same Disability Income benefits as larger companies, using a Multiple Employer Trusts (METS).

Unions, which are groups of employees in related fields, such as Carpenters Union, can offer their constituents Disability Income coverage. Federal law mandates that a trust be formed to handle or administer the Disability Income benefits for the unions.

In recent years there has been a rise in creditor-debit group insurance that is offered by the lender to the borrower. This type of insurance is not limited to just Disability Income benefits; it may also include life insurance. The purpose of both the life insurance and the disability insurance is to protect the lender to whom the policy’s benefits are paid if the borrower becomes disabled or dies before the debt is paid. Some mortgage companies have started offering policies to pay the house payment if the breadwinner becomes disabled.

The key to all group coverages is that they have a common denominator: their employer, union, association, or group borrowers to a lending institution. A person may find group coverage
because they took out a certain credit card - which may constitute a group in an insurer’s eyes. When these types of plans are mass-marketed, they are more susceptible to adverse selection, which means the process of how insureds are selected is faulty in that only the individuals who are ill apply, thus the insurer is more susceptible to having losses instead of profits.

In addition to true group insurance, there are two other approaches to providing employer-sponsored disability income benefits:

1. Franchise/association plans and
2. Individual employer-paid policies

**Association Plans**

Related to the concept of group coverage is the Association Plan. Professional associations such as the American Medical Association or the American Bar Association offer association or group-type disability income coverage to association members. Often, this coverage is provided as an inducement to attract memberships.

These plans may be very attractive due to their low premiums. The members of group plans normally are not subject to medical examinations that could reveal an uninsurable condition. As a result, every member of the group is entitled to coverage, regardless of any health conditions. No individual person's coverage may be canceled, however the entire group may be canceled by the insurer.

Association Coverage is basically individual coverage. As a member of a professional association, the person will complete an application for insurance. Association plans are "packaged plans" in that only certain elimination periods, benefit periods and benefit amounts are offered to members.

Premiums for association coverage are usually banded, grouped based on increments of age. This packaging of the product is facilitated by the fact that all members have the same occupational classification and job duties, i.e., physicians, lawyers, etc.

Association plans may offer a minimum guaranteed issue policy without regard to the insurability of the member. This of course, is an advantage for the uninsurable individual. Through the association, they can acquire disability income insurance regardless of their health history.

Disadvantages of association coverage include the fact that In essence, the association members are "renting" the coverage much like the participant in an employer-employee group plan. In addition, the individual can lose the coverage if he or she no longer maintains membership in the association.

Another disadvantage is the fact that the premiums are not guaranteed. The insurer can raise the premium for the entire plan. Also, the member will pay higher premiums whenever he or she moves into a new age band.

One of the most important definitions in a disability income policy is its definition of disability. Generally the same range of disability definitions is found in group disability insurance plans as
is seen in individual plans. The group policy’s definition may be as restrictive as any occupation or as liberal as own occupation.

**Franchise Plans**

The minimum size group required for group disability insurance may create a problem for many small businesses and other groups that don’t have a sufficient number of employees to qualify. Sometimes franchise insurance that provides disability income benefits may be an answer. In addition to overcoming the size issue, the principal benefit from this approach is a generally lower cost.

In a franchise arrangement each individual receives his or her own policy instead of a group certificate of insurance. Additionally, the franchise group members may usually make some coverage choices—choices that are not normally offered to true group insurance members. A key difference in franchise group arrangements is that insureds are usually required to provide evidence of insurability.

Just as under the true group insurance arrangement, franchise group plans may be either contributory or noncontributory, and a single premium is generally paid for the entire group.

**Occupational vs. Non-Occupational**

**Group disability plans** (long term or short term) are usually classified as occupational or non-occupational coverage.

**Occupational**

**Occupational** coverage means that the employee is covered 24 hours a day. Disabilities due to job related injuries (or sicknesses) are covered as well as non-job related disabilities.

**Non-Occupational**

**Non-occupational** coverage means that no disability benefits are provided for job related accidents or sicknesses. The insured is only covered for off the job disabilities. Non-occupational coverage is utilized because the employee is normally covered by workers compensation or other statutory plans which cover work-related disabilities.
Summary

Despite their similarities, there are a number of differences in group disability insurance when compared to individual policies. The principal group differences are found in the areas of underwriting, costs and benefits.

There are a number of sources of disability income benefits; they include both governmental and non-governmental sources. The principal governmental source of disability benefits for those unable to engage in any gainful activity is Social Security. Although providing a safety net for the profoundly disabled, Social Security’s stringent definition of disability results in a claims rejection rate of more than 60%. All states offer Workers Compensation programs, and six jurisdictions provide non-occupational disability benefits.

Many disability benefits are employer-related. They may be provided under true group programs or may be association plans, franchise plans or sick-pay plans.

A formal sick pay plan offers certain tax advantages to the employer, enhances the key employee’s sense of financial security and provides certain intrinsic benefits for the corporation such as increased employee locality and the ability to attract and retain key employees.

To be valid and thus eligible for the tax advantages, a formal salary continuation plan must be in effect prior to any disability, in writing and communicated to the employees. The IRS and the tax courts have held that if a plan does not meet these requirements, it will not enjoy the benefit of tax deductible payments to the disabled employee. The plan may be funded with disability income policies in which case any premiums paid by the employer would also be deductible.

Another employee benefit is in the form of group disability income insurance. Group policies may be short term or long term. Typically, a short term plan will have an elimination period of 30 days or less and a benefit period not exceeding one year. LTD plans will consist of longer elimination periods, such as 90 days or six months. LTD benefit periods are usually to age 65. Generally, most group LTD plans will provide for reduced disability benefits if the disabled employee is collecting Social Security or other types of disability benefits.

Although government disability programs help provide a safety net for the extremely disabled, it is only in the private sector that disability benefits come close to being truly adequate. One of the principal sources of disability income benefits in the private sector is employer-provided plans, and the most common employer-provided disability plans are group plans.

The principal benefits derived from group plans, when compared to individual plans, are:

- Generally lower cost
- Evidence of insurability is usually unnecessary.

State regulation generally controls the minimum group size for the purpose of purchasing group insurance.

Group insurance plans have participation requirements as a principal method of avoiding the problem of adverse selection—the propensity of sick people to purchase insurance. Participation requirements differ between noncontributory plans that are completely paid for by
the employer and **contributory** plans in which the cost is shared between the employer and employee. Although 75% of eligible employees must participate in a contributory plan, the participation requirement for noncontributory plans is 100% of eligible employees.

Three **benefit schedules** usually available in a group disability plan:

1. Flat benefit amount
2. Earnings schedule
3. Occupation class schedule

In a group disability plan that is designed to provide a flat benefit amount, everyone receives the same benefit. For example, the benefit might be $500 per week. Earnings schedule plans provide disability benefits that are related to the level of the individual’s earnings, such as 60% of earnings.

Position or occupation class plans link benefits to the participant’s position. For example, officers receive 60% of earnings to age 65, managers and supervisors receive 60% of earnings for 5 years and all others receive 50% of earnings for 2 years.

Motivating the disabled group member to return to work is not dissimilar to motivating the individual policyowner. The maximum benefit is usually not more than \( \frac{2}{3} \) of the employee’s regular wage, a level that is similar to the levels provided in the issue and participation limits we discussed earlier in connection with individual disability income underwriting.

A potential overinsurance problem may develop because of the nature of group insurance underwriting. Group disability underwriting is done on the basis of the entire group; no individual underwriting is performed. As a result, an employee who already has the maximum available individual disability income coverage could easily have 100% or more of his income replaced during a period of disability when a group disability plan is installed.


## Comparison

**Group vs. Individual Disability Income Underwriting, Costs and Benefits**

<table>
<thead>
<tr>
<th>Category</th>
<th>Group Insurance</th>
<th>Individual Insurance</th>
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<tbody>
<tr>
<td><strong>Underwriting</strong></td>
<td>1. Group underwritten as a whole, generally by occupation or industry&lt;br&gt;2. Individual health, habits and current coverage usually not considered</td>
<td>1. Individually underwritten&lt;br&gt;2. Eligibility determined by health, habits, income, age, occupation and current coverage</td>
</tr>
<tr>
<td><strong>Benefits</strong></td>
<td>1. Determined by occupation class, salary at claim time, or predetermined level amount&lt;br&gt;2. Maximum benefit usually limited to $7,000 - $8,000&lt;br&gt;3. Usually coordinated with other employer-provided or government benefits, such as Workers Compensation and Social Security&lt;br&gt;4. Definition of disability often restrictive, frequently with a 2 year own occupation&lt;br&gt;5. Optional benefits usually not offered</td>
<td>1. Fixed dollar amount of benefit determined at time of application&lt;br&gt;2. Usually no coordination with other benefits (except for SIS)&lt;br&gt;3. May be adjusted by automatic increases or COLA adjustments&lt;br&gt;4. Maximum benefit often much higher than group benefits — up to $15,000 per month or more&lt;br&gt;5. Definition of disability much more liberal — own occupation for entire benefit period&lt;br&gt;6. Many optional benefits are available</td>
</tr>
<tr>
<td><strong>Cost</strong></td>
<td>1. Usually lower than for individual policies&lt;br&gt;2. Determined by the “group” composition&lt;br&gt;3. Often varies from year to year based on claims experience</td>
<td>1. Usually higher than for group&lt;br&gt;2. Determined by individual factors—age, occupation, health&lt;br&gt;3. Depending upon renewability provision, may be fixed for the entire policy period</td>
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Chapter 5 Quiz

1. The percentage of claims that are denied under SSDI is:
   a. 10% - 20%
   b. 80% - 90%
   c. 60% - 70%
   d. 30% - 40%

2. An occupational DI policy means:
   a. Disabilities due to job related injuries as well as non-job related disabilities
   b. Only disabilities related to on-the-job accidents or illness are covered
   c. The insured is only covered for off the job disabilities
   d. The insured is covered for disabilities due to accidents but not sickness
Chapter Six - Special Coverage Disability Insurance Policies

*Important Lesson Points*

- In addition to disability income insurance policies designed to replace the insured’s income during disability, other disability policies provide specialty coverage for both **business and non-business** application.
- **Overhead Expense** coverage has particular application for the small business owner or professional with both a personal and business budget.
- Overhead Expense policies provide benefits on a reimbursement basis to pay the insured’s **usual and necessary business expenses**.
- **Disability Buyout** insurance provides benefits on an installment or lump-sum basis to fund the buyout of the business interest of a disabled partner or co-stockholder.
- **Keyperson Disability** insurance provides benefits to the employer of a disabled key person to help compensate the business for its loss of the key person’s skills and talents.
- **Specialty disability** insurance may be purchased, on an individual or group insurance basis, that pays disability benefits only in the case of a non-occupational disability; this coverage is generally used for insureds in high risk occupations.
- **Credit Disability** insurance is available, on an individual or group insurance basis, that pays benefits based on the monthly service on outstanding debt.

**BUSINESS USES OF DISABILITY INSURANCE**

In addition to disability income policies used as employee benefit plans, there are additional types of policies which are used to solve business needs. Business owners may require insurance to provide for the payment of certain expenses of the business. Appropriate income replacement solutions are critical for the business owner.

A business owner generally has a personal budget which typically covers items such as mortgage payments, food, clothing and so forth. The small business owner or professional also has an additional budget for salaries, rent, dues, professional publications, telephone, office supplies and so forth. The small business owner must also provide cash to meet these expenses if he or she expects to have a business or practice to return to after suffering a disability.

An owner’s disability can have a significant negative impact on a business. The business the disabled owner would normally bring in is lost or diminished although the expenses will likely continue or even increase. Disability income insurance may be used to help arrange the sale of a business interest in case of an owner’s or shareholder’s death, disability, retirement, divorce, or voluntary or involuntary withdrawal from the business.

In a small firm, such as a medical practice or a partnership, a key executive, or owner’s disability can negatively impact the profitability of the entire business. The disabled worker may be unable to service and bring in the business that the owner normally handled. Therefore, less money is brought into the practice or firm.
If the disabled worker must work because he or she cannot afford otherwise, his or her impaired or substandard performance impacts each of the other workers, as well as the overall profitability of the business.

Additional business uses of disability income insurance include the Business Overhead Expense policy, Key Person policy and the Disability Buy-Sell policy.

**Business Overhead Expense (BOE) Policies**

Business owners, whether sole proprietors, partners, or principals in a multi-owner business, must bring in sufficient income to support not only personal and family needs, but also those of the business. A significant income need in the business is the payment of overhead expenses.

Many overhead expenses will not diminish due to an owner's disability. Rent, electricity, salaries, equipment, and storage costs are just some of the overhead expenses that will continue during an owner's disability. Some expenses may actually increase due to additional employees, temporary employees, or overtime pay for existing employees.

Providing funds to pay overhead expenses incurred by the insured during a relatively limited period of disability is the function of Overhead Expense insurance. This type of coverage is often offered in two versions:

1. Professional Overhead Expense and
2. Business Overhead Expense

Although both of the overhead expense policies are designed to reimburse overhead expenses, the Professional Overhead Expense policy generally includes employees’ salaries as eligible overhead expenses; the Business Overhead Expense policy does not.

Typically, BOE policies are separate contracts from individual disability policies. However, some companies offer BOE riders with individual disability policies. Business overhead expense payments are based on expenses, which continue whether the insured is working or not.

BOE policies are designed to indemnify the business for specific types of business expenses incurred during the disability of the business owner. Typically, these policies have 30-day elimination periods and benefit periods of one or two years. Most business expenses are covered by the BOE policy except for the compensation of the business owner.

The Business Overhead Expense (BOE) is designed for the small business owner. Its purpose is to cover certain overhead expenses which continue when the business owner is disabled. If the Chief Executive Officer of General Motors became disabled and was unable to work, General Motors would not be forced to close its doors. However, the owner of a small business might indeed be forced to close the business during periods of disability. Most insurers will limit the BOE policy to firms which employ usually four to five employees.

A key factor in underwriting BOE insurance is determining whether the disabilities of the insured truly will impact the BOE. The insurance company looks closely at the business, factoring in its size, the number of owners, and the effect of the proposed insured's disability on overhead.
Generally, a smaller firm's owner will have a greater impact on BOE than a large firm with several owners or principals.

The BOE policy reimburses the business (not the business owner) for actual overhead expenses incurred during a period of total disability to the business owner. The amount of coverage provided is based on the average overhead expenses of the business.

Eligible overhead expenses generally include the expenses for all of the following that are incurred during a period of disability:

- Employee salaries, fringe benefits and payroll taxes
- Rent, telephone and other utilities
- Accounting and legal fees
- Depreciation of office equipment
- Maintenance and janitorial services
- Other necessary expenses usually incurred in operating a business

The business owner's salary is not covered under the BOE, only the compensation paid to employees. Usually, the cost of inventory is specifically excluded as an allowable expense. The cost of equipment or furniture is also excluded.

A somewhat unique feature of the BOE policy is its tax treatment. The premium paid is tax deductible to the business as a necessary business expense. This results in taxable benefits paid to the company during a period of disability. However, since these benefit payments are used to pay tax deductible business expenses it negates the tax liability.

Although the benefit periods under Overhead Expense policies are relatively short, the monthly benefits can be as high as $25,000 per month. The benefit periods offered by insurers are typically limited to 12 months, 18 months or 24 months. Overhead Expense elimination periods are also short; thirty and 60 day elimination periods are the most common in Overhead Expense policies.

Generally, BOE policies reimburse for actual business expenses incurred during a period of disability up to the policy maximum. However, since the actual expenses will vary from month-to-month the benefit paid will also vary from one month to another.

### Carryover Contract

The BOE “carryover contract” permits the client to utilize unused benefit dollars to cover months in which expenses exceed the maximum monthly benefit. The unused money could be used to cover the excess expenses incurred. With this type of BOE, the policy can actually pay benefits in excess of the monthly maximum. The insured would likely receive the full benefits.

Business expenses—even during a period of disability—typically vary from one month to the next. For that reason, one of the important provisions in Overhead Expense policies deals with this reality. A business with $10,000 per month Overhead Expense coverage may find that eligible expenses are $8,000 in one month but $12,000 in the next. The more consumer-friendly Overhead Expense policies provide for these varying expenses through their carryover provisions.
The provisions that address carryover in Overhead Expense policies may deal with:

- Expense carryover
- Benefit carryover

**Expense Carryover**

If the business owner has a $10,000 overhead expense policy and incurs eligible overhead expenses of $12,000, the policy would pay the maximum monthly benefit of $10,000. In addition, however, it would carry over the other $2,000 of expenses to be paid in a subsequent month when expenses are less than $10,000.

Suppose that eligible overhead expenses in the next month are $9,000, the policy would, again, pay $10,000, consisting of the $9,000 just incurred and $1,000 of the $2,000 carried over from the previous month. The remaining $1,000 of unreimbursed expenses may be paid in a later month.

In every month in which expenses incurred exceed the maximum benefit, the unpaid balance is held in an account for possible payment in a later month.

Another version of BOE, the “extended benefit type,” permits unused benefits to apply to expenses incurred after the end of the benefit period. If the insured were still disabled at the end of the benefit period, unused benefit dollars could be used to extend the benefit period. However any benefits paid cannot exceed the monthly policy maximum. The insured is likely to receive the full policy benefits under this policy as well.

**Benefit Carryover**

Benefit carryover clauses are not as common. When they are included in an Overhead Expense policy, they work similarly to expense carryover provisions. If the eligible overhead expenses in a month are less than the maximum monthly benefit, the policy will pay the amount of the expenses and carry over the remaining unused benefits for use in a later month when eligible overhead expenses exceed the monthly policy maximum.

The best solution for the disability of the owner of a small business is the BOE in combination with an individual disability income policy. The BOE permits the business to remain open, employees are retained and possibly some business income is generated. The individual policy enables the insured to pay his or her necessary living expenses without creating a drain on business resources.

**Disability Buy-Sell Insurance**

The Disability Buy-Sell policy is designed to provide necessary funds to implement a disability buy-sell agreement. The buy-sell is triggered by the disability of a partner or owner-shareholder following the policy's elimination period. To allow ample time for a recovery and thus prevent a premature buyout, the buy-sell policy will have a one- or two-year elimination period followed by a two to five year benefit period or a lump sum payout of the policy benefits.
Many agents actively prospect for and sell life insurance to fund buy-sell agreements in the event of the death of a business owner or partner. Too often, the economic death resulting from a permanent and total disability is overlooked. The likelihood of a disability occurring is many times greater than death at most ages. Yet, this situation and need are overlooked or ignored by many agents and business owners. Consider the statistics shown below.

The Probability of Long-Term Disability Occurring Within a Small Group of People

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<thead>
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<th>NUMBER OF PEOPLE IN THE GROUP</th>
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(Based on the 1985 CIDA Table and the 1980 CSO Table)

This table shows the near certainty of a long-term disability striking at least one person within a small group such as business partners or shareholders in a closely held corporation. For example, if a corporation was owned and operated by five individuals, the probability of a disability striking at least one of these shareholders prior to age 50 is higher than 90%.

A buy-sell agreement stipulates that in the event of disability, the corporation or other partners will buy out the interest of the disabled shareholder. The agreement is funded with disability insurance policies owned by the corporation. However, the agreement does not provide for the contingency of disability.

Any decision to buyout the interest of the disabled owner is based on whether or not there are adequate funds for such a buyout. The solution to the problem is a disability buy-sell agreement funded with disability income insurance. The provisions of the buy-sell agreement include the following.

- Each owner is obligated to sell his interest in the event of a disability
- The corporation or remaining partners are obligated to purchase the interest of the disabled owner and pass the value on to the owner and/or the owner's family
- What constitutes total disability and how long the person must be disabled before the buyout begins is stipulated in the agreement

Funding the agreement with disability income policies offers the following advantages:

- The exact sum of money will be there at the exact time it is needed
- The policy provides a definition of total disability
- The policy's elimination and benefit periods can be used to determine when the buyout will begin and how long it will take
- The insurer issuing the policies can regulate the payment of the benefits
• The active businessowner(s) will maintain voting control of the company
• Prevents non-qualified, inexperienced family members of the disabled partner or owner from taking control of the business
• Guarantees that a competitor cannot buy the interest of the disabled owner
• Provides for the continuity of management and continued business activity which is beneficial to customers and existing employees
• A definite market and value assures a fair disposition of the business interest
• Family members will not be forced into the business to sustain the family's economic welfare
• The disabled businessowner will not have to share in future business losses

Types of Buy-Sell Agreements

Four basic types of buy-sell agreements exist:

1. **Stock Redemption**: In a stock redemption buy-sell agreement, the business purchases the affected shareholder's shares.
2. **Cross Purchase**: Under a Cross Purchase agreement, the other owners of the business purchase the portion owned by the affected owner.
3. **Wait and See**: The Wait and See agreement does not specify the method of buy-out, but instead specifies a sequence of purchase options. The business is given the first option to buy and the remaining shareholders or owners the second option to purchase any remaining shares. If any shares remain, the business must purchase them.
4. **Third Party Buy Out**: As the name suggests, in a Third Party Buy Out agreement, a third party agrees to purchase the business.

**Entity Agreement aka: Stock Redemption**

The buy-sell arrangement usually provides that the corporation or other entity owns the policy, pays the premiums and is the beneficiary or loss payee. This arrangement is referred to as an "entity agreement."

Premiums paid by the corporation are not tax deductible but any policy benefits received by the company are tax free.

**Cross Purchase Agreement**

The buy-sell agreement may also be arranged on a "cross purchase" basis. Each principal owns a policy on each of the other partners or shareholders. In addition, each person pays the premiums for these policies and would of course receive the policy benefits. The cross purchase arrangement becomes very cumbersome if there are several owners or partners. This necessitates the issuance of several policies.

Another disadvantage of the cross purchase agreement is that each person must pay the premium. If one of the owners neglects to pay the premium, then that policy would lapse and disrupt the funding arrangement. There is also the possibility that a young owner may have to pay a higher premium for one of the older partners thus creating some inequity among the partners.

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**Entity Buy-Sell Agreement**

Assuming the value of the corporation is $1,000,000

The corporation (ABC Inc) buys a total of 3 policies, one on A, one on B, and one on C for the value their respective amount of ownership.
**Cross Purchase Buy-Sell Agreement**

Assuming the value of the corporation is $1,000,000

In the cross purchase buy-out, each owner buys a policy on each of the other owners. In this case there would be a total of 6 policies for a total of $1,000,000:

- A = buys $150,000 on B and $100,000 on C  
  Total $250,000
- B = buys $250,000 on A and $100,000 on C  
  Total $350,000
- C = buys $150,000 on B and $250,000 on A  
  Total $400,000

In the entity buy-out, the Corporation purchases 3 policies: $500,000 on A; $350,000 on B and $200,000 on C for a total of $1,000,000

In the cross-purchase buy-out, the major stockholder buys the least amount of coverage; the person owning the smallest percentage, who is least likely to afford the premium, must purchase the most coverage.

The problem is that the insurance most benefits the family of each stockholder since it will be used to buy-out their interest from their heirs.
The cost to each shareholder is not in proportion to their benefit. Having the corporation pay the premium helps in several ways. Since the corporation cannot deduct the premium, the benefits are received by the corporation tax-free. It also means the expense will be apportioned more equitably since the corporate expenses and profit accrue in proportion to their ownership. Also there is less risk of the individual stockholders not paying the premium, especially those with the lowest percentage of ownership.

**Using Disability Insurance in a Buy-Sell Agreement**

Disability insurance policies used in buy-sell agreements have a waiting period of sufficient length to ensure the disability is long term. The waiting period is at least one year and may be two. The reason for the long elimination period is to make sure that the disabled businessowner or partner is, and will probably remain, totally disabled and unable to function in the business. Therefore, the long elimination period will allow for an adequate period of time to determine the permanence of the disability.

A short elimination period, which triggers the buyout might result in an owner be "forced out" of the business who subsequently fully recovers and is able to resume his or her business function. Another advantage of the long elimination period is that the premium will be less. Since disability buy-sell contracts have large benefit amounts, the longer elimination periods and corresponding lower premiums are advantages to the corporation.

The policy is issued or renewed only if a formal buy-sell agreement exists. Other factors required for issue and renewal are include that the insured is still actively working in the business and the insured does not own more than 90% of the business.

Some Business Buy-Out policies pay monthly benefits for up to five years. Others pay a lump sum after the waiting period has been satisfied for the purposes of fulfilling the terms of the agreement.

The policy benefits may be paid in a lump sum following the elimination period or in a series of monthly installments during the benefit period If the policy provides a lump sum buyout. At this point, the buyout will be finalized by the lump sum payment. If the policy provides for installment payments, satisfying the elimination period can serve to trigger the buyout. The monthly installments will continue regardless of the continued disability of the businessowner.

Another method to determine the trigger date when the policy provides for monthly installments is to establish the trigger date to coincide with the last installment. If the owner returns to work during the benefit period, no buy-out has occurred. The policy benefits received by the corporation are treated as income to the business and taxed accordingly.

Many business buy-out policies have a "presumption of disability" provision that becomes effective when disability payments begin. This provision basically states that for the purposes of the policy, the insured is considered disabled when the elimination period is satisfied, even if during the benefit period he or she recovers. Therefore, the buy-sell agreement will be fully funded regardless of changes in the insured's status.

If disability insurance is used in a "stock-redemption" plan, the business should be the owner and beneficiary and should pay the premium. The structure of the insurance in a "cross purchase" plan has the business owners named as the owner and beneficiary of the insurance.
on the lives of the co-owners in the business. If more than two insureds exist, co-owners are named or a trustee will be named to act on behalf of the business owners not on the policy. In a “wait and see” arrangement, the disability insurance policy structure could be one of two ways: the business purchases a policy on each shareholder or the shareholders purchase the policies as in a cross-purchase plan. Or a “third-party” trustee named in the plan could purchase the insurance.

**Key Person Disability Income**

Keyperson disability insurance is designed to function in an identical manner to keyperson life insurance. It replaces the value that is lost to the employer as a result of the loss of the employee through disability.

The benefits are designed to help the company to recover part of the lost income due to the disability of the key person and to possibly reorganize or hire and train a replacement for the disabled person. Hiring and training a replacement can also be a costly endeavor and such expense is in part covered through the benefits provided by the key person.

Typically, this type of policy has an elimination period of 30 to 90 days and a relatively short benefit period of one or two years.

The policy will be owned by the corporation. The corporation will pay the premiums and receive the benefits. The premium is not deductible and any benefits received will be received tax free. The insured employee has no direct interest in the policy—other than being the insured. The employer is the policy:

- Owner
- Beneficiary
- Premium payor

**Valuing the Key Employee**

The value of the key person must be determined by the corporation. The criteria used will include the economic value of the key person to the company plus the cost of hiring and training a replacement for the disabled key person. This will be the amount of disability benefits applied for. It must be demonstrated to the insurance company that this value is reasonable.

Valuing the key person is one of the most difficult parts of writing key person disability insurance. Although a number of approaches may be used to assign a value, none of them is particularly precise. The following four methods are often relied upon to point to a Keyperson value:

1. One year’s profits
2. Contribution to earnings
3. Excess salary
4. Present value of lost earnings
One Year's Profits

One of the simplest and, probably, least accurate methods of valuing a Keyperson is the one year's profits method. The average annual business profit for the most recent 3 to 5 year period is simply divided by 12. The result is the amount of monthly keyperson disability insurance purchased. This approach provides a year for the business to find and train a replacement for the disabled key person.

This approach is more accurate in a small closely held company, especially when there is a single key person.

Contribution to Earnings

The contribution to earnings approach is somewhat more complex but provides a more valid estimation of a key person's value. Its method estimates the insured's contribution to the company's earnings by recognizing that earnings are generally due to two factors:

1. Invested assets and
2. Employees talents and skill

Excess Salary

The excess salary method to estimate a key person's value seeks to divide the key person's salary into two segments:

1. The amount earned by the individual because of his or her performance of routine job duties
2. The amount earned by the individual that is attributable to his or her special expertise—the expertise that makes him or her a key person

In the excess salary approach, the estimated amount of salary that would be required to hire a replacement to perform the disabled employee's routine duties is subtracted from the key person's total compensation. The balance is the excess salary paid to the key person.

The excess salary is then multiplied by the number of years it would take to replace the disabled key person. This is the amount of Keyperson disability needed.

Present Value of Lost Earnings

The present value of lost earnings approach to valuing a key person requires that some reasonable discount rate be applied to the lost earnings caused by the disability of the key person for as long as those earnings can be expected to affect earnings. The resulting present value is the value of the key person and the amount of required disability insurance.

None of these methods for valuing a key person comes is perfect, however, they provide a reasonable basis for estimating how much each of his or her executives is worth to the organization.
The definition of disability normally used in Keyperson disability insurance is a pure own occupation definition. If the key person is unable to perform the substantial and material duties of the job, he or she is not functioning as a key person, and a benefit should be paid.

Summary

Special coverage disability policies are available for business application. Business application of specialty disability policies provide benefits to pay a business owner’s overhead expenses, fund a disability buy-sell agreement and compensation an employer for the loss of a key person’s services as a result of disability.
Chapter 6 Quiz

1. The purpose of Key Person disability insurance is which of the following?
   a. To replace the value lost to the business as a result of the disability of a key employee
   b. To provide an employee benefit to owners and executives of the company
   c. To cut down on Workers’ Compensation insurance premium
   d. To benefit the key person’s spouse and/or children

2. All of the following are business uses of disability income insurance EXCEPT:
   a. Overhead Expense coverage
   b. Residual Disability coverage
   c. Key person Disability
   d. Buy-Sell Disability insurance
Chapter Seven - Taxation of Disability Coverage

Important Lesson Points

- The general rule concerning the tax treatment of disability income insurance premiums and benefits is that if the premium is non-deductible the benefits are tax-free; if the premium is deductible, the benefits are taxable.
- Disability income insurance premiums paid by an employer on an employee-owned policy are generally tax deductible and non-taxable to employees.
- Disability income insurance premiums paid by an employer on a policy owned by the employer are not tax deductible, but benefits are received tax free.
- Disability income insurance premiums paid by an employer on a policy owned by the sole proprietor, partner or more-than-2% S corporation owner are not deductible by the business.
- Disability income insurance premiums paid by a regular corporation on a policy owned by an employee-stockholder are tax deductible, regardless of the extent of the employee’s corporate ownership.
- Disability Overhead Expense policy premiums are tax deductible to the premium payor, regardless of the type of organization.
- Although Disability Overhead Expense benefits are taxable when received, their reimbursement of deductible expenses results in a tax wash.
- Disability buyout and Keyperson policy premiums are not deductible to the premium payor.
- Disability buyout and Keyperson benefits are tax free when received.

Disability Income Insurance Taxation

Benefits may be tax free if the premiums are paid using after-tax dollars. Benefits under most employer-provided plans are taxable because they are usually paid with pre-tax dollars.

The rules surrounding disability income insurance taxation are generally pretty straightforward. However, if the insurance is purchased by an employer or if premium payments are split between the insured and the employer, taxation rules become more complicated.

There is a general rule that applies to the income tax treatment of disability insurance.

- If deduction of the premium is not deductible, the benefit is received income tax-free.
- If the premium is deductible or is paid with after-tax dollars, then the benefit is taxable as income.

When considering disability income insurance taxation, the focus is on the entity that is paying the premiums for the disability insurance policy.

Individual Disability Income Insurance Taxation

Premiums paid for an individually owned disability income plan are not tax deductible. However, benefits received from the policy are tax free.
This concept also applies to a sole proprietorship or a partnership. A sole proprietor is a non-incorporated form of business owned by one individual. A sole proprietor is not considered an employee. Therefore, any coverage provided through the business, is considered individually owned. This same principle applies to a partnership. Partners are not considered employees therefore disability benefits will be considered individually owned. Thus the premiums are not deductible but the benefits are tax free. A sole proprietor or a partnership which provides a formal sick pay plan for employees will receive a tax deduction for the premiums paid on the behalf of the employees. In these instances, benefits received by the employees are taxable.

If the policyowner pays the premiums, no deduction is permitted for premiums, but benefits are tax-free. Generally, benefits from individual disability income insurance are received income tax free. Individual disability benefits are income tax free whether received by the insured or by a person with an insurable interest in the insured.

**Disability Insurance Purchased By an Employer**

Generally, the group disability policy is paid for by the employer on a tax deductible basis. Benefits are taxable to the employee. However, these plans may be implemented on a payroll deduction basis whereby the employees pay all or part of the cost of the plan.

In a payroll deduction plan, any contribution from the employee will not be tax deductible to the employee but any benefits received, attributable to the employee's premium contribution, will be tax free. Usually, the employee will pay a percentage of the premium such as 10, 20, or as much as 50%. In some plans, the employees may pay the entire premium through payroll deduction. Under this method, the premium is deducted from the employee's check after all taxes have been deducted. The employer sends one premium on behalf of the entire group to the insurance company.

Disability income insurance premiums paid by regular corporations are deductible regardless of the extent of the employee's ownership in the corporation. The difference in the tax treatment lies in the fact that the regular corporation and its owner are separate tax entities.

**Overhead Expense Policies**

The tax treatment that is afforded certain specialty disability policies is not entirely consistent with the tax treatment given to disability income insurance policies. This difference is readily apparent in Overhead Expense policies.

The premiums paid for overhead expense policies are tax deductible, regardless of the type of organization that pays them. The sole proprietorship, partnership and corporation all enjoy the tax-deductibility of Overhead Expense policy premiums.

Consistent with the general rule concerning disability insurance taxation, the Overhead Expense benefits are considered taxable income when they are received. However, because Overhead Expense benefits are reimbursement benefits that are received for tax-deductible business expenses that have already been paid by the policyowner, the net tax treatment is a wash. While the benefits are taxable, the paid expenses are deductible.
**Disability Buy-Sell & Keyperson Policies**

In the case of Disability Buy-Sell and Keyperson Disability policies, the premium payor and the beneficiary are the same entity. As a result, they share the same tax treatment given to personally owned disability income insurance policies. Both disability buyout policies and key person disability policies enjoy tax-free benefits, but the premiums are paid with after-tax dollars, since the business is both premium payor and beneficiary of these policies.

**Summary**

Income taxation rules with respect to disability income insurance generally provide that premiums are not deductible, but benefits are received tax-free. An exception to the rule concerning non-deductibility of disability income insurance premiums applies to policy premiums paid by an employer on a policy owned by the employee. In such a case, the premiums are generally tax deductible to the employer and non-taxable to the employee. When received, however, benefits are taxable to the employee.

Disability Overhead Expense policy premiums are tax deductible to the premium payor. Benefits, however, are taxable. Disability Keyperson and Buyout policy premiums are not deductible to premium payors, but benefits are received tax-free.
Chapter 7 Quiz

1. The general rule regarding taxation of Disability Income insurance is which of the following?
   a. Benefits received from an individually owned DI policy are usually received for free
   b. Group DI insurance is usually taxable to the employer but the benefits received by the employee are tax free
   c. If the premiums are not tax-deductible then benefits are taxable income
   d. Premiums paid for individually owned disability income insurance are usually not tax deductible

2. Which of the following is true in regard to Key Person DI insurance?
   a. The premium payer is the employer and the beneficiary is the employee
   b. The premium payer and the beneficiary are the same person or entity
   c. The premium payer is the key person and the beneficiary is the employer
   d. The benefits are taxable income to the key person
Glossary

**Accident.** An unplanned event, unexpected and undersigned, which occurs suddenly and at a definite place. See also Occurrence.

**Accident Insurance.** A form of insurance against loss by accidental bodily injury to the insured.

**Accidental Bodily Injury.** Traumatic damage to the body, of external origin, unexpected and undersigned by the injured person. Contrast with Accidental Means.

**Accidental Death and Dismemberment.** A policy or a provision in a disability income policy which pays either a specified amount or a multiple of the weekly disability benefit if the insured dies, loses his or her sight, or loses two limbs as the result of an accident. A lesser amount is payable for the loss of one eye, arm, leg, hand, or foot.

**Accidental Death Benefit.** An extra benefit which generally equals the face of the contract or principal sum, payable in addition to other benefits in the event of death as the result of an accident. See also Double Indemnity and Multiple Indemnity.

**Accidental Death Insurance.** A form that provides payment if the death of the insured results from an accident. It is often combined with dismemberment insurance in a form called accidental death and dismemberment. See also Accidental Death and Dismemberment.

**Accidental Means.** Unexpected or undersigned cause of an accidental bodily injury. Under a definition of accidental means, the mishap itself must be accidental, not just the resulting injury. An example would be an individual chopping wood: If the axe slipped out of his hand and cut his foot, it would have been accidental means. However, if his finger got in the way of the axe, it would not have been.

**Additional Monthly Benefit.** Riders added to disability income policies to provide additional benefits during the first year of a claim while the insured is waiting for Social Security benefits to begin.

**Any Occupation Definition of Total Disability.** The total disability definition providing the least protection for the insured is the any occupation definition. Under the any occupation definition of total disability, the insured must be unable to engage in any occupation in order to be considered totally disabled.

**Adverse Selection.** The tendency of poorer than average risks to buy and maintain insurance. Adverse selection occurs when insureds select only those coverages that are most likely to have losses.

**Adverse Underwriting Decision.** Any decision involving individually underwritten insurance coverages resulting in termination of existing insurance, declination of an application, or

**Benefit Period.** The benefit period is usually defined as that maximum period of time, beginning at the conclusion of the elimination period for which disability income benefits are payable during the continuation of the insured’s disability.
**Cancellable.** A contract of insurance that may be terminated by the insurer or insured at any time. Practically every form of insurance is cancelable, except life insurance and those health insurance policies designated as a "guaranteed renewable" or "noncancelable and guaranteed renewable." Some states also regulate when or if automobile policies can be cancelled.

**Cancellation.** Termination of a contract of insurance in force by voluntary act of the insurer or insured in accordance with the provisions in the contract or by mutual agreement.

**Change of Occupation.** A provision in a health insurance policy that allows the insurer to adjust policy benefits if the insured has changed to a more hazardous occupation.

**Claim.** A demand made by the insured, or the insured's beneficiary, for payment of the benefits provided by the contract.

**Conditionally Renewable.** Under a disability policy with a conditionally renewable provision, the insurer guarantees to renew the policy provided the insured meets the conditions of renewability but retains the right to increase premiums. Generally offered on disability policies covering insureds in high-risk occupations.

**Cost of Living Adjustment Rider (COLA).** A COLA rider adjusts the amount of monthly disability benefit received by the insured each year during his or her disability. The first adjustment is on the 13th month of disability.

**Cost of Living Benefit.** An optional disability benefit where the monthly benefit will be increased annually once the insured is on claim for 12 months.

**Disability.** A condition that curtails to some degree a person's ability to carry on normal pursuits. A disability may be partial or total, and temporary or permanent.

**Disability (likelihood).** At most ages, the probability of disability occurring is from 2 ½ to 4 times more likely than that death will occur at that age.

**Disability Benefit.** The benefit payable under a disability income policy or a provision of some other policy, such as a life insurance contract.

**Disability Buyout Insurance.** Disability insurance that provides funds, in a lump sum or in installments, with which to purchase a disabled partner's or co-stockholder's business interest.

**Disability Buy-Sell.** A disability income policy used to fund a disability buy-sell agreement whereby the business interest of a disabled stockholder following the elimination period. The policy's benefits may be paid in a lump sum or in installments.

**Disability Income Insurance.** A form of health insurance that provides periodic payments to replace income, actually or presumptively lost, when the insured is unable to work as a result of sickness or injury.

**Disability Purchase Option Rider.** A disability purchase option rider allows the insured, usually on specific policy anniversary dates, to increase the monthly benefit payable in the event of his or her future disability without regard to his or her current health.
Elimination Period. A loosely used term, sometimes designating the probationary period, but most often designating the waiting period in a health insurance policy. See also Probationary Period and Waiting Period. The elimination period is that period of time beginning with the onset of disability and ending when benefits for that disability begin to accrue.

Exclusions and Limitations. Those disability insurance policy provisions that exclude or limit coverage for certain conditions.

Expected Claims. The estimated claims for a person or group for a contract year based usually on actuarial statistics.

Expected Morbidity. The expected incidence of sickness or injury within a given group during a given period of time as shown on a morbidity table.

Experienced Mortality or Morbidity. The actual mortality or morbidity experienced in a group of insureds as compared to the expected mortality or morbidity.

Financial Underwriting. The principal underwriting concern in the area of financial underwriting is whether the insured will be financially motivated to return to gainful employment after a period of disability.

Guaranteed Renewable. A contract that the insured has the right to continue in force by the timely payment of premiums for a substantial period of time as set forth in the contract. During that period of time, the insurer has no right to make any change in any provision of the contract other than a change in the premium rate for all insureds in the same class. Contrast with Noncancelable, from which Guaranteed Renewable should be distinguished.

Guaranteed Renewable. In policies containing a guaranteed renewable provision, the insurer guarantees not to refuse to renew the policy but retains the right to increase premiums on a class basis.

Illegal Occupation Provision. A health insurance policy provision that voids liability if the loss results from the insured's committing or attempting to commit a felony or from the insured's engaging in an illegal occupation.

Illness. A loss which is sustained due to sickness or disease usually due to an organic cause.

Income Replacement Policy. The typical income replacement policy pays a monthly income benefit that is equal to the percentage of income lost by the insured as a result of sickness or accident multiplied by the maximum monthly income benefit.

Income Sources During Disability. For most people the sources generally available to provide an income during their disability are savings, spousal employment, borrowing or disability income insurance.

Incontestable Clause. A clause in a policy providing that after a policy has been in effect for a given length of time (two or three years), the insurer shall not be able to contest the statements contained in the application. A health insurance provision also states that after that time no claim shall be denied or reduced on the grounds that a condition not excluded by name at the
time of issue existed prior to the effective date. In life policies, if an insured lied as to the condition of his or her health at the time the policy was taken out, that lie could not be used to contest payment under the policy if death occurred after the time limit stated in the incontestable clause.

**Inflation Protection.** Provisions in a health insurance policy that increase benefit levels to account for anticipated increases in the cost of covered services.

**Keyperson Disability Insurance.** Keyperson disability insurance is designed to function in an identical manner to Keyperson life insurance. It replaces the value that is lost to the employer as a result of the loss of the employee through disability.

**Limited Own Occupation Definition of Total Disability.** Under a limited own occupation definition of total disability, the definition of what constitutes total disability changes with the duration of the disability from a pure own occupation definition of disability to any occupation definition. As the disability continues, its definition becomes more restrictive.

**Long-term Group Disability Plan.** A typical long-term group disability plan may have benefit periods of 5 years, to age 65 or for lifetime and elimination periods that are as short as 30 days to as long as 6 months, or longer.

**Loss-Of-Income Benefits.** Benefits paid for inability to work for remuneration because of disability resulting from accidental bodily injury or sickness. The loss of income may be real or presumptive.

**Loss-of-Income Insurance.** Insurance paying loss-of-income benefits.

**Modified Own Occupation Definition of Disability.** The modified own occupation definition of total disability states that the insured will be considered totally disabled if he or she is unable to perform his or her own occupation and not engaged in any other occupation.

**Moral Hazard.** A condition of morals or habits that increases the probability of loss from a peril. An extreme example would be an individual who previously burned his or her own property to collect the insurance.

**Morale Hazard.** Hazard arising out of an insured's indifference to loss because of the existence of insurance. The attitude, "It's insured, so why worry," is an example of a morale hazard.

**Morbidity.** The relative incidence of disease.

**Morbidity Rate.** The ratio of the incidence of sickness to the number of well persons in a given group of people over a given period of time. It may be the incidence of the number of new cases in the given time or the total number of cases of a given disease or disorder.

**Morbidity Table.** A table showing the incidence of sickness at specified ages in the same fashion that a mortality table shows the incidence of death at specified ages.

**Noncancellable** ("Non-Can"). A contract of health insurance that the insured has a right to continue in force by payment of premiums, as set forth in the contract, for a substantial period of
time, also as set forth in the contract. During that period of time, the insurer has no right to make any change in any provision of the contract. The NAIC recommends that the term "Noncancelable" not be permitted to be used to designate any form that is not renewable to at least age 50 or for at least five years if issued after age 44. Note that this is in contrast to Guaranteed Renewable, on which the premium may be increased by classes. The premium for Noncancelable policies must remain as stated in the policy at the time of issue. Contrast with Guaranteed Renewable.

**Noncancellable & Guaranteed Renewable.** In coverage that is noncancellable and guaranteed renewable, the insurer makes two important guarantees: that it will not increase the premium and that it will not refuse to renew the policy or unilaterally modify any provision. Noncancellable and guaranteed renewable coverage offers the greatest amount of protection to the insured and has the highest premium when compared to identical coverage offered under the other three provisions.

**Non-disabling Injuries Benefit.** Under the provisions of a non-disabling injuries benefit, an insurer will typically pay for the medical treatment prescribed by a physician required within 90 days of and as a result of an accident. Generally the benefit is limited to not more than 50% of the monthly benefit for total disability and is payable in lieu of disability benefits.

**Non-occupational Disability Programs.** Six jurisdictions have compulsory non-occupational disability insurance programs. These non-occupational disability programs provide short-term financial assistance for disabilities occurring off the job. Their maximum benefit periods are limited to 6 months.

**Occupation Classification.** The assigning of each occupation into a class generally indicative of the disability hazard posed by the occupation and the probability of the insured’s returning to it following a period of disability.

**Optionally Renewable.** A contract of health insurance in which an insurer reserves the unrestricted right to terminate coverage at any anniversary or, in some cases, at any premium due date. It may not do so in between. Under an optionally renewable provision, premiums may be increased and benefits modified on a class basis. In addition, the insurance company may cancel an individual policy – but, only on a policy anniversary or on a premium due date.

**Overhead Expense Coverage.** Overhead Expense insurance provides funds to pay for overhead expenses incurred by the insured during a relatively limited period of disability.

**Own Occupation Definition of Disability.** Under a pure own occupation definition of total disability, the insured is considered totally disabled if, as a result of accident or sickness, he or she can’t perform the substantial and material duties of his or her regular occupation – even if employed doing something else.

**Partial Disability.** A condition in which, as a result of injury or sickness, the insured cannot perform all of the duties of his or her occupation but can perform some. Exact definitions vary from policy to policy.

**Partial Disability Benefit.** Partial disability benefits require that the insured be unable to perform one or more of the duties of his or her regular occupation as a result of accident or
sickness, but there is no requirement that the insured suffer any income loss. Partial disability benefits are usually a fixed percentage of the total disability benefit, payable for a limited period.

**Permanent and Total Disability.** Total disability from which the insured does not recover. When used as a definition in a policy (usually a life insurance policy rider), "permanent" is presumed after a stated period of time, commonly six months.

**Permanent Partial Disability.** A condition where the injured party's earning capacity is impaired for life, but he is able to work at reduced efficiency.

**Permanent Total Disability.** A condition where the injured party is not able to work at any gainful employment for the remaining lifetime.

**Pre-existing Condition.** A pre-existing condition is defined as a sickness or physical condition for which medical advice or treatment was recommended by or received from a physician, or symptoms existed which would cause a prudent person to seek diagnosis or treatment in the two-year period preceding the policy’s effective date.

**Presumptive Disability.** A disability involving loss of sight, hearing, speech, or any two limbs, which is presumed to be a permanent and total disability. In such cases, the insurer does not require the insured to submit to periodic medical examinations to prove continuing disability.

**Probationary Period.** A period of time between the effective date of a health insurance policy, and the date coverage begins for all or certain physical conditions.

**Recurrent Disability.** Disability resulting from the same or a related cause as a prior disability. The typical recurrent disability provision provides that a subsequent disability occurring within a specified period – usually 6 months – following a prior disability from the same or related cause is considered a recurrence and a continuation of the earlier disability.

**Renewability.** There are four different renewability provisions that may be contained in disability income insurance policies: noncancellable & guaranteed renewable, guaranteed renewable, conditionally renewable and optionally renewable.

**Residual Disability.** That form of disability which becomes defined as partial disability when an insured has returned to work immediately following a period of total disability.

**Residual Disability Benefits.** Residual disability benefits pay a monthly disability income that is generally equal to the insured’s lost income percentage multiplied by the policy’s benefit for total disability. It is paid in lieu of total disability benefits. A 20% income loss is generally required before any residual disability benefit is paid.

**Residual Income.** A clause used with disability income policies that provides for benefits to be paid when the insured can do some but not all of his or her normal duties. For example, if the insured suffers a disability that causes him or her to lose a third of his or her earning power, the residual disability clause would provide one-third of the benefit that the policy would provide for total disability.
**Return of Premium Rider.** In the typical Return of Premium rider, the policyowner pays a premium in addition to that required for the disability benefit. That additional premium creates a cash value that is payable to the policyowner less the total of any claims previously paid on dates specified in the policy.

**Selection.** The choosing by an underwriter of risks acceptable to an insurer.

**Short-Term Disability Income Policy.** A disability income policy with benefits payable for a "short term," usually less than two years, as opposed to a long-term disability income policy.

**Short-Term Disability Insurance.** A group or individual policy usually written to cover disabilities of 13 or 26 weeks duration, though coverage for as long as two years is not uncommon. Contrast with Long-Term Disability Insurance.

**Short-Term Group Disability Plan.** Short-term group disability coverage is characterized by short elimination periods, that generally range from 0 days to 30 days and limited benefit periods that normally are 13, 26 or 52 weeks in duration.

**Social Insurance Benefit Rider.** Social Insurance Benefit riders pay a monthly disability income benefit only if Social Security does not pay. If and when Social Security disability benefits are payable, some or all of the benefits under these riders cease.

**Substandard Risk.** A risk not measuring up to underwriting standards. It may still be written but usually at a surcharged premium.

**Temporary Partial Disability.** A condition where an injured party's capacity is impaired for a time, but he is able to continue working at reduced efficiency and is expected to fully recover.

**Temporary Total Disability.** A condition where an injured party is unable to work at all while he is recovering from injury, but he is expected to recover.

**Total Disability.** A degree of disability from injury or sickness that prevents the insured from performing the duties of any occupation from remuneration or profit. The definition in any given case depends on the wording in a covering policy. There are three definitions of total disability. These three definitions are known as the "own occupation," "limited own occupation," and "any occupation" definitions of disability.

**Underwriting.** The process of selecting risks and classifying them according to their degrees of insurability so that the appropriate rates may be assigned. The process also includes rejection of those risks that do not qualify.

**Underwriting Profit (or Loss).** (1) The profit or loss realized from insurance operations, as contrasted with that realized from investments. (2) The excess of premiums over losses and expenses (profit) or the excesses of losses over premiums (loss).

**Waiting Period.** The period of time between the beginning of a disability and the start of disability insurance benefits. Also called Elimination period.
Waiver of Premium. Waiver of Premium is a benefit generally available on disability insurance policies. In a waiver of premium provision the insured’s disability for a 90-day period will cause the insurance company to waive all future premiums during the continuation of disability and refund those premiums paid during the 90-day period.

Workers Compensation. Workers compensation provides an array of benefits in the form of cash payments and medical and hospital services. These benefits are provided to works that sustain job-connected injuries or illnesses and are available to every worker.
Chapter Quiz Answer Bank

Chapter One
1) B (Pg 11)
2) A (Pg 12)

Chapter Two
1) A (Pg 14)
2) D (Pg 37)

Chapter Three
1) A (Pg 48)
2) B (Pg 49)

Chapter Four
1) D (Pg 61)
2) A (Pg 68)
3) C (Pg 81)

Chapter Five
1) C (Pg 87)
2) A (Pg 101)

Chapter Six
1) A (Pg 106)
2) B (Pg 107)

Chapter Seven
1) D (Pg 119)
2) B (Pg 121)