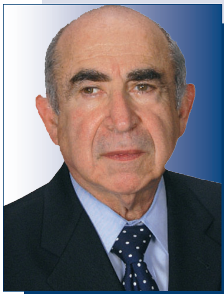
BROKER WORLD

Disability Insurance Insights…



EUGENE COHEN

began his insurance industry career in Cleveland, OH, with a company that specialized in disability income protection.

In 1981 Cohen founded the Eugene Cohen Insurance Agency, Inc., Skokie, IL, which specializes in DI, life, LTCI, fixed annuities, and impaired risk cases. The agency is a member of LifeMark Partners, NAILBA, the IDIS and is a founding member of The Plus Group.

Cohen received the W. Harold Petersen Lifetime Achievement Award from the IDIS and NAILBA's Douglas Mooers Award for Excellence.

MICHAEL COHEN,

CLU is president of the Eugene Cohen Insurance Agency, helping brokers, general agents, broker/dealers and financial advisors serve their clients.

Cohen has served on carrier advisory boards and organization boards of directors. He is a member of the Risk Appraisal Forum.

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Individual Disability Insurance: A Look At The Misunderstanding Of 60 Percent Income Replacement In The Individual Marketplace

You have clients that need individual disability insurance. They are employees, they are professionals, they are self-employed, they are your clients and, most importantly, when sick days become sick months and then sick years they are most likely going to have financial issues. We know this part is true for most of the clients you work with every day, some may be relatives, some will be friends and neighbors as well.

So, you have a client that makes $50,000, another makes $100,000, a third is making $300,000 and another is making $500,000. You tell your client that you can get them 60 percent of their income for individual disability insurance…or so you thought. Let's use these clients to better understand income replacement ratios with individual disability insurance. Of course, we have a really simple way of knowing how much can be issued by just plugging the numbers into the software program the company provides. Easy enough, right? Even with modern technology, we still need to know some basics in order to even use the software.

"Just get me the quote for 60 percent of their income," we sometimes hear. Anyone can run illustrations, but when the company will not issue the policy for the benefit amount that what was applied for it will be harder for a producer to place a policy. First, you need to realize that each company has issue limits that may vary based on a client's income, occupational class, health underwriting rating, and other existing disability insurance coverage. The monthly benefit a company will offer is based on income and there will be maximums the underwriter must calculate and confirm before issue. While it's possible that the benefit amount will be 60 percent, it's usually more by coincidence. Okay, for those more experienced, we know there are some ways on the individual side to get 60 percent plus, but let's put that aside for now and we'll address this later in the article. Let's focus on that attorney or veterinarian making $300,000 per year and needs an individual disability policy. Or perhaps it's a social worker earning $50,000 or $100,000…or maybe the surgeon or periodontist that's making $500,000….etc.

There's going to be a few steps to figure out how much a company may offer in coverage. If you want a rule of thumb, we tend to find that with many of the companies, at $100,000 of annual income you'll see about 60 percent of income being offered. The income replacement charts for incomes less than $100,000 will trend higher than 60 percent. The flip side occurs for incomes over $100,000, as the percentage will trend lower for these higher incomes. In fact, as the income gets higher and higher, the percentage that a company will replace will get lower and lower.

In addition, we need to account for a few other things for the software to figure out the amount that can be offered. We need to know how much individual and group coverage (if any) that the client has as well. When calculating how much a company will allow to be issued, they need to consider how much coverage is already in force. This is because if someone has a qualifying disability, they can end up being overinsured. We call this part of the underwriting the Participation Limits. Essentially, if a client has multiple sources of disability income insurance, regardless of group or individual, we need to know this in order to run the quote properly. The question will be on the application, so better to find out ahead of time. It's not fun to take an application just to find out it's been declined due to having too much disability insurance. Yes, your client can be declined based on the financial underwriting.

Every company has "Issue" and "Participation" limits that need to be followed. We talk a lot about income, but income can mean different things to different people. When ordering an initial quote for individual disability insurance, we need to know the earned income before taxes. For a regular W-2 employee, this can be pretty straightforward, as you can just ask your client for their W-2 income and if they have any other coverage in force. The mistake producers will make is not being clear enough to those that have some or full ownership of their business. This is where a client may provide the gross income, which is usually not what their taxes would be based on. Let's take a closer look at this part, as it's a very common issue that we see weekly.

To make it easy, it is best to find out the client's earned income for the last two years to include W-2 and/or K-1, or their Schedule C income from the business that they are actively engaged in. If your client has substantial bonuses, commissions, and/or passthrough income that have some swings, the underwriter may need to use an average income. Note, the underwriter will be looking for income that is defined as non-passive income as opposed to passive income. Passive income or unearned income is income from investments, royalties, trusts, or other types of income that are generated without your client actively at work. Most companies will ignore a certain amount or percentage of passive income, but this will vary company by company. When a company does include passive income, it's treated similarly as another disability policy is handled and would reduce the amount of coverage a company can offer.

Why does a company spend so much time on the financial underwriting? When someone on claim ends up receiving as much after-tax income as they would have working full time, then, in theory, there may not be a financial incentive for one to want to go back to work. The purpose of the disability policy is not to create a retirement for someone, but to allow someone with a qualifying disability to pay, at a minimum, their fixed monthly expenses.

Okay, real quick. When can someone get 60 percent of their income covered regardless of their income…well…most incomes? There are a few ways that we've seen this occur. The first is by adding a catastrophic disability rider to a traditional individual disability quote. Think of a claim where someone needs a special van…this rider will pay in addition to the base coverage and in doing so, can bring the income replacement close to or even exceeding the 60 percent mark. The caveat is that they usually must have a severe enough disability to need assistance with two out of six ADLs or severe cognitive impairment. Each company may vary in their definition of a catastrophic disability, so be sure to check the policy definition.

The other way an individual may perhaps get more than 60 percent of their income would be in the GSI, guaranteed standard issue market that will usually layer on top of the group DI and possibly the surplus lines/Lloyd syndicate type marketplace.

While that may have seemed like a lot, the good news is that there are MGAs/wholesalers like us and many others that can walk you through the process from beginning to end. When working with experts in the field, you'll get the hang of it in no time at all.