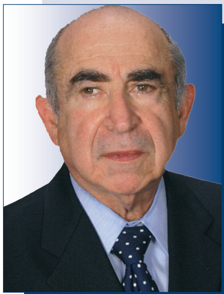
Disability Insurance Insights…



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.

*Eugene and Michael can be reached at Eugene Cohen Insurance Agency, Inc. Telephone: **800-333-4340**. Website: **www.cohenagency.com**. Emails: **michael@cohenagency.net**; **eugene@cohenagency.net**.*

Disability Insurance Issue And Participation Limits

How much coverage to recommend in a low interest rate environment

When it comes to designing a disability policy for a client, it's easy to advise the maximum amount that client can qualify for based on the insurance company's issue and participation limits. There are clients and planners who would like to understand more about the amount of coverage available and some of the planning considerations, especially in a seemingly perpetual low interest rate environment.

Issue and participation tables in the individual disability insurance marketplace: Disability insurance companies will usually give the field guidance as to how much coverage the company is willing to issue a client. These are the issue limits and may be the same or less than the participation limits. The participation limits give the indication of how much total coverage the company will participate in at the time of the application. Let's take a closer look at the differences.

For issue limits, the amount of coverage a company will issue will be based on a few factors that include, but are not limited to, income, occupation, and other disability coverage.

For income, the company will usually look at earned income, which is the earned income before income taxes are paid. For occupations in which the income can fluctuate, such as commission-based sales, the company may take an average of the past two or three years. In addition, if your client has passive income, then depending on the company and the amount of passive income, a formula may be applied that could limit or even eliminate the amount of coverage that can be offered.

For occupation, the client's occupational rate class will usually have a direct correlation with issue limits, with the more risky rate classes having lower limits. In addition, companies may have "select occupations," in that they will issue a greater amount of coverage than the issue limits would normally allow. For example, an attorney or physician in their first year of practice may be allowed to buy a higher amount than they would have been able to qualify for solely based on their income. This may also apply for students of certain professional occupations or certain medical residents.

Other disability coverage: If a client already has disability coverage, then depending on the coverage type, various formulas may be used to determine the maximum amount of additional coverage that a company may be able to offer. The formulas usually require the producer to know if the client pays all or a portion of the cost of the additional coverage. In addition, the company would need to know if the coverage is group disability insurance or an individual disability policy. Also, if someone is a community, state, or federal employee, the companies may have a separate formula that is used to calculate the maximum amount that can be issued due to the benefit packages that come with most of these occupations.

Participation limits may have similar rules and calculations to the issue limits that were described above. The key with participation limits is to know that, with some companies, these limits may be higher than the issue limits. This would allow a planner to use multiple companies until the participation limits are fulfilled.

"I've never had a client on claim who thought they bought too much disability insurance!"

For example, take a physician who has no coverage and has an income that would allow him to obtain $30,000 per month of individual disability coverage. Due to the occupational rate class, let's say there are two desired companies that have an issue limit of $20,000 per month of coverage, but will participate up to $30,000 of coverage. The planner could then take two applications, one application for the $20,000 per month with the first company and a second application for $10,000 per month of coverage with the other. This would allow the physician to obtain the $30,000 per month of coverage desired even though both companies have an issue limit of $20,000 per month of coverage.

Note, there are surplus lines carriers that may allow for higher issue and participation limits, but the coverage tends to have benefit period limitations as well as other limitations.

How much coverage to recommend? There's a saying among producers who specialize in disability insurance: "I've never had a client on claim who thought they bought too much disability insurance!" Usually the opposite is true, where a client on claim wishes they bought more coverage, not less. As discussed in previous articles, during a disability claim expenses actually tend to increase while income decreases. Yet, there are clients who may qualify to buy more coverage but decide to take less coverage in order to save on premium. While this may be valid for clients who have high expenses and limited income, for others it may be purely a way to save premium dollars. This is where clients need to understand some trends that we have seen in the marketplace.

Interest rates have been very low for the past few years and no one knows when or if they will increase to any substantial level. The key is the *substantial level*, as clients who have enough investable assets may feel that the assets can be shifted into fixed income type of investments that can produce income while they are disabled. Given that the duration of the disability may be unknown, planners may recommend conservative investments to preserve the principal. In doing so, the low interest rate environment comes into play as the amount of passive income generated from conservative investments tends to have a direct correlation. In general, the more conservative the investments, the lower the interest rates. For example, at one percent interest, it would take $500,000 to earn a taxable $5,000 per year of income while a client could buy an extra $1,000 per month of disability coverage, which would be $12,000 per year, for usually a minimal amount of additional premium. To us, the answer is obvious in how much coverage should usually be considered.