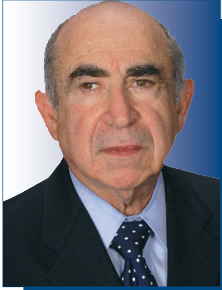
BROKER WORLD

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.

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****.*

Going Deep Into Residual And Partial Disability Provisions

When structuring and choosing an individual disability insurance policy and the available riders, understanding the importance of partial disability is essential. While on the surface it would seem self-explanatory, the intricacies can make the difference in your explanation of the plan to a client.

As you know, our industry tends to use language that is somewhat unique to the insurance world and individual disability insurance is not any different. When we think of someone working part time, many of us would think that the rider to describe this would be called a partial disability, which could be a separate rider or built into the policy. Like many industries there is an evolution of product design and riders—which helps to explain the reason for the naming of the partial and its successor, the residual disability rider, which, again, can be a separate rider or built into the policy.

In the evolution of today's individual disability policies we've seen product ingenuity which has either resonated within the industry or has gone by the wayside. Originally when individual disability policies were developed they were designed to cover total disabilities, and if you could work you were expected to go back to work and be off claim.

Eventually companies added a partial disability provision that would allow for someone to go back to work on a part time basis and still receive a benefit from a qualifying disability claim. This provision was

appropriately named "partial disability." This provision may or may not be found in today's modern policies. The classic version of partial disability, in general, would only pay for partial disability for six months, or for some other limited time period, and it would pay 50 percent of the total disability benefit. Of course there were maybe some slight variations, but this is what we saw as most common. This was much easier for companies to administer in the low technology days when it was more common to use calculators and not computers.

The insurance industry is very dynamic and companies needed to differentiate themselves. Thus, an improved partial disability started to evolve in the marketplace. They had to change the name so there was a distinction between the old and new definitions. The new, modern definition of partial disability became known as a residual disability, which is essentially a partial disability on steroids. Instead of just paying 50 percent of the base benefit for six months, or some limited time, a formula was now able to be administered and used to pay claims.

The formula is really quite inventive and the industry should thank the mystery innovator(s) who most likely spent months or years with the actuary, claims, underwriting, and marketing departments. You could just imagine the reactions when this new type of partial rider was being presented by the innovator(s).

The formula takes an average yearly income for a disabled client and comes up with an average historical monthly base income. Once we have that historical monthly base income, we can see how much income the client makes when they go back to partially working and come up with a percentage of income loss. For example, if a client made $240,000 per year for the past few years, the average monthly income would be $20,000 per month. If the disabled client went back to work part time and made $5,000 per month, then $5,000/$20,000 would be 25 percent of the previous monthly income, which is a 75 percent loss of income, which would allow for 75 percent of the monthly total disability benefit to be paid. As the client goes back to work for longer amounts of time, their income can grow, and the residual rider would adjust accordingly. So, if now the client's income is $15,000 per month, $15,000/$20,000 would be 75 percent of the previous monthly income or a 25 percent loss of income, in which case 25 percent of the monthly benefit would then be paid out for a qualifying claim.

"The residual disability provision of individual policies has evolved even more in the past few decades."

There was a time in our country's economic history in which inflation was more prevalent and had a real impact on the planning process. While inflation could still be a major factor in our daily lives, the rates have been very low for the last couple of decades. If we do have a period where inflation becomes a major factor, then the indexing part of the residual rider will be a provision that claimants may come to appreciate during a long duration disability claim with stable or decreasing partial income.

The theory in the indexing provision of the residual rider is that if someone has a very prolonged partial disability then inflation would erode the residual formula. Think about our example above, where a client was making an average of $20,000 per month and then became disabled. Let's say the disability will never allow this person to work full time, but they can work on a part time basis making about $10,000 per month for the foreseeable future. Using the regular formula, $10,000/$20,000 would be a 50 percent income loss and then 50 percent of benefit would be paid.

The $20,000 base monthly benefit is in today's dollars, but let's say that the disability will last for the next 20 years! Eventually the base monthly average income of $20,000 will be in old, uninflated dollars, which would make the payment always 50 percent of the total disability benefit. You would have 2020 dollars used in the base of the residual formula and, in 10 years, you would have 2030 dollars used as the divisible dollars.

For the formula to be equitable for both the client and the company, the same dollars should be used in the formula. Therefore, most residual riders will have a provision that will index the base monthly average by using an inflation formula so that the dollars are inflation adjusted. This is the reason you'll see an inflation indexing provision in the residual definitions of modern individual disability policies.

In our example, eventually the payment would be greater than 50 percent as the monthly average income increases based on the inflation factor being used. For example, in 10 years the base $20,000 could inflate to $24,000, in which case the $10,000/$24,000, would be 41.6 percent of the inflation adjusted base monthly income, which would result in a 58.4 percent income loss and a payout of 58.4 percent of the total monthly disability benefit.

The residual disability provision of individual policies has evolved even more in the past few decades. Some examples of this evolution include, but are not limited to, changes in the percentage of income loss needed to be on claim or stay on claim, minimum payout floors, allowing or extending residual payments even if there is not a loss of time from work or duties from work.

Companies are consistently tweaking and modifying the provisions of this rider as new policy versions are developed. As always, please read the specimen contract of any disability policy you are reviewing or presenting for details about how that individual policy is designed to payout for partial and/or residual disabilities.

Reprinted from BROKER WORLD October 2020
Used with permission from Insurance Publications

www.brokerworldmag.com
Subscriptions $6/yr. 1-800-762-3387