



DI PRIMER

What Agents Need to Know About Disability Insurance

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DI Primer

What Agents Need to Know About Disability Insurance

Disability Income insurance provides coverage that pays a benefit to an individual who due to a medical condition resulting from an injury or illness that causes the individual to lose earned income from their occupation, profession, or business.

In essence disability insurance (DI) is intended to replace income lost due to an injury or illness that prevents a client from being able to earn a living. An individual's need for DI depends much on the effect the lost income due to a disabling condition affects their business or personal financial needs or lifestyle.

ELIGIBILITY AND CRITERIA

While eligibility for disability coverage may appear to be like life insurance in that medical and financial underwriting factors are reviewed, there are a few more considerations that impact an applicant's eligibility for including the amount and type of disability coverage that might be available to them. They include:

- **Earned Income and Financial Wherewithal** – Generally income earned by an individual from wages or qualified self-employment, or business income profit or work services rendered are key considerations to qualify for Individual disability income coverage. “Unearned income” from passive activities such as investments and real estate are not eligible to be counted. Although in very rare cases when such income is totally dependent on the personal work of an applicant and would cease if the applicant became disabled, it can be considered by a few insurers. Other financial factors such as financial wherewithal and net worth may also be considered. With this in mind, the applicant may be asked to provide income documentation such as pay or income records to verify their income.
- **Occupation** – Unlike life insurance and other individual insurance coverages eligibility for disability income coverage is very much dependent on the type of occupation an applicant engages in. More will be discussed later, but generally the less manual or physical duties are involved, the broader the coverage can be.

DISABILITY DEFINITIONS

How is a disability defined? Aside from medical definitions of disability, insurers providing disability coverage have their own definitions. Such definitions primarily apply to what they consider total disability, although there are adaptations to the term “total” touched on later.

While there are a few different situational definitions and variations for different types of disability coverages for individual and group DI insurance, this writing will focus those most often used for individual disability coverage, which include:

Regular Occupation – Usually defined as being unable to perform the Substantial and Material Duties of your regular current occupation in your usual and customary way and you do not or choose not to work

at another occupation. Regular Occupation is generally considered as the occupation at the time the disability occurs, which may not be the same as when the coverage was applied for

Own Occupation – Sometimes called “Own Occ. can be built into the policy or added as a rider to a policy with a Regular Occupation definition. Own occ is usually defined as being unable to perform the Substantial and Material Duties of your regular or current specified occupation but you have the option of working at another occupation. Thus, you are insured for the occupation you are currently in. This is often preferred by those in specialty medical, dental or other professions such as law. Depending on individual insurer definition details, the insured may be allowed to work and earn any amount of income in another occupation while being considered collecting income from their original “regular” or “own” occupation policy.

There are other “own occ” variations such as Transitional Own Occupation which also pays the benefit if you are unable to perform the main duties of your own occupation but to receive full benefits your income from other work it cannot exceed 100% of indexed pre-disability earnings.

While own occupation definitions can allow for a benefit to be paid for the entire length of a benefit period, described later, some offer an own occ definition for the initial period of years, i.e. two or five years and then regular occ for the later years, this then requiring the insured to determine whether to continue working at the alternative occupation or stop working.

Regular and Own Occupation definitions can vary amongst insurers, so to be sure check definitions for individual insurers.

Other Definitions – The above definitions are those most common in today’s individual disability income marketplace. However, there are and have been other definitions you may come across in older policies, some group or association plans or those converted from group DI plans or for higher occupational risks.

- **Any or Alternative Occupation** – The “Regular” or “Own Occ” definition is broadened to consider the insured may be considered to be disabled only if they cannot engage in another occupation commensurate with their prior education, training and experience
- **Any Occupation** – While rarer in limited occupation a definition may state that the insured cannot engage in any occupation for remuneration or profit. This is of course a most limiting definition but may be all that is available for certain individuals with difficult occupations or other medical conditions.

OCCUPATION CLASSES AND DUTIES

The premium rates and the type of benefits an insurer will offer an applicant will be based on what their occupation is and the duties they perform. Generally, the less physically active occupations will provide broader benefits and be premium rated more favorably than those requiring manual labor or physical activity. The terms white collar and blue collar are frequently used to categorize occupations. In most cases more favorable benefits can be available to white collar occupations versus those considered blue collar, but the most important factor will be the applicant’s duties.

Some occupations are easily definable by their title, and some may not be. While titles such as schoolteacher, dentist, bookkeeper, tax preparer, ditch digger may connote obvious duties or functions,

for disability income the actual duties are the most important factor. Some titles such as executive, or president or manager may seem to connote white collar work, but an owner or executive for a mining or drilling company or a farmer who works in the field has different duties than one always in an office at a desk. We could provide quite a number of examples, but in factfinding with potential disability income clients keep in mind that determining duties along with a title may be the most important fact-finding information gathered to make a proper recommendation to a client.

Also, there are those “in office” white collar or blue-collar individuals who have second occupations or avocations that can affect what occupation they are in. For example, where an in-office executive or manager or administrator works on construction or auto repair in evenings or weekends an insurer may consider the more dangerous of their occupational activities when it comes to determining their rating class.

Similarly, avocational activity may affect the occupational class used for executives, physician or professionals who also trains horses, rodeos, races cars, rides hang gliders or participates in any number of relatively less safe recreational activities may be evaluated on the most hazardous activity.

Specialty Professional Classes – Some general occupational titles or classes such as physicians can also have their further definable “specialty” occupational classes evaluated for what is often called specialty coverage.

Also, some occupations considered hazardous are not eligible for individual disability coverage, although some may be eligible for specialty or excess risk coverages which is beyond the scope of this writing, but Cenco can help in such situations.

BENEFIT AMOUNT

Most often stated as a monthly income payment amount the client will receive when considered totally disabled by the insurer.

Benefit amounts are most often stated per \$100 per month of benefits often with a minimum such as \$500 per month and a maximum for some professional and executive occupations as high as up to \$20,000 per month.

The benefit is determined at the time a policy is applied for and issued. The amount chosen is based on a few factors:

1. How much the client desires in the event they are disabled
2. How much an insurer is willing to issue based on the client’s current earned income. Most often insurers will limit the benefit amount to no more than about 60%+* of the client’s documented earned income from wages or net profit from proprietorship, partnership or other approved business activities. Investment or most passive income is not counted, although some passive income where the passive income is solely dependent on the client’s work efforts can be considered, although rarely.

* Such a limit usually applies to any disability income benefits an individual may have whether it be other individual or group coverage. For clients desiring to maximize their DI coverage, obtaining individual coverage before group coverage is recommended, since having group coverage will limit or can eliminate their ability to obtain individual coverage which generally can offer broader benefits including definition choices.

ELIMINATION OR WAITING PERIOD

Is the period of time between the date the onset of the disability has been determined and the date from which the benefit amount will be paid. An elimination period functions much like a deductible and has been called a deductible period. The most common elimination periods are 30, 60, 90, 120 and 180 days, but there are occasionally both shorter and longer periods available. Generally, the longer the elimination period the less the premiums will be.

BENEFIT PERIOD

The benefit period is the length of time that the monthly disability income benefit will be paid. Usually stated in years, the most common choices may be for 2, 5 and 10 years or to a specified age such as age 65 or 67 or 70. Some statistics indicate that the average for disability claim is five years, but what it decided on is up to individual needs and what is available from an insurer. Generally, the longer the benefit period the larger the premium will be.

PREMIUM CONSIDERATIONS

Frequency – As with life insurance policies and other insurance coverages premiums can be paid annually, semi-annually quarterly or monthly and in a few rare cases may be paid in lump sums or shortened periods.

Fixed or Graded – Occasionally an insurer will offer a Graded Premium option for the insured to pay less in early years and more in later years. This is sometimes appropriate for professionals starting a practice where their income is low at the start but will most likely increase later.

Guaranteed Renewable (GR) – Guaranteed renewable means that the insurer cannot ever change or cancel a policy as long as the insured continues to pay the premiums as required by the policy provisions. However, the insurer has the option to change premiums in later years, although only for all insureds with the same type of policy with that insurer, and not on an individual insured or policy basis.

Non-cancelable (Non-Can) – Non-cancellable may be a misnomer, it does not only refer to the policy being not cancellable, but it is also a premium rate guarantee where the insurer cannot increase the premium rate on policies during the stated non-cancellable period which may be for part of or usually the entire length of the policy period that the insured retains the policy.

Multi-Life Discounts – Besides discounts for multiple insureds with a common employer and common billing, some insurers offer discounts for individuals who are employed with a firm where more than one or a few disability policies that are individually written and individually paid for by the insureds may be eligible for a discount simply by being with a common employer, whether in the same location or not. Surprisingly such discounts, which many may be unaware of, are becoming more readily available for individuals simply desiring their own coverage. Due to differences amongst insurers, the best option is to check with individual insurers to see who has such offers available. Or check with Cenco who retains updated lists of such employers.

Guaranteed or Simplified Issue – Some insurers offer individual disability income policies to commonly employed defined groups of individuals in professional or executive occupations. Check with individual insurers or Cenco for the availability of such plans.

Large Case Premium Discounts – Discounts of as much as 25% or more may be offered where multiple policies are obtained and the combined total premiums are large enough (i.e. \$50,000) annually. Check with insurers or Cenco for more information.

RIDERS AND OTHER BENEFITS

Depending on the insurer, additional benefits to enhance the value of the policy may be offered on policies as riders, although some products include such benefits in the product. Examples of the types of other benefits that may be available whether via rider or within the policy can include:

Non-Cancellable – As mentioned above some insurers offer a non-cancellable rider if such a benefit is not included in the base policy.

Residual Benefit – A residual benefit allows the insured to collect an income benefit while partially disabled but is still working in proportionate to the loss of income. For example, a 50% loss of income could result in receiving 50% of the benefit. A representative residual definition would include “Due to injury or sickness the insured is unable to perform one or more of the substantial or material duties of their occupation, is working and is suffering a loss of income of _____ %” typically from 15% to 25% depending on insurer. Some insurers will consider an insured totally disabled if their loss of income exceeds 75% or 80%.

Partial Disability – An insured may be eligible for a partial disability payment if after a period of total disability that has lasted for a time such as 180 days and the insured is able to do one or more of their main occupational duties for often less than 50% of the time normally required.

Non-Disabling Injury – If an insured experiences an injury that does not result in their being disabled or receiving a disability income benefit, some insurers offer a benefit that will provide a payment to cover the cost of treatment for the injury up to either a set amount or a percentage of the base policy’s monthly benefit.

Catastrophic Illness – Such a rider would pay an additional monthly benefit in the event of a catastrophic disability. For most insurers the policy language resembles long term care policy Activities of Daily Living (ADL’s) policy provisions. Check with each insurer to see what may be available.

Cost of Living Adjustment (COLA) – This type of rider on an individual policy annually adjusts the benefit amount while the insured is on disability claim and is intended to help offset inflation. Increases are often tied to a consumer price index (i.e. CPI-U) with a cap that can be from 3% to 6% and depending on insurer can be calculated using simple or compound interest. Such riders often are appropriate for younger insureds and can be among the higher premium cost riders.

Guaranteed Purchase (GPO), Guaranteed Increase (GIO), and Future Increase (FIO) Options – Allows the insured to increase their monthly benefit on specified policy anniversaries without evidence of medical insurability, although income underwriting will still apply. Such riders are often available at no or little cost and provide a sure way for an insured to increase their benefit if needed in the future.

Automatic Increase Option (AIO) – Increases the monthly benefit by a set amount or percentage such as 5% on a policy anniversary for a set number of years the policy is in force, i.e. the first 5 years. Typically

the increase will be automatic and there will be premium increase although in most cases the insured can decline implementing the increase and also avoid the premium increase.

Social Security Offset (SSO) – Although more recently less available from insurers, this rider provides an income benefit above the normal base policy benefit, but the payments are integrated or offset and reduced if the insured also receives Federal and/or State government income benefits such as social security, some workers comp and other benefits. Consult insurer literature for applicability. The base policy benefit still pays irrespective of other benefits received such as workman’s compensation. The benefit amount that is offset, however, is reduced when such benefits are received. The maximum benefit that can be offset varies by carrier, ranging from about \$1,200 a month to \$2,000. The premiums per \$100 of monthly benefit will be lower than those for the base benefit, but it allows the insured the possibility of having a higher paying benefit when disabled.

Note: When considering the value of a social offset rider, knowing the Social Security definition of disability when compared to individual policy definitions may be helpful. For Social Security, the law defines disability as the inability to do any substantial gainful activity (SGA) because of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months.

For other such possible offsets such as SDI, workers comp or PIA, consult individual insurer literature.

OTHER DISABILITY INCOME PRODUCTS

Besides what are considered individual disability income plans which insure the earned income of an individual, there are other coverages that insure an individual’s business related expenses that may be incurred and unpaid due to the disability of an individual or individuals who own a business whether as a sole proprietor partnership or otherwise. Some examples include:

Retirement Savings Disability – This is a type of individual DI that is obtained to help fund an individual’s retirement plan contributions to a qualified retirement plan such as a 401K, when the individual can no longer afford funding it themselves due to a qualifying disability. This policy replaces savings for retirement in the event of a disability. High benefit amounts can be available and certain administrative procedures will apply that can be learned by consulting materials available from insurers who offer such coverage.

Overhead Expense (OE, DOE or BOE) – An overhead expense policy, can be obtained in addition to an individual policy by one or more owners of small businesses (i.e. up to ten+ employees). Waiting periods are similar to individual policies and benefit periods are typically shorter such as one or two years and are intended to pay overhead expenses such as rent, non-owner salaries, utilities, property taxes, licenses etc. while the primary insured is disabled.

Key Person and Key Person replacement – A Key person disability policy can be obtained by a business insuring a key person whose disability would negatively impact the business’s success, revenue, or profit for a time period. A policy is owned by, and the benefit is paid to the business while the key person is disabled. In some cases, the benefits can be used to find and train a replacement, when the benefits can be used at the discretion of the employer.

Buy–Sell or Buyout – A buy–sell policy can be obtained bought by two or more small business owners for the purpose funding a buy–out of the disabled owner’s ownership interest in the event they cannot continue their ownership duties for the business. The principal is similar to the reasons and structure of buy–sell life insurance. Depending on the business situation, such coverage can be obtained in addition to individual disability insurance and even BOE coverage. The waiting or elimination periods are typically longer such as one year or more and can be paid as a lump sum rather than a monthly benefit.

Specialty or Hazardous Occupations – A few insurers offer special disability or disabling injury plans for entertainers, professional or college athletes and other non–traditional occupational or activity classes, including boxers and professional football and basketball and other sports players. Cenco can assist if you have such a client.

See Cenco’s *DI Dictionary* for more descriptions of definitions and disability income terminology

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