Disability Insurance

Over the years I have found that the most misunderstood type of personal insurance is disability coverage.

The odd part of disability insurance is that it is the only type of insurance that actually pays you! Think about all other kinds of insurance and who they pay. It's always someone else. Life insurance pays your beneficiaries, medical insurance pays your doctors and the hospital, and long-term care insurance pays the care givers and the facility. Only disability insurance pays the insured directly.

One of the often-overlooked effects of America's ever increasing life expectancy is that all the major killers of the last generation are now the major disablers of this generation. Although medicine has not eliminated the vast majority of diseases and afflictions, it has gotten much better at treating them so people can continue to live. The result is that many, many more people now live with the conditions that once killed them. But this longevity comes at an economic price.

Living a long time is wonderful if you have assets and income. Living a long time without assets or income can be a nightmare. What provisions have you made for personal protection? Specifically, what is your plan to protect your family during a period of income loss due to permanent illness or injury?

This may not be the kind of question that gets your attention, especially if you are the sort of person who doesn't like to contemplate bad things happening to good people. If so, think of it this way: if you had a goose that laid golden eggs, would you insure the eggs or the goose? I hope you said the goose. Because in this case, you (or your spouse, or both of you) are the goose. You are a money machine, and disability insurance is the service contract on you.

To put it bluntly, how will your income be replaced if you could not work in the event of injury or illness?

Isn't it true that there would be little – or at least a lot less – money available for mortgages, car payment, investments, vacations, etc? Your income will be dropping just at a time when your expenses are increasing. Your assets will be draining and it is very unlikely that someone will want to let you borrow money, especially if your future earning capacity is severely constrained.

I know what you are thinking. My family can gut it out. My husband or wife will pick up the slack. But honestly, can your spouse be a full-time employee, spouse, parent, and nurse? Is this a chance you really want to take?

To answer this question as rationally as we tried to answer the life insurance question, we return to the fundamental issue: how much coverage do you need? Specifically, how long do you want to drain your resources before an insurance company steps in and begins to pay you? For some people, the answer may be "never." If so, fine. You do not need disability insurance. But I suspect the older you are, the more income you make, and the more quickly you would like to get to retirement, the more likely you are to see the wisdom in a well-crafted disability insurance program.

FAQs - Starting a New Career & Early to Mid Career

Disability Insurance

Integrating disability coverage into your plans reduces the risk that a temporary or permanent loss of income due to illness or injury will derail your financial plan.

Is it worth taking 1-2% of your income to pay for the right kind of disability insurance to assure that your family won't have to pay the devastating price if you become disabled? Does that make sense? I hope it does because the cost of having coverage is far less than the cost of not having an income.

How much will it cost? Like life insurance, the cost of disability insurance depends a great deal on age and health. The older you are, the more likely you are to be disabled. Likewise, the healthier you are, the less likely a company will have to pay a claim on you. But there are also several other important factors. For example, your occupation has a significant affect on your rate. A psychiatrist or a CPA is less likely to be injured on the job than a bridge painter or a construction worker.

Disability insurance has many unique benefit features. Some plans pay for five years while others pay through age 65. Some policies will pay you if you lose some, but not all, of your income due to illness or injury, while other plans pay only if you lose all your income. Again, the risk an insurance company will have to pay affects the cost. A "residual" or partial benefit feature is more costly than a policy which has only an all-or-nothing definition of disability. Likewise, a policy that pays you if you are unable to go back to your specific occupation is more expensive than coverage that pays only if you are unable to do any kind of productive work.

Because insurance companies do not want to eliminate the incentive for folks to work, they will not insure 100% of your income. The more typical figure is about 70%. As a general rule, the cost to cover 70% of one's gross income to age 65 is somewhere between 1% and 3% of the pay. If you make $100,000 per year and you wish to fully insure that income, the cost will be about $700 to $2,100 annually, as this represents 1% to 3% of the $70,000 maximum most carriers are willing to cover.