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White Paper

Comparing Individual Disability Income Insurance Policies

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Comparing Individual Disability Income Insurance Policies

What is it?

One great thing about individual disability insurance is that it's a very flexible product, allowing you to design and buy a policy to fit your needs and your budget. However, you'll have to do your homework. Although relatively few companies sell disability insurance policies, there are many types of policies available that come with an array of features and options. Comparing policies and benefits is crucial if you want to buy a good policy at an affordable price.

How to do it

Contact a financial advisor or insurance professional

Although you may be able to research disability policies independently, the easiest way to find out what's out there is to contact a financial advisor or insurance professional. Not only can he or she give you general advice regarding disability insurance, but he or she likely has access to a computer database and can give you information on specific products that might suit your needs.

Analyze your disability income insurance needs

When you sit down with your financial advisor or insurance professional, he or she will help you evaluate your disability income insurance needs. Your aim when purchasing disability income insurance is to replace the income you will lose when you suffer a disability. However, you probably won't be able to replace 100 percent of your income; typical disability policies replace only 50 to 70 percent of your earned pretax income. For further information on this topic and a worksheet you can use to determine how much income you will need to replace if you become disabled, see [Determining the Need for Disability Income Insurance: How Much Is Enough?](#).

Decide what kind of disability policy you'd like to buy

Before you can fairly compare policies, you have to determine what features and coverage you want. Would you prefer to buy a policy that will pay you benefits only if you are completely disabled and can't perform any of the duties of your own occupation, or do you want to buy a policy that will pay you benefits if you can go back to work part-time? Do you need short-term disability coverage or long-term coverage? These are only some of the many factors you should consider before you begin comparing disability insurance policies. Sit down with a professional who can review policy features with you. Also, read [Private Disability Income Insurance](#) for an explanation of what's included in a typical individual disability insurance contract.

Example(s): After researching disability income insurance, Pat decided to buy a policy that paid her a residual disability benefit for up to five years. She wanted the benefits to start as soon as possible after she was disabled, so she opted for a 60-day elimination period. She also wanted her benefits to increase with inflation, so she purchased a cost-of-living rider as well.

Obtain literature and samples of two or more similar policies

Once you have narrowed down the type of disability coverage you'd like to buy, compare two or more policies that have similar features. You don't have to do an exhaustive study of every disability product on the market, but you should evaluate more than one to see how coverage and cost compare. You can obtain literature directly from the insurance company or through your financial advisor or insurance agent. You can usually obtain both a brochure that describes a product as well as a sample (specimen) policy. Read any insurance literature you receive carefully, and ask questions if any provisions seem unclear so that you fully understand the coverage you are considering.

Analyze and compare four key points

You should analyze and compare the disability policies according to four key points: (1) how each policy defines disability, (2) the base and optional features each policy offers, (3) the cost of each policy, and (4) the insurer's financial strength and claims practices.

Buy the policy that best suits your needs and your budget

After you've compared disability insurance policies, you're ready to make a decision. In many cases, one policy will obviously be far superior to another, and your decision will be easy. In other cases, though, you'll have to spend some time weighing the strengths and tradeoffs of each policy before you can decide which policy is right for you. Of course, price will be a big consideration, but be careful not to buy a policy that's seriously lacking because it's cheaper. Quality of coverage is as important as price, something you'll find out if you ever need to file a disability claim.

Tip: Although you should make the final decision, give your financial advisor or insurance agent the chance to offer input. A professional can often help you see the hidden weaknesses of a policy that you think is adequate. However, don't let yourself be pressured into buying any policy that you can't really afford or don't really want.

Example(s): Lucinda compared two disability policies, one from FGH Insurance and one from LMN Insurance. On the advice of her insurance agent, she decided to buy FGH's policy even though it cost \$200 more per year than a similar policy from LMN. Her insurance agent had pointed out that not only did FGH's policy include partial disability benefits (LMN's policy did not), but FGH Insurance had also received a better rating from A. M. Best than had LMN Insurance. A few months later, Lucinda was glad she had chosen the better-quality policy when she suffered a heart attack but was able to work part-time. FGH paid her partial disability benefits, whereas LMN would not have.

How does each policy define disability?

One of the most overlooked--yet most important--aspects of disability insurance is how the policy defines disability. Some policies define disability according to how an illness or injury affects an individual's ability to do his or her own job or any other job, while others define disability according to how an illness or injury affects an individual's ability to earn income. For a comprehensive discussion of this topic, see [How Disability Income Insurance Policies Define Disability](#).

Total disability

Although the specific language may vary, each policy will define total disability either as the inability to perform the material and substantial duties of your own occupation (own occupation coverage) or the inability to perform the duties of any occupation for which you are reasonably suited by education, training, or experience (any occupation coverage). Some policies offer a split definition, providing own occupation coverage for short-term disabilities, then providing coverage only if you can't perform the duties of any occupation.

Tip: Choose a policy that provides own occupation coverage whenever possible. This is a much more liberal definition of disability than that of any occupation coverage.

Example(s): Cleo became seriously ill after she fell into the Nile and contracted malaria. Because she couldn't fulfill her royal duties, she began receiving disability insurance benefits based on an own occupation definition of disability. Had she owned a disability policy that paid her benefits based on an any occupation definition of disability, however, she would have received benefits only if she couldn't be queen or do anything else, such as make papyrus in the royal mill.

Residual and partial disability

If a disability policy offers total disability coverage, it often offers you the chance to purchase residual or partial coverage as well. Residual and partial coverage are similar concepts, but they are applied differently. Both pay benefits in the event that you can go back to work part-time after suffering a disability. Residual disability, however, considers what percentage of earnings you've lost due to disability, whereas partial disability pays you benefits equal (usually) to 50 percent of the disability benefit you were receiving before you returned to work. In addition, residual disability benefits are payable up to the maximum benefit period stated in the contract; partial disability benefits are usually payable for only 3 to 6 months (occasionally 12 months).

Here is an example of residual disability benefit:

Example(s): Craig suffered from anxiety attacks and was unable to work as a full-time stockbroker. However, he was able to go back to work part-time. Under the terms of his residual disability contract, he was able to receive partial disability benefits because he was earning only 40 percent of his average earnings in the 12-month period that immediately preceded his disability. Before Craig was disabled, he was earning \$5,000 per month. After he returned to

work part-time, he earned \$2,000 per month. His residual benefit was calculated by multiplying the amount his total monthly disability benefit might be receiving (\$3,000) by the percentage of income he was losing by not working full-time (60 percent). Thus, his residual monthly disability benefit was calculated to be \$1,800.

Here is an example of partial disability benefit:

Example(s): Craig suffered from anxiety attacks and received a \$3,000 a month disability benefit for 24 months until he was able to return to work part-time. Under the terms of his partial disability rider, Craig continued to receive a benefit of \$1,500 per month (50 percent of the disability benefit he received prior to returning to work part-time) for an additional 6 months.

Tip: A partial disability or residual disability provision is important because it will allow you to ease back into the workforce after suffering a disability. Some policies offer residual or partial disability benefits as part of the base coverage, while others offer one or both types of coverage as a rider you can purchase. Carefully review the terms of each policy.

Presumptive disability

Most insurers consider you to be totally disabled when you suffer a catastrophic illness or injury that results in the loss of sight in both eyes, the use of both hands or both feet, the loss of the ability to speak, or a total loss of hearing. When you compare policies, check to see if each one contains a presumptive disability provision.

Tip: Although a presumptive disability provision is common and useful, you shouldn't be overly concerned if a policy omits this provision.

Recurrent disability

Many policies define how disability benefits will be paid if your disability recurs after a previous period of disability ends. If your total or residual disability recurs within several months from the date the previous disability ended, this second period of disability will be considered a continuation of the previous period of disability. The advantage is that you can begin receiving benefits immediately. The disadvantage is that you may quickly reach the end of your benefit period.

Example(s): Arthur dislocated his shoulder and applied for disability insurance benefits. After satisfying the 90-day elimination period, he began receiving disability benefit checks and received them for 14 months until he was able to go back to work. Then, 6 months later, he hurt his shoulder again and had to have surgery to repair it. Since his disability recurred within 6 months of the end of his previous period of disability, he began receiving benefits right away. However, since the second disability was seen as a continuation of the first, he was entitled to receive benefits for only 10 more months, up to the limits of his two-year benefit period.

Tip: Look for a policy that has a relatively long recurrent disability period, no shorter than 12 months. However, a few states limit the recurrent disability period to 6 months.

Compare coverage: what's included in the base policy?

Policy basics

All disability contracts share some common coverage provisions. These provisions are found in the base policy, usually on the first page (the face of the policy or policy schedule). These provisions form the backbone of the disability policy, and you should carefully consider how the terms of these provisions differ from policy to policy.

Type of contract: renewability

The type of contract section will state whether the policy is noncancelable or guaranteed renewable. This is vital information. Noncancelable means that the policy can't be canceled and the premium can't be raised for the life of the policy as long as you continue to pay your premiums. Guaranteed renewable means that the policy can't be canceled as long as you pay your premiums, but the premium can be raised under certain circumstances (with permission of the state and for a whole class of insured individuals).

Tip: A noncancelable contract is preferable to a guaranteed renewable contract. However, because insurance companies are experiencing losses from noncancelable policies, they are becoming rarer, and most policies issued are guaranteed renewable. Noncancelable policies are often offered only to low-risk occupational groups at high premiums. If you're offered only a guaranteed renewable policy, don't despair. It's not easy for the insurance company to raise your premium, and you may see your premium raised only every few years.

Elimination period

An automobile insurance policy passes on some of the cost of a claim to you by requiring that you pay a deductible. Similarly, a disability insurance policy passes on some costs to you by requiring you to wait a certain period of time after you become disabled before you can begin receiving benefits. This time period is known as the elimination period (waiting period). Some policies even offer two elimination periods--a shorter one for accidents, a longer one for sickness. When you buy a disability policy, you choose the elimination period that best suits your needs. You have to balance two variables: how long you could afford to support yourself after a disability and how much you can afford to pay for disability insurance.

Tip: You can choose a period as short as 30 days or as long as 720 days, depending on the policy. However, the shorter the elimination period, the higher the premium. Many people compromise and choose a moderate elimination period of 90 days because it's usually the most economical choice.

Benefit period

When you buy disability insurance, you choose how long you want to receive benefits in the event you become disabled. You can usually choose to receive benefits for periods of one year, two years, five years, or up to age 65. Some policies even offer lifetime benefits, particularly if your disability was caused by an accident. A few policies offer lifetime benefits for sickness as well, but they are usually very expensive and may cover only low-risk occupations.

Tip: People often buy what they can afford; the longer the benefit period, the higher the premium. If you can afford to buy coverage that lasts at least until age 65, this is the best option because you'll be guaranteed coverage for disability even if your health changes. However, if this is too expensive, buy the longest term coverage you can afford. Don't panic if you can only afford a short benefit period (two years or less). Even short-term coverage may be enough, because many disabilities end within two years, although the average period of disability is about four years. In addition, because the benefit period offered to you is based on your occupation, you may only be able to buy two-year or five-year coverage. In this case, the best option would be to opt for the longest benefit period you can.

Monthly benefit

The maximum amount of disability insurance you can purchase will be determined by the insurance company based on certain underwriting factors such as your income, sex, health, age, and other disability benefits to which you may be entitled. Each company may have a stated maximum, as well as a maximum percentage of your income that it will replace. Most companies aim to replace 50 to 70 percent of your earned income. However, as long as you don't exceed the maximum allowable monthly benefit, you can choose the benefit amount you want or can afford. You might want to do this to keep down the policy cost.

Tip: When you compare policies, make sure that you compare them on equal terms; don't, for instance, give equal weight to a policy that promises to pay you a benefit of \$1,000 and a policy that promises to pay you a \$2,000 benefit.

Compare coverage: What optional benefits can be added?

Adding riders to your base disability policy is how you personalize your coverage. However, riders also increase the policy's cost. You can choose among many different riders, but the following is a list of a few popular options that you should consider buying. Again, read the policy or brochure carefully. Some companies include one or more of these options in their base coverage and raise the price accordingly.

Example(s): Lisa compared two disability insurance policies. One policy offered comprehensive base coverage, guaranteeing both that benefits would automatically be adjusted 4 percent per year to counteract inflation and that Lisa would have the chance to buy additional coverage in the future without a medical exam. The premium for this policy was \$985 per year. The other

policy's base coverage provisions were sparse; however, Lisa could buy an array of add-on riders. The premium for this policy was \$850 per year. Which policy was better? Lisa finally decided that even though the second policy cost less, the first policy suited her needs better when she compared the coverage offered.

Automatic benefit increase rider

This rider (sometimes offered as part of the base policy) stipulates that the monthly policy amount will be adjusted automatically every year to account for pay raises or increased income you receive after you've purchased a disability policy. The rider provides annual increases for a certain term (often five years). During this time, you won't have to provide proof your income has gone up or evidence of medical insurability. However, upon renewal of the rider, you may have to show evidence that your income has increased; otherwise, you won't be able to renew the rider.

Cost-of-living rider

If you are afraid that inflation will eat away at your disability benefit, you can purchase a cost-of-living adjustment rider that increases your monthly benefits (after you have been receiving disability benefits for a year) if inflation rises. If inflation is low, a minimum percentage (usually 4 or 5 percent) often applies. When comparing policies, be aware that some companies cap the increase, while others let you choose your own maximum.

Tip: Price is certainly a factor here; while important, a cost-of-living rider can be quite expensive. Choose a policy that offers this as base coverage (unless the policy premium has been raised accordingly), or compare the cost of this rider in each policy.

Social benefits rider

This rider provides disability benefits in addition to your base monthly benefit. This benefit amount is payable to you as long as you are not receiving (or are eligible to receive) a social benefit (e.g., Social Security disability insurance). When you receive a social benefit, your social benefits rider may be reduced by the dollar amount you are receiving. This rider typically costs less than your base benefit because it takes some of the guesswork out of underwriting and protects the insurance company against some risk.

Tip: Occasionally a Social Security income rider is included with base coverage, and sometimes the insurance company requires it. In addition, there are several versions of Social Security income riders that pay benefits in various ways. When you compare policies, determine how each policy handles the Social Security rider.

Tip: Some insurance companies offer social insurance riders, which are similar to Social Security income riders but which also cover other forms of social insurance, such as workers' compensation.

Future benefits increase rider

Also called an option to increase coverage or a guarantee of insurability rider, this rider gives you the option to buy more disability coverage if you need it later without being turned down for medical reasons. You'll be able to purchase a specified amount of coverage on certain option dates, often every two to three years. This is a useful rider if you are young and anticipate needing more disability coverage later because you expect your income to rise significantly over the years.

Example(s): Heloise purchases a disability income insurance policy when she is 30 that includes a future benefits increase rider. At the time she buys the policy, she earns \$2,000 per month, and her policy pays her a \$1,200 per month benefit. By the time she is 35, however, she is earning \$3,000 per month and wants to increase her benefits. She does so under the terms of her rider, which allows her to purchase an additional \$400 of monthly benefit every three years.

While you can increase disability coverage under this rider, you usually cannot exceed twice the monthly indemnity that you have in force from all insurance companies that cover you against disability.

Compare coverage: special provisions and exclusions

The following provisions and exclusions are found in most disability insurance. They should be used as points of comparison but should not be weighed as heavily as other factors.

Rehabilitation provision

Look for a rehabilitation provision in each disability insurance policy. This provision promises to pay for certain expenses you incur if you enter a rehabilitation program, such as books, the cost of a training program, or living expenses.

Waiver of premium provision

Most disability policies include a waiver of premium provision that states that your premium will be waived after you've been disabled 90 days. In addition, any premium you paid in the first 90 days that you were disabled will be refunded to you.

Normal exclusions

Typically, disability policies have a general exclusion provision that excludes loss for unpredictable or uncontrollable events. Many don't cover injuries or illnesses resulting from aircraft accidents (pilot or crew), war or acts of war, suicide attempts or self-inflicted causes, and normal pregnancy (although some states require that pregnancy be covered as an illness).

Special exclusions

Special exclusions may apply if you have a pre-existing condition at the time you apply for disability insurance benefits. In addition, some policies also exclude (or limit the duration of benefits paid for) mental and nervous disorders and drug and alcohol abuse. Check the language of each policy carefully.

Compare cost: make sure that the price is right

Evaluate equivalent products

You can't fairly compare the cost of two disability insurance policies unless they have similar terms and provisions. For instance, it would be unfair to compare a noncancelable loss of income policy that has a 60-day elimination period to a guaranteed renewable any occupation policy with a 90-day elimination period. Before you begin comparing policies, figure out what terms and conditions best suit your needs. Then compare policies that offer the features you are looking for.

Find explanations for price disparities

If one policy costs much more than another equivalent policy, try to figure out why. Perhaps the more expensive policy has some extra coverage hidden in the base policy, or maybe the cost of each additional rider is higher. Maybe the company can afford to charge less because it pays claims less frequently due to strict underwriting standards. Maybe you've overlooked an important provision. This is where a financial advisor or insurance professional can be an invaluable source of information, because he or she has knowledge of other companies' products as well as his or her own.

Example(s): Jake wanted to buy disability coverage and started comparing policies. Company A offered him a policy that cost \$300 a year more than a policy from Company B. His financial advisor told him, however, that Company A's policy included coverage in the base policy that Company B's policy did not. Company B offered the additional coverage as two add-on riders, each costing \$200 a year. Thus, all things considered, purchasing coverage from Company B that was equivalent to Company A's coverage would actually cost Jake more.

Find ways to reduce premiums

If you prefer the coverage one policy offers over another policy but you can't afford it, look for ways to reduce the cost of the premium.

Compare companies: three questions to ask

What's your company's industry ranking?

Although it's unlikely that an insurance company will become insolvent, it has happened. To protect yourself, find out where the companies you are comparing stand within the insurance industry. Several

companies rate insurance companies based on financial strength, profitability, and claims-paying ability. These companies (such as, A. M. Best, Standard & Poor's, Fitch (formerly Duff and Phelps), and Moody's) assign insurance companies letter grades as a way to compare and evaluate their performance. However, each evaluator uses a slightly different ranking system, so it's important to know what grading scale and standards are being used. You should specifically ask about the company's past ratings, because one indicator that a company might be in trouble is that its rating has been declining.

Example(s): Veronica purchased a disability insurance policy from LMN Insurance, a company that was rated B+ by A. M. Best. One year later, LMN Insurance became insolvent. Veronica found out that prior to her purchasing her disability insurance contract, LMN had been steadily decreasing in the ratings. At one point, it had received an A+ (excellent) rating, then slid to B+ (very good) within two years. Although a B+ rating was acceptable, the ratings downturn indicated that the company was experiencing financial difficulties.

When will you receive your first benefit check?

Find out when you will begin receiving benefits after the elimination period ends. Many companies issue checks at the end of the month, so you may have to wait an extra 30 days from the time your elimination period expires before you receive your first check. So if you have a 90-day elimination period, you won't receive your check for at least 120 days after your disability began. Some companies, however, process checks more quickly. You may be able to call the company's claims department to find out how quickly claims are processed.

What's your company's lapse ratio?

Your insurance agent should be able to tell you what your company's lapse ratio is. The lapse ratio shows the percentage of policyowners who terminate their policies after the first year. A low lapse ratio may indicate that policy owners are generally satisfied with the company.

What happens next?

Submitting an application

After you've selected the disability policy that best suits your needs, you'll fill out an application to purchase the insurance. Your financial advisor or insurance agent will likely have already begun the underwriting process by doing a preliminary evaluation. If you haven't already filled out an application for disability insurance, you'll do this now. It will ask you questions about your age, income, medical history, and lifestyle. You may be required to submit proof of income, take a physical exam, and submit to blood testing. Your application will be submitted to an underwriter, who will evaluate your answers and determine what coverage you can purchase and at what price.

Know your rights

Some states require that you receive a printed buyer's guide when you're comparing and purchasing disability insurance. Some states also require that the company give you an outline showing your benefit entitlement and provisions. In addition, you may also have the right to review the policy, returning it to the insurance agent or company within 10 days if you wish to cancel. You will then receive a full refund of any premiums you have already paid.

Questions & Answers

You already have a group disability insurance policy through your employer. Should you depend on this coverage or purchase an additional individual policy?

Insurance companies want you to have adequate disability coverage, but they don't want to overinsure you. Most companies will take into account what other disability benefits you may be entitled to before issuing you coverage. This means that you may be able to purchase a supplemental individual policy that works with the insurance you already have. Remember, though, that one of the primary differences between group disability and individual disability insurance is that a group policy can be canceled; if you lose your group affiliation, you lose your disability insurance coverage. On the other hand, an individual policy is yours to keep unless you choose to cancel it.

Disclosures

This material does not constitute the rendering of investment, legal, tax or insurance advice or services. It is intended for informational use only and is not a substitute for investment, legal, tax, and insurance advice.

State, national and international laws vary, as do individual circumstances; so always consult a qualified investment advisor, attorney, CPA, or insurance agent on all investment, legal, tax, or insurance matters.

The effectiveness of any of the strategies described will depend on your individual situation and on a number of other factors. After reviewing your personal situation, we may recommend that you not use any strategy in this document but instead consider various other strategies available through our practice.

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