

# End of the Line

If the Unforeseen happens, have you protected your client's income?

By Marlene Y. Slatter – December 1, 2002

One of the most dramatic illustrations of how one person's life can change in a heartbeat is the 1995 riding accident transforming Christopher Reeve from Superman to a wheelchair-bound paraplegic. Aside from the enormous impact of the disability, another aspect, faced by many families daily, was how to deal with everyday financial obligations and rapidly escalating expenses in the face of sudden, total loss of income. Even a movie star's pay would be hard-pressed to support the needs of Reeve and his family after the accident. But with Reeve unable to work, how long would the money last?

Fortune intervened in Reeve's case, both in the form of comic Robin Williams, Reeve's Juilliard classmate, and in Reeve's own eventual return to work. But most families do not have the luxury of a rescuer waiting in the wings with a financial bailout, and many professions cannot be pursued in the face of disability. Planners must consider the question of what will happen to a client's entire family if accident or illness robs them of a reliable income stream. That's where disability insurance comes in.

Even though disability insurance is a complex product, advisors should be familiar with what it can and can't do. In fact, Kevin Meehan, a planner in Itasca, Illinois, argues that "all financial plans will become unraveled without appropriate risk management before the event. To call yourself a planner and not address protecting someone's income borders on malpractice."

In the 1990s, he says, many advisors ignored the more "difficult" areas of the financial plan, such as insurance planning. Since these advisors could make "significant dollars" from clients by managing money, rather than by constructing a complete plan, many clients are now unprotected against losing their income stream—"the most important asset you have," according to Rob Moody, a planner in Atlanta. The younger a client is, and the greater that client's income potential, says Moody, the more it must be protected. While he concedes that "it's no fun to sit there and read through an entire disability policy," he also emphasizes, "that's what comprehensive financial planning is all about."

Disability insurance is meant to protect against loss of income due to accident or illness. You can start your search for coverage by consulting one of the insurers listed in the sidebar on page 76 (a more comprehensive directory is available for download at [www.investmentadvisor.com](http://www.investmentadvisor.com)). But there are many factors to consider when selecting a policy. For example, is the coverage for the insured's own occupation, or any occupation? Must your client return to work in any capacity available? "As long as you could sell movie tickets, [an insurer] might consider it gainful," Moody says. How is disability defined? Under what conditions will a policy pay? Is there a cost of living provision? How long will benefits be paid? And what are the exclusions and limitations?

## Caveat Advisor

Once you've waded through the terms of the policy itself, you'll find your job is not over yet. Individual disability insurance is not easy to buy. Companies are merging or exiting the field. Underwriting has become more stringent, with certain types of coverage more difficult to get. But even amid the turmoil since 9/11, ratings on the "very small number of companies" selling disability insurance have not changed, says Kevin Maher, associate director of Standard & Poor's Financial Services. In fact, says Maher, companies are working to expand their market in group sales, which involves packaging disability coverage with other benefits. In addition, Maher points out that companies are targeting lower age groups "that don't believe they'll ever be disabled." Ken Smith, a first vice president at Mutual of Omaha, for instance, is looking at expansion into blue-collar markets with a policy that offers a limited benefit period of five years or less.

The group-sales effort may frustrate individual advisors. Often, clients will say of disability insurance: "I have it at work." Moreover, they may have no clue just what they have acquired. According to Peg Downey, a planner in Silver Spring, Maryland, "Ninety-nine percent of the time, what they have at work is inadequate. Many times they don't get any more from employers than two sentences that say they're covered for up to 60% of their base salary." Employees tend not to inquire how base salary is defined or what conditions trigger coverage. Employees also often fail to realize that 60% may not be adequate for their needs, or that they can purchase supplemental policies to bridge the gap.

Consumers and advisors need to ask questions for another reason. Insurers, says Maher, are "more careful as to what they're including and not including in coverage." Companies also, he says, seem to be investigating more claims as they are presented. Often such areas as mental health are "segregated into a package" so the insurer can provide it as an add-on or to a whole company, rather than offering it to all potential policyholders.

George Paquin, a fee-only planner and licensed insurance advisor from Chelmsford, Massachusetts, has also seen insurers "getting smarter about asking questions. It turns out that most people have smoked something funny in the past or have been seeing a counselor, and the companies run like hell." Indeed, Paquin cites one client, a recovering alcoholic who hadn't had a drink in 15 years, who was nonetheless denied a policy. Moody, meanwhile, tells the tale of one client, a widower, who went to see a mental health professional and then found it hard to increase his disability coverage through his group plan. The insurance company, asserts Moody, "was afraid he might be habitually depressed."

Moody, himself in the process of increasing his disability coverage, worries about a back injury he suffered in 1994. "I went to see a back doctor once, who referred me to a physical therapist whom I visited one time," says Moody, "and I haven't had any problems since." But he expects that his insurer will add a waiver to his policy to exempt his back "and not cover it because of this injury that happened more than eight years ago." His advice? While still young and healthy, purchase a good, non-cancelable disability policy on which coverage can be increased as income rises. "Once you start [having health problems] it's going to be very difficult to get coverage for that problem," he warns.

Not only would-be policyholders are upset with insurance companies' tougher standards. Some policyholders have filed a class action suit against UnumProvident Corp., the nation's largest disability insurer, charging it denied claims based on decisions made by non-medical personnel to cut costs. The suit, following an individual suit filed by a former UnumProvident doctor who alleged the same things, seeks, in addition to unspecified monetary relief, a reevaluation of all claims denied by UnumProvident in the last few years. While UnumProvident's Rick Magro, VP of individual product design and marketing, declines to comment on the suit, he adds, "our core purpose is to pay claims in an ethical manner." He notes UnumProvident paid more than \$3.6 billion in disability-related benefits in 2001.

### **Picking a Winner**

So how do you pick the right policy for your client? You could start with a list of items Rob Moody has compiled to make the selection process more efficient. He suggests you look at these:

- How strong is the insurer? "You're buying a promise to pay," he says. The strongest companies, he warns, also usually have the highest premiums. "Northwestern Mutual Life is probably the strongest financially," he points out, "but will also charge very high premiums." Compare the financial strength rating of the company with its premiums; he uses ratings from five different firms, and pays attention to what percentage of companies rated by each firm had a higher rating. "It's possible," he says, "for a rating firm to rate an insurance company A+, but it might be that that firm rated maybe 60% of all the companies they rated higher than A+." Also weigh the financial rating against the premium; finding the strongest company won't help if your client can't handle the premiums.
- Is the benefit tax-free? When an employer pays the premium on a disability policy, the benefit is taxable. Moody suggests that if a client has the option to pay premiums with after-tax dollars, she should, because the benefit itself becomes tax-free.

- What's the waiting period? It's usually 90 days, but can be from 30 days to a year; the longer the waiting period, the lower the premium. "Keep in mind that usually a policy won't pay until one month after the end of the waiting period," he says.

- Will benefits be reduced by benefits from other sources, such as Social Security, other individual policies, or a group policy? Most individual policies, Moody says, will not reduce benefits, but sometimes one will.

- How is disability defined? Definitions fall into three main categories, he says: own-occupation, modified own-occupation, and any-occupation. This is extremely important, because "if you don't meet the definition, you don't get paid." Own-occ policies will pay if you can't do the job you're doing before disability strikes, even if you can hold a job of another type; this kind of policy costs more. Most, says Moody, are modified own-occ; some are own-occ for the first couple of years "and then the definition changes to any-occupation." In the realm of any-occ, he warns, "it could vary quite a bit depending on the language they use." This is where advisors must be careful; if any gainful occupation is considered, a client could end up working at a job paying substantially less than her previous occupation and no longer be considered disabled and eligible for benefits, even if what she earns is insufficient to keep her and her family. Usually, says Moody, the definition is "any occupation for which you are reasonably suited given your education, experience, and training."

- How long are benefits payable? Moody says most are payable to age 65, "but sometimes you can get one that's only good for five years. I don't recommend that." Some policies offer payment to age 67. Since many boomers can't retire until age 67 anyway, this could be better.

- Are there cost of living adjustments? There are a couple of different ways to do this. Benefits can be adjusted to reflect changes in the CPI, but the policy may also adjust pre-disability earnings to the CPI, thus mirroring what the client's income would have been without disability and therefore providing for a larger benefit.

- Are there residual benefits? These are paid while the client is not fully recovered, allowing the client to return to work part-time or for half-days and still receive a reduced benefit throughout recovery.

- Can the benefit amount be boosted without having to provide evidence of insurability? You need this protection if you expect your client's income to grow.

- What limitations does the policy have? Preexisting conditions, self-inflicted injuries, commission of a felony, wars, and riots are a few. Also consider limitations due to Alzheimer's, mental health issues, and substance abuse.

- Will the policy waive premiums if you become disabled? Some will even refund premiums payable during the waiting period, he points out.

You will also want to find out if clients must go through another waiting period if a second disability follows the first.

### **Other Considerations**

You've negotiated the maze of conditions, riders, and definitions and are ready to pick a policy. Are you done yet? No, according to Paquin, who points out other areas to explore. He mentions the dilemma of a client whose coverage ends at age 65 and who cannot collect Social Security until 67. What will the client do for those two years? And what of a client unable to work for many years and therefore not contributing to a retirement plan? Again, if the policy only pays to age 65, what will that client do for retirement income? There are policies available that will provide retirement contributions upon disability so that there will be retirement income.

Clients working at home may also have a tough time getting coverage, Paquin warns. UnumProvident's Eleanor Clifford, VP of underwriting, says that individuals working at home are considered on a case-by-case basis, with a number of factors—occupation, nature of business, stability, earned income, and financial documentation—considered in addition to the other "usual underwriting evaluation."

The advisor must work to find a good disability policy for a client. If the advisor doesn't sell insurance, he's doing it for not a lot of money; perhaps even free. It's not easy; as Rob Moody says, "Disability has probably more moving parts than any other type of insurance policy." But if you're doing your job and protecting your client, this is one coverage that must be employed. You can work with an insurance person; fee-only advisors and many others who aren't up to speed on all the ins and outs of income protection do. Kevin Meehan points out, "I don't want to visit you in the hospital, or come to your wake, and think that we didn't talk about the issues that are now foremost in the minds of the people around you."