



## Overview

Without disability insurance, you face considerable financial risk if you become disabled and are unable to work. While it is more common to have life insurance than disability insurance, you are far more likely to become disabled than to die before reaching retirement age. Because the chances of losing earnings to disability are so high, we advise our clients to make sure they have coverage at least equal to 60% of their pretax income.

The goal is to insure your most valuable asset: your ability to earn an income.

Disability insurance is not overly complex, but it's important to understand some technical terms and nuances. Unlike car insurance, disability insurance is not readily available online. To secure coverage tailored to your individual situation, you'll need to work with a reputable agent.

## Benefits should equal at least 60% of pretax income

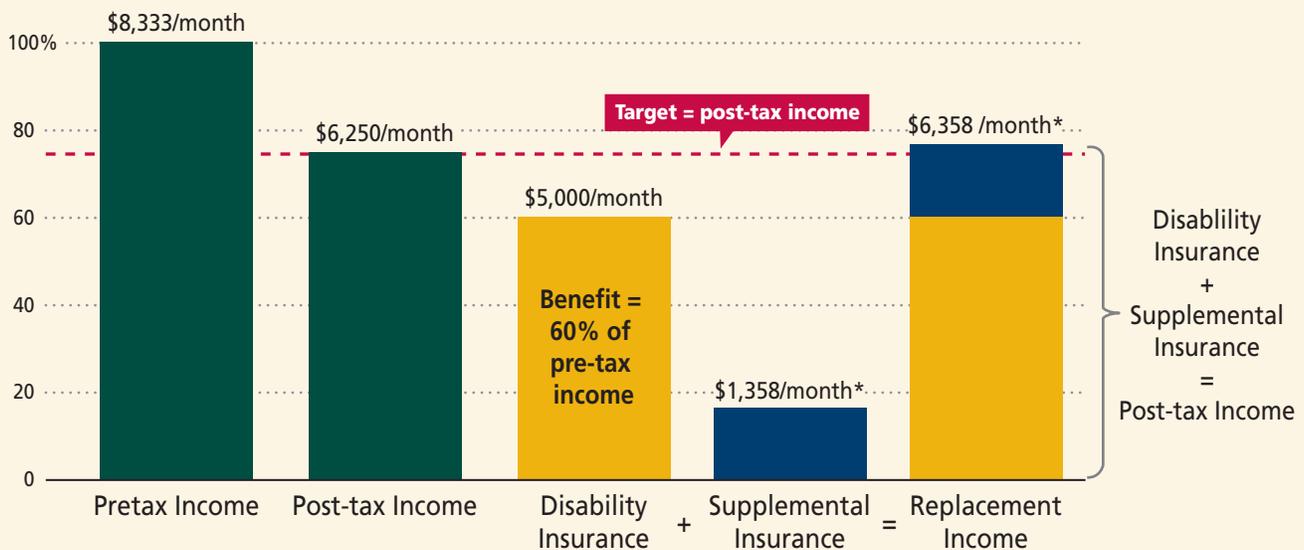
Two benefits combine to enable people to replicate their post-tax income: private disability insurance and supplemental sources, such as Social Security Disability Insurance.

- 1 **Private disability insurance.** When you pay for private coverage with after-tax dollars, the benefits you receive are **not taxed**. With coverage equal to 60% of your pretax income, your monthly disability benefit will be close to your previous monthly income.

For example, assume you earn an annual salary of \$100,000 (\$8,333 per month) and pay a 25% income tax rate. Your net monthly pay would be \$6,250 (\$8,333 gross pay – \$2,083 in taxes). Your disability benefit, by comparison, would be \$5,000 per month (\$8,333 gross pay x 60%).

The following chart shows how the two benefits combine to replicate monthly post-tax income.

**Disability Insurance Coverage Illustration**  
Assuming \$100,000 annual pretax income and 25% tax rate



\*Subject to change as SSDI benefits could be eligible for taxation

- 2 Supplemental sources.** The gap between your net pay and your disability benefit can be covered through supplemental sources, such as coverage available through an employer plan or SSDI. Typically, employer plans permit employees to purchase disability insurance at favorable rates in addition to any benefits the employer may provide. The other major supplemental source of disability insurance is SSDI, which offered an average payment of \$1,358 per month in 2021.<sup>1</sup> Continuing with our example, SSDI would raise your monthly disability benefit to \$6,358, comparable to your prior monthly income after taxes.<sup>2</sup>

## Other important considerations

Typically, private coverage is available for incomes up to \$400,000 per year, providing up to \$20,000 per month of disability benefit. Additionally, most providers allow you to stack coverage by adding a policy from another company. High limit disability insurance is another option for those with even higher incomes. HLDI is designed to ensure that your disability payouts cover 65% of your total income — not just your base salary — by offering between \$2,000 and \$200,000 per month on top of your existing coverage.<sup>3</sup>

### 60% maximum rationale

Insurance companies generally cap the disability benefit at 60% of your income to ensure you have an incentive to return to work.<sup>4</sup>



## Do I really need disability insurance?

According to the Social Security Administration, more than one in four 20-year-olds entering the workforce today will become disabled for at least a year before reaching retirement age.<sup>5</sup> Long-term disability insurance offers the peace of mind that comes with knowing your income will be secure even if you are unable to work for an extended period of time due to injury or illness.

If you do become disabled, statistics indicate there's a significant likelihood you will be unable to work for quite a while. For example, a 35-year-old person with a disability lasting 90 days or longer has a 38% chance of that disability lasting at least five years.<sup>6</sup> Moreover, the serious financial repercussions of disabilities are well-documented; historically, disabilities have led to many home foreclosures and bankruptcies.

## What to know before buying a policy

There are six major factors to consider when evaluating a disability insurance policy.



### 1 Elimination period

If you become disabled, your policy will not begin paying out benefits right away. You are expected to cover your own expenses during the “waiting period” or “elimination period.” This period is essentially a deductible that is measured in time rather than money. It typically lasts 90 days, though it varies by policy.



### 2 Occupation class (best to worst)

One determinant of your policy premium is your occupation. When you apply for insurance, your occupation is matched with a class based on how risky your job is. The lowest-risk class includes architects and attorneys, while the highest-risk insurable class includes carpenters and mechanics.

<sup>1</sup> “Annual Statistical Report on the Social Security Disability Insurance Program, 2021,” Social Security Administration, October 2022.

<sup>2</sup> It is important to note that certain SSDI benefits could be subject to taxation, and they should be considered on a case-to-case basis.

<sup>3</sup> “What is High Limit Disability Insurance and Who Qualifies for it?” KBI, May 27, 2022.

<sup>4</sup> Brian Beers, “How Much Disability Insurance Can Be Bought?” Investopedia, March 4, 2021.

<sup>5</sup> “Individual Disability Insurance,” New York Life.

<sup>6</sup> “Chances of Disability,” Council for Disability Awareness.



### 3 Policy definitions (“own occupation” vs. “any occupation”)

One crucial policy definition to consider is “own occupation” coverage versus “any occupation” coverage. Under the former, if you become disabled and are no longer able to perform your chosen occupation, then you will be covered. Under “any occupation” coverage, you have to be unable to perform **any** occupation in order to receive benefits. Whenever possible, we recommend protecting your income more completely by selecting “own occupation” coverage.



### 4 Benefit amount

This feature is straightforward: It is the amount your policy pays out each month if you become ill or injured. The higher the benefit amount, the more expensive the policy premium. We recommend maximizing your coverage at 60% of income, subject to the cap for high income earners.



### 5 Benefit length (or “benefit period”)

The benefit period designates how long your monthly benefits will be paid out for a **long-term** disability. Periods may be as short as two years or as long as up to retirement age. While a five-year period might cover the length of many long-term disabilities, we suggest prioritizing peace of mind and covering your income through retirement.



### 6 Policy riders

Policy riders are add-ons to a base policy that provide additional coverage in case of a disability.<sup>7</sup> There are a litany of options outside of the scope of this briefing, but one worth highlighting is the future purchase option, which allows you to increase your coverage automatically when your salary increases, without a reevaluation of your medical history.

## How to obtain disability insurance

The best time to buy disability insurance is when you are young and healthy, as that is when it is most affordable and easiest to obtain. However, it’s never too late to get the coverage you need.

To do so, you will have to speak to an agent. A good agent is essential to ensure you get exactly the right amount and type of coverage.

After you receive a quote, the insurance company will conduct an underwriting process by soliciting and evaluating information about your health before approving you for a policy. Most workers can expect to pay between 1% and 3% of their annual income for long-term coverage.<sup>8</sup>

## Other sources of coverage

Alternative sources of coverage are rarely sufficient on their own, and they should always be treated as supplemental rather than primary.

### Employer-sponsored insurance

Many employers provide **short-term** disability coverage, which typically pays out for a few months—sometimes up to a year. Some employers also provide **long-term** coverage through a group disability plan. However, be wary of low benefit limits.

### Odds of becoming disabled

Chances of becoming disabled for one year or more before retirement:

**1 in 4**

<sup>7</sup> Shawn Plummer, “Everything You Need To Know About Disability Insurance,” *The Annuity Expert*.

<sup>8</sup> Andrew Hurst, “How much does long-term disability insurance cost?” *Policygenius*, August 15, 2023.

For example, many policies pay out a maximum of \$3,000 per month, regardless of your income. Also, many of these policies offer only “any occupation” coverage, meaning that as long as you are capable of working in any occupation at all, you will not receive benefits.

Finally, some employers allow you to purchase your own additional coverage through your company at a preferred rate. This coverage is not automatically transferable if or when you change employers. However, there is often a conversion option that allows a departing employee to continue the policy individually, no longer under the auspices of the employer plan.

### **Social Security Disability Insurance**

SSDI is difficult and time-consuming to obtain and will not pay out enough to replicate your standard of living. Approximately 67% of applicants for SSDI are rejected, and the average payout is only about \$1,358 per month.<sup>9</sup>

### **State-level disability insurance**

A handful of states offer disability insurance, but those benefits last one year at most. This is far less than the average length of a long-term disability claim, which is nearly three years.<sup>10</sup>

### **Workers’ compensation**

Workers’ compensation covers only work-related injuries and illnesses, which affected just 2.7% of American workers in 2021.<sup>11</sup>

<sup>9</sup> “Annual Statistical Report on the Social Security Disability Insurance Program, 2021,” Social Security Administration, October 2022.

<sup>10</sup> Amanda Shih and Elissa Suh, “How long do long-term disability insurance benefits last?” Policygenius, November 3, 2022.

<sup>11</sup> “Employer-Reported Workplace Injuries and Illnesses (Annual) News Release,” U.S. Bureau of Labor Statistics, November 9, 2022.

**Important Legal Disclaimer:** *We are not an insurance agency and are neither licensed nor qualified to render insurance recommendations or advice of any kind. Moreover, insurance is a specialty area that requires a subject matter expert to advise on the particulars of a given situation. The best course of action is to consult a qualified, licensed insurance expert in your state.*

September 2023



www.keatingwealth.com  
(720) 408-5250