A Guide to Disability Insurance

Introduction

The following information is for educational purposes only. This information is not intended to replace the advice of an insurance professional or address specific situations. Your personal situation should be discussed with your professional advisor(s).
For a list of Authorized CBIA Representatives, please click here.

If you are like most Canadians, you own insurance because you understand the risks and consequences of losing an asset. You insure your home, your car and you probably insure your life, but do you insure your most valuable asset?

Your most valuable asset is your ability to earn a living.

Think of it this way: assuming a 2.5% raise per year, if you are age 35 and making $70,000 a year, you will, by age 65, have earned over $3 million of income.

Total potential earnings to age 65 assuming 2.5% annual increases

	Annual Income						
	$30,000	**$50,000**	**$70,000**	**$90,000**	**$120,000**	**$150,000**	**$200,000**
Age 25	$2,022,077	$3,370,128	$4,718,179	$6,032,080	$8,088,306	$10,110,383	$13,480,511
30	$1,647,846	$2,746,410	$3,844,975	$4,943,539	$6,591,385	$8,239,231	$10,985,641
35	$1,317,841	$2,195,135	$3,073,189	$3,951,243	$5,268,324	$6,585,405	$8,780,541
40	$1,024,733	$1,707,888	$2,391,043	$3,074,199	$4,098,932	$5,123,665	$6,831,553
45	$766,340	$1,277,233	$1,788,126	$2,299,019	$3,065,359	$3,831,699	$5,108,932
50	$537,958	$896,596	$1,255,235	$1,613,873	$2,151,831	$2,689,789	$3,586,385

Do you own any other asset that is this valuable?

Recognizing the immense value of your ability to work is only the first step toward understanding your need for disability insurance protection. Your next step is to understand your risks of becoming disabled.

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What are the odds I'll ever become disabled?

If you became disabled tomorrow, could you live without an income for the next 3 years or more?

You may be surprised to learn that more than one third of all people between the ages 35 and 65 will become disabled for 90 days or more. Of those disabled, the average duration is two years and one in seven will be disabled for more than five years.

Of 100 Males and Females, here is how many will suffer a disabling injury or illness for at least 90 days or more before age 65, and the average duration of that disability:

	Risk of Disability Males*	Risk of Disability Females*	Average Duration**
Age 25	41%	47%	2.6 years
30	39%	45%	3.1 years
35	37%	42%	3.5 years
40	35%	38%	4.0 years
45	33%	34%	4.4 years
50	29%	28%	4.7 years
55	24%	21%	4.9 years

*Source: 1985 DTS Table, Society of Actuaries and 1986-92 CIA Aggregate Mortality Table
**Source: 1985 DTS Table, Society of Actuaries

Although your odds of becoming disabled for at least 90 days reduces slightly as you age, the risk that your disability will be very severe increases until age 65.

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I have a nice safe desk job. I really don't think there is much risk I'll get hurt and be disabled.

Approximately 90% of all disability insurance claims for lawyers insured under the Canadian Bar Insurance Association (CBIA) Disability plan are the direct result of an illness, not an injury.

Working at a desk does little to reduce your risk of being disabled by illnesses like cancer and heart conditions. A disabling illness can strike anyone, regardless of their occupation. In fact, the stresses of being a legal professional may put you at a much higher risk for certain illnesses than the average person. Of lawyers who claim under their CBIA disability benefit each year, approximately 40% are the result of a mental or nervous system illness such as depression. With other professional groups, the rate is closer to 30% of claims.

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How does my risk of being disabled compare with the other risks I've insured against?

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In any given year:

Fire Insurance	1 in 274 homes have fires
Auto Insurance	1 in 150 vehicles have serious accidents (causing disabling injury or death)
Life Insurance	1 in 140 people die
Disability Insurance	1 in 13 people become disabled for at least 30 days

Sources:
US Census Bureau (1999), National Fire Protection Association (1999)
Injury Facts, Motor Vehicle, (1998)
Statistics Canada (1999, 2000)
Society of Actuaries, CIA 86-92 Table
1985 DTS Table, SOA

Have life insurance on your mortgage? A disability is up to 16 times greater than death to be the cause of a mortgage foreclosure!

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If the risk is really that great, why don't I know any disabled people?

We don't see air, but we know there's a lot of it out there. Deaths, car accidents and house fires are highly visible insurance claim events. They are in the news everyday and most of us have personally experienced or know someone who was touched by one of these events. However, most disabilities are the result of invisible conditions such as heart disease, cancer, or psychiatric disorders.

Many lawyers are disabled by mental and nervous system illnesses. The fear that this will negatively impact their peer and client relationships causes many to hide their condition from the public eye. Only those closest to a disabled lawyer know the real reason for the "long term sabbatical", "early retirement" or "leaving the partnership to start a new career". Unless you were told, how could you possibly know the person you shook hands with yesterday can no longer work due to a heart problem, cancer or a psychological issue? Most disabled people are quietly hidden all around us.

Most psychiatric illness disability claims are for depression or anxiety issues. Sometimes these illnesses are associated with other factors such as alcohol or other drug addictions.

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If I become disabled, I could get by on my savings, assets and government benefits.

There are people who have accumulated a considerable amount of wealth and really don't need to work for a living. Then there are the rest of us. While a number of potential sources of funds might come to mind, all fail the long term test.

Savings:

If you save 5% of your income each year, six months of being totally disabled will wipe out 10 years of savings.

Retirement Savings Plan Withdrawals:

Not only are there tax consequences and penalties, your long term retirement plans may be unattainable if you withdraw money from your RSP.

Borrow from the Bank:

Banks are not interested in loaning money to people without a source of income.

Borrow from Family Members:

Your family has its own financial needs, obligations and goals. These don't include the financial burden of loans that may never be repaid by an unlucky relative.

Working Spouse:

Can one person really be expected to be the parent, private nurse and breadwinner all at once? What if your household depends on two incomes? Is it realistic to believe your spouse can easily find a new job to make up the difference?

Liquidation of Assets:

Do you believe people will offer you a fair market price if they know you have been forced to sell your assets? What are you left with should you recover?

Government Benefits:

Canada Pension Plan pays an amount based on how long and how much you have contributed. To qualify before retirement, you must prove that you have an extremely serious disability that will likely lead to death. If you do qualify, the maximum benefit for 2007 is only $1053.77 per month and subject to taxation. The average monthly benefit paid out in 2006 was only $772.88. Government benefits like CPP and welfare are intended to provide those most in need with a subsistence income.

Using your savings and assets is not a sensible long term solution to your disability protection needs. The best way to protect yourself is to obtain disability insurance.

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Economic Death

Economic Death occurs when a prolonged disability prevents you from earning a living. When Economic Death occurs, you are still alive, but have become a financial burden on your family, friends and society. For many people, this is a fate worse than death.

A disability that lasts for 90 days is not Economic Death, but as you have seen from the previous statistics, this is only the minimum number of days most people are unable to work. With an average duration of disabilities between three and five years, it's not difficult to understand the impact of living that long without an income. Fortunately for most people, Economic Death is completely preventable.

How would you maintain your home and car without the ability to pay for them? What happens to the future of your family? Economic Death results in profound changes to your lifestyle and has a devastating effect on you and your family's future.

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How does disability insurance help?

Disability insurance pays you an income for a set number of years, or until a specific age, in the event an injury or illness prevents you from working. The amount of benefit you are entitled to receive is based on a percentage of your pre-disability income. Typically, this percentage ranges from about 40% to as much as 75% of your income. The higher your income, the lower the percentage offered as a benefit. If you are paying the premiums yourself, the benefits are received tax free. Normally, your benefit is paid to you on a monthly basis.

While disability insurance may not provide you with as much money as you earned when you were working, if it is a well designed benefit, you will have an income that will allow you to maintain your financial obligations. This allows you to focus on your health, rather than worry about where the money is going to come from to pay your bills.

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Are there different kinds of disability insurance?

Disability insurance protection can be broken down into two basic categories of protection.

Short Term Disability Insurance

As the name implies, Short Term disability pays income replacement benefits for a brief duration of only a few weeks or months. Most employer group insurance plans do not offer a short term disability benefit. Instead, many employers offer paid sick leave.

If you are self employed, short term disability coverage can be purchased alone or in addition to a long term disability benefit. However, many people do not buy this benefit but choose to use their personal savings until they become eligible to collect on their long term disability benefits.

Long Term Disability Insurance

Most long term disability insurance contracts pay a salary replacement benefit to age 65. This is the most common and important type of disability benefit and will be the focus of the remainder of this article.

The Definition of Disability

One of the first things that you need to understand about Long Term Disability Insurance is the definition of disability. There are three common definitions.

Own Occupation Definition

The Own Occupation definition is the most liberal offered and is usually made available only to individuals in the lowest risk occupational classes. Own Occupation protects the insured in his/her particular job. It is usually offered as a rider at an additional cost. A typical own occupation definition might read as follows:

Total disability means that due to injury or sickness:
a) You are unable to perform the important duties of your own occupation; and
b) You are under the regular care of a physician

Under this definition, you could be unable to perform the duties of your own occupation, but could earn an income in another occupation while still receiving full disability benefits.

Regular Occupation

The Regular Occupation definition is similar to an Own Occupation benefit, but unlike the much more expensive own occupation contract, most Regular Occupation contracts would reduce or cease benefits if you went back to work in a completely different occupation. However, many people do not see this as a contractual weakness in their protection. A typical definition of regular occupation might read as follows:

Total disability means that due to injury or sickness:
a) You are unable to perform the important duties of your own occupation;
b) You are not working in any other occupation; and
c) You are under the regular care of a physician.

Any Occupation

The Any Occupation definition is the least liberal of the three definition types. Any occupation measures total disability based on the insured's ability to work in any occupation for which they are reasonably fit to perform by education and training. A typical definition might read as follows:

Total disability means that due to injury or sickness:
a) You are unable to perform the important duties of any gainful occupation for which you are reasonably qualified, based on your education, training, or experience; and
b) You are under the regular care of a physician.

Under this definition, if you are able to perform the duties of any occupation as defined above, the insurance company can cease claim payments. The insurance company does not consider the availability of a job, only your ability to perform the duties of one. Keep in mind that the insurance company must take into account your education, training, and experience.

Definitions of Group Disability vs. Individual Disability

Now that you understand the different definitions, you would think that it would be relatively easy to know what you're buying. Not so.

Some insurance policies have a tiered definition. For example, the definition might say that the policy will pay benefits if you are unable to do the regular duties of your own occupation only for the first 24 months. After which time the definition will reduce to being unable to do the regular duties of any occupation. This is very common in employer sponsored group plans.

You also should be aware that Group plans often refer to their definition as own occupation, when what they really cover is a regular occupation definition. Therefore, it's very important to actually read the contractual details of any definition of disability and not just rely on the words 'own', 'regular', or 'any'.

What are my choices for long term disability insurance?

There are several types of long term disability insurance. All have their advantages and disadvantages. The following is a breakdown of the major categories:

Employer Group Long Term Disability

Most employer provided disability plans are designed to provide employees with a very basic level of protection at a low cost. A small amount of coverage may be offered without proof of good health.

To keep costs down and allow the insurer to offer benefits without evidence of good health, these plans can often be very restrictive in the total amount of benefit they offer. If you are relying on employer group long term disability protection as your sole source of insurance protection, you need to be aware of the shortcomings inherent in these plans.

Here are some of the important things you need to know if you rely on this type of insurance contract.

Is the benefit amount enough?

First, open your employee booklet and take a good look at what you've got. Many group benefits state that your benefit is based on 66.67% of net earnings up to a maximum and then a smaller percentage, say 50% of the balance to an overall maximum. However, most employer provided plans put a cap on the maximum benefit available, which is lower than most high-income earners may otherwise be eligible for.

You should also look for wording that describes "eligible income" for the purpose of determining your benefit. You may be surprised to learn that some contracts will only insure your regular salary. Income from bonus payments, for example, may not qualify. Net income is often defined in group policies as "income after taxes and other deductions such as Canada Pension Plan". You are advised to do the math. The amount you are actually entitled to receive may be a great deal less than you need if you are in a higher income tax bracket.

Offsets

Look for "Direct Offsets" and "Indirect Offsets" in your employee booklet. Should you go on claim, these items, if applicable, will be deducted from your monthly benefit. Some offsets are normal for Disability contracts. However, most group contracts include many more items than you would expect to see in similar individually owned Disability policies.

All Source Maximums

While on claim, your benefit will be subject to an "all source maximum". This is a cap on the amount of benefit you are entitled to receive from all sources of income. If you have a non-taxable plan, most plans will reduce your monthly benefit by the amount, if any, by which the total monthly income from all sources exceeds 85% of net monthly earnings prior to being disabled. Better plans offer a 100% all source maximum.

Definition of Disability in Group Plans

You should be aware that most group policies contain two definitions of disability. For the first two years the policy will pay benefits if you can't perform the regular duties of your own job. It may be described as "own" occupation. After two years on claim, the policy will continue to pay benefits only if you are unable to perform any job. This is known as an "Any" occupation definition and is the most restrictive definition of an eligible disability.

Requiring you to prove you are disabled for Any Occupation after two years of disability is intended to keep costs down by reducing the number of eligible claims. In theory, you could be re-trained during those initial two years and be ready to re-enter the job market to perform any job for which you are reasonably trained and educated. While it is an exaggeration to say that Any Occupation means "if you can sell pencils on a street corner, you will lose your benefits", the definition does offer the insurer significantly more opportunities to take you off claim.

Control

Your coverage is controlled by your employer and the insurer, not by you. Benefits can be reduced or even cancelled without your permission. Should you leave your job, in most cases, you will not be able to take your group disability insurance with you. The result is that you could suddenly be left without any disability protection if your health prevents you from buying new coverage elsewhere.

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What are my choices for long term disability insurance?

Conclusion

While group disability insurance has several drawbacks, it's not entirely bad. It is a great tool for employers to reward and retain employees. It also offers a level of protection for people who might not otherwise have the resources or the good health to buy disability insurance on their own. However, if you are covered by one of these plans and can afford it, it may be wise to consider a purchase of additional disability insurance on your own.

Association Plans

Many professional associations offer a group disability insurance plan exclusively to their members. This is often the result of a negotiated arrangement between the association and an insurance company. While many association plans are essentially the same as an employer sponsored group plan (please read above) coverage is sold to individuals and enrolment is voluntary.

As a rule, associations are negotiated by a board of volunteers and the insurer is responsible for all aspects of plan design, pricing and marketing. Members receive a special rate and in exchange for an endorsement by the association, the insurer pays a percentage of every premium dollar collected back to the association.

While many association offerings suffer from the same short comings of an employer plan, there are some significant exceptions to this rule that represent excellent value and protection.

The Canadian Bar Insurance Association (CBIA) is one such example of an organization that is significantly different from most other association programs. The CBIA blends the best contractual protection of an individually owned insurance policy with the lower price of an association group plan.

To learn more about the CBIA Disability Income benefit, please click here.

Individual Plans

Individual plans, as the name implies are disability insurance policies that you purchase on your own. Like an association plan, enrolment is voluntary and subject to proof of good health.

There are three main types of Individual Disability Insurance plans, Non-Cancellable, Guaranteed Renewable, and Conditionally Renewable.

Non-Cancellable

The non-cancellable plan is the most beneficial for the insured, the most strictly underwritten, and the most expensive. Non-cancellable disability policies put the most control in the Insured's hands. As long as the insured pays the premiums as they come due, the insurance company:

- Cannot cancel the policy, regardless of changes in the insured's occupation or health. In essence, the insured owns the contract and has the unilateral right to cancel it.
- Cannot change any provision or add any restriction to the policy. If the company changes the provisions for its policy in the future, it cannot go back to existing policies and make any changes to policies in force without the agreement of the policy owner.
- Cannot increase the premium or add any additional charge for the policy, without the agreement of the policyowner.

Because the insurance company cannot modify a non-cancellable policy after issue, it is reasonable to assume that they will be very careful during the pricing and the underwriting processes. Any mistakes made at the time of sale may obligate a company for the duration of the contract.

The non-cancellable provision is probably the most important advantage offered by individual policies in comparison to Group Long-Term Disability plans.

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Guaranteed Renewable

A disability insurance policy that has a guaranteed renewable provision offers the same first two guarantees that a non-cancellable contract offers. That is, the insurance company cannot cancel the policy and it cannot change any provision or add any restriction, providing the premiums are paid on a timely basis. However, the company does reserve the right to change the premium for the policy.

Unless provided for in the policy, the company cannot normally single out an individual policyholder and raise only his/her premium. The company can only change the premium for all insureds of a specific class who own the specific contract that is being changed.

Classes could be specified by a number of criteria, such as: age, gender, specific waiting periods, benefit periods or policy type to name a few.

The guaranteed renewable contract offers the insurance company some flexibility. It may increase the premium if it is suffering from poor claims experience. As as result, the company is generally less restrictive in its underwriting (sometimes offering policies to individuals who do not qualify for non-cancellable coverage) and usually charges a slightly lower premium since it can raise the rates at a later date.

Conditionally Renewable

Conditionally renewable policies give the insurance company the most flexibility in making changes to policies in force. The policy usually does not provide for any premium or policy provision guarantees and, in fact, does not guarantee the actual continuation of the policy. As with guaranteed renewable, any changes or cancellations that the insurance company initiates would have to be done by class in most cases.

Conditionally renewable policies are often used as a last resort for people who cannot qualify for non-cancellable or guaranteed renewable policies due to poor health or working in a high risk occupation.

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What else should I know about these plans before I buy?

Premiums

Unlike many other forms of insurance, disability policies can vary significantly in both price and the level of benefits they provide. When comparing benefits, you can expect the prices to be considerably higher for the better designed policies. However, there are some low cost exceptions to this rule. Therefore, price should not be your number one purchase criteria. Let the policy details, how well they fit your specific needs and the reputation of the company you are dealing with guide your buying decisions. Once you've become a well informed consumer, you will be far less likely to spend more than you need to for the level of protection that is right for you.

You are not purchasing just a monthly benefit. A permanent long-term disability could be equal to hundreds of thousands, or even millions of dollars in claim payments over your life-time.

The Monthly Benefit

The first thing that you need to do is determine how much coverage you need. Do you go for the maximum benefit or can you afford to live on a little less? Don't assume that your expenses will significantly reduce if you are disabled. Your disability could result in additional costs such as childcare, modifications to your home or nursing services that are not covered by your private or provincial health insurance.

The Waiting Period

Next, you need to determine how long you can go without benefits. This is known as the "Elimination Period" or "Waiting Period" and is the number of days you need to be completely disabled before you are considered eligible for benefit payments. The longer you make your waiting period, the lower your premium. Before making your selection, consider how long you could live off of your current savings. You also need to consider your income flow. As a lawyer, you would likely continue to receive an income for a period of time as a result of work completed just prior to your disability. Most plans offer waiting periods as long as 1 or 2 years, however, most people select 90 or 120 days. Expect to pay a substantial premium for benefits that start after 30 or 60 days.

The Benefit Period

The benefit period is the length of time that benefits will be paid to you once you have become disabled. Comprehensive coverage will pay the monthly benefit, as long as you are disabled, to a normal retirement age of 65 or 71. Some policies will offer shorter benefit periods of 2, 5, or 10 years. These shorter benefit periods allow for lower premium costs, but if you are disabled for a longer period of time, you may run into financial difficulty as your monthly income will end when the benefit period is over, even if you're still disabled.

Optional Benefits and Riders

Lastly, you'll have to pick your way through a series of optional features. Some of these riders aren't cheap and for some individuals, represent poor value. However riders such as Cost of Living benefits and Residual or Partial benefits are very important and should be given serious consideration.

Benefits and Riders

The following are a few of the more commonly purchased policy riders.

Own Occupation Rider

The Own Occupation rider amends the total disability definition by removing the restriction against working in any gainful occupation. If you cannot perform the duties of your own occupation, you can take a job in a different field and remain eligible for benefits.

Cost of Living Adjustment (COLA) Rider

As time passes, inflation gradually erodes the value of your Disability benefit. Most contracts allow you to compensate for this with the COLA rider. While on claim, this rider would ensure your benefit is increased by an amount equal to the Canadian Price Index or a flat percentage.

First Day Hospitalization Rider

With this rider, benefits will begin from the first day you are hospitalized due to your disabling condition regardless of how long your Qualification Period may be.

Return of Premium (ROP) Rider

For a substantial extra premium, the ROP rider will guarantee a refund of a percentage of your premiums after a pre-determined number of claim free years. A typical example would be for an additional 40% of the premium, the insurer will refund 50% of the premium (including the ROP amount) after being claim free for 8 continuous years. Some contracts will also allow you to receive a refund if you claim, but the total benefit was 20% or less of premiums.

Residual Disability Rider

What if your disability doesn't keep you from working, but does prevent you from putting in as many hours? Or what if you can't continue to practice law, but you're able to work in another occupation at a lower income? Also many people find that after a disability, it takes time to ease themselves back into work. They can only work part-time at first. During this time, they experience a loss of income.

Residual benefits are designed to make up for a shortfall in income in such instances.

Many insurers now include a "loss of earnings" definition of disability in their basic policies that promises to make up the shortfall between what you earned before you were disabled and after, so as not to penalize policyholders for continuing to work. If your policy doesn't have residual disability built in, or include a "loss of earnings" definition of disability, pay the extra premium to have residual disability added as a rider.

Guaranteed-Increase or Future Increase Option Rider

All first-time disability buyers have to pass medical muster. Though increases in your income may make you want additional coverage in the future, you probably won't want to undergo a second physical -- especially if you've acquired an ulcer or a bad back since you bought your policy. A guaranteed-increase option, sometimes called a "guarantee of insurability rider" or "future-increase option," will help you avoid this hassle.

This rider allows you to purchase additional insurance without providing evidence of good health. You need only provide proof of your income, to ensure that your total insurance amount does not exceed the maximum benefit amount available for that income. Some insurers offer the guaranteed-increase option as part of their standard policy. Other insurers tack on 7% to 10% to the policy's price for the rider. Make sure to ask.

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Conclusion

Buying disability insurance can be a complicated process. The best advice is to take the time to meet with an insurance professional with specific knowledge of disability insurance for professionals, who can advise you on the right choices.

To learn more about the CBIA Disability Income benefit, please click here.

To contact a CBIA Local Agent, please click here.