

## HOW MUCH DISABILITY INSURANCE COVERAGE DO YOU NEED?

More and more workers recognize the need for disability insurance, also known as income-replacement insurance. The reason: they are more likely to be disabled for at least 90 days before age 65 than they are to die. But many of those same workers remain underinsured, and they often don't realize it.

One of the major reasons workers are underinsured is that they assume that their group disability policy at work, perhaps combined with Social Security disability benefits, will replace their full monthly income. It won't, and the gap is often significant. How much disability coverage do you need?

First, understand that disability insurance—whatever the source—won't replace all of your pre-tax income. At a maximum, your total insurance sources won't replace more than 70 to 80 percent. As we'll see later, that's not necessarily a concern, but it is something to be aware of.

Now let's imagine the unimaginable: tomorrow you are disabled and unable to earn any wage income for months, perhaps a year or more, perhaps permanently. Would you have sufficient non-insurance sources of income to live on at least comfortably, keeping in mind you may have additional expenses associated with your disability? Sources might include your spouse's income, investment income and savings. If you still have a gap, then you'll need insurance to fill it.

If the disability is work-related, you may be eligible for workman's compensation or veteran's insurance. An auto insurance settlement might pay for disability resulting from an auto accident. But you can't count on these sources, obviously. Social Security may provide benefits, but qualification requirements are strict. Some states also provide short-term disability coverage.

Key disability coverage usually is through work, but here is where much confusion exists, say CERTIFIED FINANCIAL PLANNER™ professionals.

Roughly nine in ten employers sponsor long-term disability insurance, according to a Hewitt Associates survey[Money April 200]—something that would last you more than a few months, though not necessarily to age 65. But do you know what percentage of your income your employer's policy would actually replace? Four in ten workers don't, found a Consumer Federation of America/American Council of Life Insurances study a couple of years back.[Bus Week, June 4, 2001]

Be aware that over half of employer group plans require employees to pay the premiums, so if you're not paying premiums right now, check to see if the employer is paying for the policy. It may not.

Typically, group policies pay 60 to maybe 70 percent of your pre-tax income, but there are numerous cautions when considering this figure.

**James N. Whiddon, CFP®, MSFS**

**Lance Alston, CFP®**

JWA Financial Group, Inc. • 6200 LBJ Freeway, Suite 180 • Dallas, TX 75240 • (972) 661-3355 • [www.jwafinancialgroup.com](http://www.jwafinancialgroup.com)

*This article is intended as general information and not as advice to specific individuals.*

*JWA Financial Group, Inc. is a Registered Investment Advisor*

Some policies cap benefits at 50 percent, and most group policies have a monthly income cap (\$5,000, for example), so higher-paid workers won't be able to replace anywhere near 60 or 70 percent of their income. Bonus income usually is not included, either.

Social Security disability payments the worker might receive typically offset dollar-for-dollar payments he or she would receive through a group policy. So when adding up your potential replacement income, check to see how the group policy treats Social Security disability income. Individual policies are less apt to offset Social Security payments.

Taxes are another critical factor. If you pay the premiums for the group policy with after-tax dollars, the benefits are not taxable. The same applies to a policy you buy on your own. But the payments are taxable if the employer pays the premiums. Paying taxes on 60 percent replacement income could significantly reduce what you have left to meet critical expenses.

You may find at this point, perhaps with the help of a financial planner, that you would have an income shortfall if you became disabled, so you'll want to buy a supplemental policy. You may be able to buy this through your employer, where it's likely to cost 10 to 15 percent less than on the open market. But you may find the group policy caps monthly income too low for your needs, so you'll have to buy an individual policy.

And remember, the total from all of your policies can't exceed 70 or 80 percent, so don't try buying policies from multiple companies in order to receive 100 percent or more. It won't work.

One other consideration when determining the amount of coverage to buy: A sufficient amount today probably won't be sufficient years down the road due to inflation, so consider an inflation rider.

February 2003— This column is produced by the Financial Planning Association, the membership organization for the financial planning community, and is provided by a local member in good standing of the FPA.

**James N. Whiddon, CFP<sup>®</sup>, MSFS**

**Lance Alston, CFP<sup>®</sup>**

JWA Financial Group, Inc. • 6200 LBJ Freeway, Suite 180 • Dallas, TX 75240 • (972) 661-3355 • [www.jwafinancialgroup.com](http://www.jwafinancialgroup.com)

*This article is intended as general information and not as advice to specific individuals.*

*JWA Financial Group, Inc. is a Registered Investment Advisor*