

Individual disability insurance protects against group gaps

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(July 2004) Traditionally, Canadians have relied on their employers to provide benefits: health, dental and short- and long-term disability protection. But in today's environment, this is often no longer the case — many people work under contract with no benefits, or are laid off from jobs and forced to work from home or at a reduced income.

Let me illustrate one potential problem with a very personal example. My brother Chris was the president of the Canadian subsidiary of a significant American corporation, a role which came with a full package of benefits. However, the owner of the American corporation decided to sell and the buyer brought his own person in to run the Canadian company, resulting in a "golden handshake" for my brother.

While Chris was with that employer, he could not purchase individual coverage because he had group insurance. Thankfully, these rules have now changed, allowing any employee to purchase individual disability insurance for any amount up to the maximum his income allows. This policy is fully portable, good even if the employee is disabled while "between jobs" and it will pay the full amount even if income drops significantly.

Let's illustrate why this is so valuable. After Chris left his company, he decided to set himself up as a self-employed graphic designer, working from home. Again, disability insurance was not available because of the lack of an established income. He had no choice but to take his chances. He lost. The Easter weekend following all of these changes, Chris was driving down to the Toronto airport to pick up his daughter when another driver tried to pass traffic where he shouldn't have, a mistake that resulted in a head-on collision at a combined speed of over 160 kilometres an hour. It took the police two hours to remove Chris from the wreckage and he was then transported to hospital in Toronto. We did not expect him to survive the weekend — but I am glad to say he did. However, the blood transfusions he received which allowed him to live also gave him hepatitis C.

He has dealt with the disease and was lucky enough to win a lawsuit against the other driver, but think of what might happen to you or to your clients if they found themselves without disability coverage. This is happening regularly today.

Two policies

I have specialized in living benefits for 35 years and one of my standard phone requests is, "My client has lost his job" or "my client has decided to go off on his own" or "my client's benefits have been eliminated at work" — or any of a dozen similar scenarios — and now needs disability protection. In many cases, the income flow is not yet re-established or the income has dropped significantly. Further, in some cases, an individual has gone from an executive- type job to one requiring more manual effort.

What can be done? It is extremely difficult to provide high quality disability protection when income can not be reasonably projected. If the job is more physically demanding, the terms and conditions (and prices!) will not be as generous as permitted for the original occupation — plus the client will have to qualify medically for the coverage.

Because of the guarantees associated with this type of product and the large amounts of coverage involved, this is the hardest type of insurance to obtain. One can definitely say that an individual should purchase it as early as possible, before the minor aches and pains associated with adulthood become more serious.

In addition, the amount of the benefit available will almost certainly be significantly less than what the client would have been entitled to if they had purchased protection while with their employer. If a policy is purchased based on an established level of income and an established occupation, the amounts, terms and conditions will not be affected by a subsequent change of situation.

Further, all insurance carriers will offer improved conditions and prices to someone in an established job — with employees reporting to them — with reasonable levels of regular income. These terms and conditions are guaranteed to follow the employee, regardless of any subsequent changes in employment situation.

Sound too good to be true? Can someone who is insured under a group plan purchase an amount of benefit, which effectively ignores the group coverage? Yes, this can be done, but if the client is protected under the group plan and if the client is considered disabled by the group plan, he will not receive double payment. In this case, the group plan will pay and the individual plan will not.

Risk and disability

To balance out this possible non-payment, the individual plan price is discounted, generally by 10%. However, if the group coverage is no longer available, as in my brother's situation and that of anyone who is no longer covered by a group plan, the individual plan will pay full benefits. Note that there are many situations that most group insurance plans do not cover — "partial" disabilities being the most significant. An example of a partial disability would be the early stages of cancer or any progressive or degenerative illness, or the recovery period after a major illness such as a heart attack.

Many plans will also stop paying benefits after two years if you can do a "reasonable" job. I know of one plan that ceased paying benefits to a comptroller of a company, because she was able to be a receptionist. I am not saying that receptionists are not extremely valuable to a company (they are!), but they are no where near as well paid.

Finally, it is not the responsibility of the insurer if you cannot find a new job. In today's job market, who is more likely to be hired (all other things being equal): a healthy individual or someone coming off two years of disability?

Our two most important assets in life are our health and our ability to earn an income. All of our plans revolve around these two items, which are really two sides of the same coin. Life holds many twists and turns, some we can predict and some we cannot — like my brother's accident and what transpired after.

I take exception to the old adage about death and taxes being the two things in life you can count on. There's actually a third certainty — everyone will be disabled before they die. The only things we do not know are the timing (before or after retirement) and the duration (short, like so-called "instant death" in a drowning or an accident, or prolonged over years).

If you can guarantee me that you will die instantly or in old age, you may not need disability insurance. If you cannot make that guarantee (and who really can?), disability insurance is the most important purchase you can make.

Here's a scenario to discuss with your clients. Ask them if they would prefer job "A," which pays \$50,000 annually while working and nothing if they become disabled, or job "B," which pays \$48,178 while working and \$32,400 tax-free and indexed while disabled? What is the difference in lifestyle between \$50,000 and \$48,178? What is the difference between \$0 and \$32,400 annually tax-free? Not to mention the additional \$7,500 that is set aside annually for their retirement!

We insure our cars and our homes but we rarely consider insuring the one item which gives us our possessions — our income. Think of my brother and then think of all those you know who have had serious illnesses or accidents. Then talk to your clients about protecting their most valuable asset — their income — because without that, all other planning they do will accomplish little.

A final note: I often hear that disability insurance is complicated from an advisor's standpoint. Do you think you are able to learn 10 or 12 basic concepts? If you can, disability is not complicated at all.