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# Disability Insurance Basics

## The Fundamentals of Disability Insurance

Disability insurance pays benefits when you are unable to earn a living because you are sick or injured. Most disability policies pay you a benefit that replaces a percentage of your earned income when you can't work.

### Why would you need disability insurance?

Your chances of being disabled for longer than three months are much greater than your chances of dying prematurely, due in part to medicine that has made many fatal illnesses treatable. (Source: 1985 Commissioner's Individual Disability Table A--most recent data available.) Although this is good news, it increases your need to protect your income with disability insurance.

Consider what might happen if you suffered an injury or illness and couldn't work for days, months, or even years. If you're single, do you have other means of support? If you're married, you may be able to rely on your spouse for income, but you probably also have many financial obligations, such as supporting your children and paying your mortgage. Could your spouse's income support your whole family? In addition, remember that you don't have to be working in a hazardous position to need disability insurance. Accidents happen not only on the job but also at home, and illness can strike anyone.

If you own a business, disability insurance can help protect you in several ways. First, you can purchase an individual policy that will protect your own income. You can also purchase key person insurance designed to protect you from the impact that losing an important employee would have on your business. Finally, you can purchase a disability insurance policy that will enable you to buy your partner's business interest in the event that he or she becomes disabled.

### Likelihood of Suffering a Disability by Age 50



Source: 1985 Commissioner's Individual Disability Table A (most recent data available)

### What do you need to know about disability insurance?

Once you become disabled and apply for benefits, you have to wait for a certain amount of time after the onset of your disability before you receive benefits. If you are applying for benefits under a private insurance policy, this amount of time (known as the elimination period) ranges from 30 to 365 days, although the most common period is 90 days. Group insurance policies through your employer will generally have a waiting period of no more than 8 days for short-term policies that pay benefits for up to six months, and 90 days for long-term policies that pay benefits up to age 65.

You can purchase private disability income insurance policies that offer lifetime coverage, but they are very expensive. Most people buy policies that pay benefits up until age 65; however, two- and five-year benefit periods are also available. Because many injuries or illnesses do not totally disable you, many policies will offer a rider that will pay you a partial benefit if you can work part time and earn some income.

## Where can you get disability insurance?

In general, disability insurance can be split into two types: private insurance (individual or group policies purchased from an insurance company), and government insurance (social insurance provided through state or federal governments).



Private disability insurance refers to disability insurance that you purchase through an insurance company. Many types of private disability insurance exist, including individual disability income policies, group policies, group association policies, and riders attached to life insurance policies. Depending on the type of policy chosen, private disability policies usually offer more comprehensive benefits to insured individuals than social insurance. Individually owned disability income policies may offer the most coverage (at a greater cost), followed

by group policies offered by an employer or association. Check with your employer or professional association to see if you are eligible to participate in a group plan. If not, contact your insurance broker to look into individual coverage.

Workers' compensation and Social Security are two well-known government disability insurance programs. In addition, five states (California, Hawaii, New Jersey, New York, and Rhode Island) have mandatory disability insurance programs that provide disability benefits to residents. If you are a civil service worker, a military servicemember, or other federal, state, or local government employee, many disability programs are set up to benefit you. In general, however, government disability insurance programs are designed to provide limited benefits under restrictive terms, and you should not rely on them (as many people mistakenly do) as your main source of income if you are disabled.

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## How Much Disability Income Insurance Should You Have?

The amount of individual disability income insurance you should buy depends on three things: how much income you'll need if you become disabled, how much money you can afford to spend on premiums, and how much insurance you'll be able to purchase under the insurance company's guidelines.

### Determine how much income you'll need if you become disabled

It's hard to know exactly how much income you'll need after you suffer a disability, but you'll probably need more than you think. Most of your fixed expenses won't change, and you may save money on work-related expenses such as clothing, automobile costs, and lunches out. However, you'll also spend more on other items, including the following:

**Medical expenses:** You can expect your medical expenses to rise when you suffer a disability. Assuming that you have health insurance, you'll probably have to satisfy a deductible as well as an out-of-pocket maximum, which may increase your expenses immediately after your disability occurs. In addition, if you suffer a long-term disability and are forced to quit your job, your group medical insurance coverage may be terminated. If you work for a large enough employer, you may be able to continue coverage on your employer's plan through the government regulation known as COBRA, but you'll have to pay the premium yourself, and the coverage cannot last beyond 18 months in most cases. This can add hundreds of dollars to your budget. You may also need to buy medical equipment or supplies, or even renovate your house to accommodate your disability.

**Living expenses:** What if you can't drive, clean your apartment or house, mow the lawn, or cook for yourself after you become disabled? Will you need to hire household help to take care of day-to-day activities that you can no longer do? Hiring help can be a substantial, unexpected expense when you become disabled.

**Child-care expenses:** If you have young children and both you and your spouse work, you know how expensive child care is. Can you afford it if you or your spouse becomes disabled and unemployed? The disabled partner may be able to care for the children at home, but not if his or her disability is too limiting. On the other hand, if you currently stay at home with your children, you may be forced to return to work if your spouse is disabled, and you may have to contend with an unforeseen additional expense.

### Find out what disability benefits you're already entitled to

You may already be covered by some disability income insurance through your employer. This may be short-term

### How Much Disability Insurance Can You Buy?

**Pre-disability income**

**Disability insurance benefits**

**Get the maximum you can obtain—usually limited to about 2/3 of your income**

**Note:** If policy premiums are paid with after-tax dollars, the benefits will be received tax free. Premiums paid with pretax dollars, usually through your employer, may cause the benefits to be taxable when received.

coverage, long-term coverage, or both. Short-term coverage pays a weekly benefit, usually after the first day of an accident or the eighth day of an illness, for a period of 13 or 26 weeks. Long-term coverage pays a monthly benefit that begins after the short-term period expires. The benefits are usually paid until age 65. If you have one type only, you should look into buying a private policy for the type of coverage that your employer does not provide. If you have both short-term and long-term coverage, you are probably ineligible to buy any additional coverage, unless your employer's plan limits the maximum benefit to an amount that is less than 60 percent of your annual income.

You could depend on getting disability benefits from Social Security, if you pay into the system. However, relying on this type of insurance can be dangerous. Social Security pays benefits only under strict definitions of disability, making it very difficult to qualify. Also, benefits are limited and may not be adequate for your needs. Review the coverage available to you, take a look at the specifics of any group disability policies you already are covered by, then decide whether you need more disability coverage.

### If you need more disability income insurance, how much should you buy?

Once you've decided that you need to buy more disability income insurance, you should aim to cover a significant portion of the income that you will lose if you become disabled. However, you may not be able to buy as much coverage as you want. The insurance company determines the maximum amount of disability income insurance you can purchase, based on your income, health, age, and the amount of other disability benefits you're entitled to. Most companies will sell you insurance that replaces 50 to 70 percent of your monthly pretax earnings (of course, you can opt to buy less than this amount).

## Social Security Disability Benefits

Like most people, you probably don't expect to become disabled. However, you are three times more likely to become disabled due to illness or injury than to die during your earning years. (Source: 1985 Commissioner's Individual Disability Table A.) That's why it's important to know what disability benefits you may be entitled to under Social Security.

The Social Security Administration (SSA) administers two programs that pay disability benefits. The Social Security Disability Insurance (SSDI) program pays benefits to qualified individuals who are under age 65, regardless of their income. The Supplemental Security Income (SSI) program pays benefits to qualified individuals with limited income. Only the SSDI program is discussed here.

### To qualify for benefits, you must meet a strict definition of disability

Because the definition of disability that the SSA uses is strict, it's hard to qualify for Social Security disability benefits. To receive benefits as an adult, you must have a physical or mental impairment that has lasted or is expected to last for at least 12 months or is expected to result in your death. Your impairment must also be severe enough to prevent you from performing any "substantial gainful activity" or, in other words, the work that you were doing when you became disabled or any other work.

The SSA has a list of impairments that are considered so severe that they automatically define you as disabled. If your condition is not on the list, the SSA must decide if it's severe enough.

When determining your ability to work, the SSA will consider your medical condition, age, education, past work experience, and transferable skills. If you're working, the amount of income that you are able to earn also plays a role. If your earnings from work average more than \$980 per month (in 2009), you generally won't be considered disabled for Social Security purposes. Special rules and income limits apply if you're blind.

### You'll also need sufficient work credits to qualify

When you work and pay Social Security taxes, you earn credits that enable you to qualify for Social Security benefits. You can earn up to 4 credits per year, depending on the amount of income that you earn. The number of credits that you need depends on how old you are when you become disabled. For instance, if you're age 31 to 42, you'll need to have earned 20 credits within the last 10 years, ending with the year in which you became disabled. If you're younger than 31, you'll need fewer credits; if you're older than 42, you'll need more.



### Your family members don't need work credits

If you qualify for disability benefits, certain family members can also collect monthly disability benefits based on your work record. Eligible family members may include:

- Your spouse age 62 or older, if married at least one year
- Your former spouse age 62 or older (if you were married at least 10 years)
- Your spouse or former spouse of any age, if caring for your child who is under age 16 or disabled
- Your children under age 18, if unmarried
- Your children under age 19, if full-time students (through grade 12) or disabled
- Your children older than 18, if severely disabled

Each eligible family member may receive a monthly check equal to as much as 50 percent of your basic benefit. This is in addition to your benefit--your check doesn't get reduced.

## The amount of money that you'll receive depends on your Social Security earnings record

The amount of your monthly disability check is based on your average lifetime earnings. Generally, you'll receive an amount equal to what you would receive were you to begin receiving Social Security retirement benefits at full retirement age. You can review your earnings record and get an estimate of the Social Security disability benefit that you might be eligible to receive by ordering a Social Security Statement from the SSA, either by phone at (800) 772-1213, in person, or on its website. Or, you can wait for it to come in the mail--you will automatically receive a Social Security Statement from the SSA annually about three months before your birthday if you are age 25 or older and not yet receiving Social Security benefits.



Eligibility for other state and federal benefits may affect the amount of your SSDI check. And because the SSA will periodically review your case and decide whether you are still disabled, your disability benefits may stop altogether. This will happen if your medical condition improves to the point that you're no longer considered disabled, or if you are able to earn a substantial amount of money. Finally, once you reach full retirement age, your disability benefits will automatically convert to Social Security retirement benefits (the amount is usually the same).

## You should apply for benefits as soon as possible

You should apply for benefits at a Social Security office as soon as you become disabled, and it appears that the disability will continue. That's because

there's a five-month waiting period before you'll get your first check. You can file for benefits in person, through the mail, online, or over the telephone. You'll be asked to provide the following information:

- An original or certified copy of your birth certificate (if you were born in another country, you'll need to provide proof of U.S. citizenship or legal residency)
- An original or certified copy of your military discharge papers (DD 214) if you were in the military
- A copy of your W-2 form (or, if self-employed, a copy of your federal tax return for the past year)
- Workers compensation information, including date of injury, claim number, and payment amount
- Social Security numbers of your spouse and children
- Your checking or savings account number
- Name, address, and phone number of a person who can get in touch with you if necessary
- Medical and job information, including information about physicians who have treated you, names of medicines you are taking, medical records you have, and jobs you worked in during the 15 years before your disability began

Once your application is complete and has been reviewed by your local Social Security office, it will be sent to the Disability Determination Services (DDS) office in your state. There, the DDS will determine whether you are disabled under Social Security rules. If your claim is approved, you'll receive a letter showing the amount of benefit that you'll receive and when your benefits will begin. If your claim is denied, you'll receive a letter explaining the decision and telling you how to appeal if you don't agree with it.

For more information on Social Security disability benefits, visit your local Social Security office, look at publications available on the SSA website, or call the SSA at (800) 772-1213.

***You should apply for benefits at a Social Security office as soon as you become disabled, and it appears that the disability will continue.***

## Individual/Group Disability Policy Alternatives

Policy type	Description	Conditions	Advantages	Disadvantages
<b>Individual policy</b>	A policy you buy through your insurance agent that pays you disability benefits when you are sick or injured	You must meet the underwriting criteria set by the insurance company for occupation, health, habits, avocations, etc.	<p>Benefits are tax free if premiums paid with after-tax dollars</p> <p>Flexible policy benefits and features such as lifetime benefits, cost-of-living increases, partial benefits, etc.</p> <p>Provides the most comprehensive coverage</p> <p>Premiums generally can't increase</p> <p>Generally, you can't lose coverage if you pay the premiums</p>	Most expensive type
<b>Group policy issued through an employer</b>	A disability benefit you receive through your employer. Your employer may or may not pay part of the premiums	You have to be a member of the group (in this case, a group of employees) that sponsors the insurance	<p>Low group premium</p> <p>Available as short- or long-term coverage (or both)</p> <p>Usually, you don't have to prove insurability</p>	<p>Less flexible benefit design than individual disability policies</p> <p>Will terminate when employment ends (non-portable)</p> <p>Premium will increase as you get older</p> <p>Definition of disability may be less liberal than individual coverage</p> <p>Benefits will be offset by Social Security, workers' compensation, and some other types of disability insurance</p>
<b>Group policy issued through an association or organization</b>	A disability policy purchased through an association or organization, such as the New Hampshire Realtors Association	You must be a member of the group that sponsors the insurance (in this case, a trade association or organization)	<p>Low group premium</p> <p>May have more liberal underwriting requirements, although not guaranteed acceptance as with employer groups</p>	<p>Less flexible benefit design than individual disability policies</p> <p>Definition of disability may be less liberal than individual coverage</p> <p>Contracts may be cancelable by insurance company or association</p> <p>Premium will increase as you get older</p>



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