

Overlooking disability insurance can be costly

By Dave Counihan on 31 July, 2012

Long-term disability insurance is often the forgotten insurance.

The importance of car, homeowners and life insurance and medical aid is well known. But disability coverage, which replaces lost earnings if you can't work, tends to be ignored — until you need it.

Government studies show that a 20-year-old worker has a 30 percent chance of becoming disabled before reaching full retirement age. Yet only about a fourth of employees in private industry have long-term disability insurance, according to the Bureau of Labor Statistics.

"It could be argued that the disability of a breadwinner is worse than the death of a breadwinner," says Dave Counihan, "because the disabled person is still soaking up money, sometime more than before he/she became disabled."

That's why it makes sense to purchase individual coverage if you're self-employed -- or not covered sufficiently or at all by your employer.

A look at what you need to know about disability insurance:

Q: How does disability insurance work?

A: Disability insurance protects you from a loss of income resulting from an inability to work due to an accident or illness. You typically receive disability checks starting three to six months after you become unable to work.

There are three sources of this coverage: The Government Disability Grant, employers and private insurers.

— Government Disability Grant is the base protection against disability in South Africa. It has a very strict definition of disability and it can take very long to be approved for benefits.

— Many employers offer disability coverage through a group plan, which pays a specified portion of your salary for short period (usually between two and five years)

— Private insurance coverage is vital; your group life policy falls far short of your long term needs. It's most often sought out by those whose debt is in excess of three times their annual income. They need their bonds and vehicles paid off..

Q: Do you need to buy coverage if you receive disability insurance through your employer?

A: It depends whether you could get by on the benefit checks. A typical group plan replaces just 60 percent to 75 percent of your salary, up to certain maximums, which depends on the

employer's contract with the insurer. If the employer pays your premiums, the pay outs will be taxable.

Benefits can last for either a set number of years or until retirement age. Check your plan's details closely. Company benefits have been steadily shrinking in recent years. Group policies often limit the duration of benefits to only two years if you can't perform your job duties.

If your policy looks insufficient, ask your employer whether you can pay for additional coverage. Otherwise, consider getting extra insurance from a private insurer to extend the duration or bring the coverage up to 75 percent or 100 percent of income.

Q: Why can't you count on Government Disability Grant to cover your needs if you are disabled?

A: The average disability benefit is just R1080.00 a month. You only qualify for it if you are unable to work in any capacity, not just at your chosen occupation.

Q: What should you look for in a policy?

A: A policy that is subject to an 'own or similar occupation' clause means that you may have to work in any other capacity, industry, job that may be deemed to be suitable. I don't believe that is the way to go. It's worth paying extra to have an "own occupation" policy. This coverage pays benefits if you are unable to perform the major duties of your own occupation. To trim some of the costs, it may be advisable to obtain "own occupation" coverage for one or two years and "any occupation" coverage after that.

The length of benefits is key, and will affect the cost of premiums significantly. Some policies pay benefits until age 65, 70 or even for life.

You probably also want a policy that will pay "residual" benefits, which will compensate for a decline in income if you are able to work at a new job that pays less.

Q: How much does disability insurance cost?

A: Prices vary based on age, gender, occupation, amount of coverage and health status. Check with a broker to get quotes from at least three different insurers.

For someone who does not have coverage at work, a plan with all the extras including inflation protection costs roughly 3 percent to 4.5 percent of annual salary for a man, and 3 percent to 5.5 percent for a woman. Women pay more because they file claims more frequently and for a longer duration than men.

If someone has coverage at work but wants earnings to boost benefits to 80 or 100 percent salary replacement, the annual cost is typically about 1 to 1.5 percent of the worker's salary.