

Is Disability Insurance Important to You?

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Is disability insurance important to you? If you are like 65% of the working population, you haven't ever considered this question. Take a minute to review the following statements.

My investment income represents more than 50% of my total income.	True	False
My children will not need my financial help for their education.	True	False
I am prepared to sell my home in the event of financial difficulty.	True	False
If I were disabled, the government would take care of me.	True	False
I have no expensive hobbies.	True	False
I do not know anyone who has been disabled for a month or more.	True	False
My family would happily pay for all my living expenses if I could not.	True	False
My mortgage payment is less than 10% of my total income.	True	False
I could afford to take a two-year vacation.	True	False

If you answered "false" to any of the above questions, then disability insurance may be very important to you. In fact, anyone who works to earn an income and depends on that income to provide for their living and lifestyle expenses needs disability insurance. Why then does 65% of the working population not have any form of private disability insurance? When asked, the number one reason is that they have never been told about it.

Most people own life insurance and understand the value it provides. They know that a premature death could have serious financial consequences for the people who depend on them. Perhaps these people should consider how different the consequences would be if they were to become permanently disabled. Wouldn't their dependents be in a worse position than if they had actually died? Not only would their income stop, but they would become a financial drain on the scarce resources available to those dependents. This drain would take the form of both on-going living expenses and the additional cost of medical expenses for the disabled person.

Beyond the financial problems of disability are the psychological implications. When a person becomes disabled, initially there is sympathy for the disabled person. As time goes by, this sympathy can develop into resentment. It's human nature. And certainly there is the personal impact of the loss of dignity that a former productive and self-sustaining person will feel. The old lifestyle is quickly replaced by "no lifestyle", and friends and family drift away as they get on with their lives.

There are also health implications of not having disability insurance. The burden of financial worry and the feeling of helplessness can actually prolong a disability. It is known that those who have disabilities that are "recoverable" actually recover faster if disability insurance is acting to remove the financial worries during the disability. If "laughter is the best medicine", then "worry is a slow poison". Those without disability insurance may recover into a life where savings are gone and debts are high. If you save 10% of your income each year, six months of disability will deplete five years of savings. Many people have spent years contributing to an RRSP because they know this money will be needed for retirement. The prospects of completing a retirement plan, starting over at ground zero after half a career has past, are very bleak.



On several levels, a disabled person's quality of life would be greatly enhanced if they had the foresight to purchase disability insurance.

So what is disability insurance? Simply stated, disability insurance is a policy much like a life insurance policy. However, rather than on death, it pays during disability. And rather than a lump sum benefit, it pays a monthly benefit while the policy's definition of disability is being satisfied. There are different definitions of disability, but a typical one might read, "due to injury or sickness, the insured cannot do the important duties of the regular occupation, and is not working in any other occupation". While this definition is being satisfied, the insured is considered totally disabled. At the time the policy is purchased there are some choices to be made regarding benefit payments. The buyer must select the monthly benefit amount, the waiting period and the benefit period.

Monthly Benefit: The monthly benefit amount available is based on the person's earned income. The maximum percentage of income available typically ranges from 40% to 75% of earned income. The higher the person's income, the lower the percentage. An insurance representative will tell you exactly how much you qualify for based on your income. Note that if you purchase the policy with your own money (i.e., your company is not purchasing it for you), any monthly benefits that become payable will be tax-free.

Waiting Period: The waiting period is how long a disability must last before benefits become payable. The typical choices include 30 days, 60 days, 90 days, 120 days and 180 days. The longer the waiting period, the less expensive the insurance will be. The most popular waiting period is 90 days.

Benefit Period: The benefit period is how long benefits may be payable during a continued disability. The typical choices are 2 years, 5 years, 10 years and "to age 65". The longer the benefit period, the more expensive the insurance will be. The most popular benefit period is "to age 65".

There are many other features and options that a disability insurance policy may provide, but they go well beyond the scope of this article. A Canada Life insurance representative can explain them all, and can produce a computer-generated description of those features, options and costs specific to your situation. Having this done only takes a few minutes and it's free, so why not have one done?

The title of this article asks the question, "Is disability insurance important to you?" The answer to this question is that for one in four people (the odds that a person will have at least a 90-day disability during their working years), it could be one of the most important life-changing decisions they will ever make, both for themselves and their loved ones.

SUPPLEMENT – The Return of Premium Rider

Some life insurance policies are structured so that policyholders can benefit if the company's experience on a large block of policies is better than expected. The company will pay out such proceeds in the form of policyholder dividends. Disability insurance usually does not have this feature. It is more of a "pure" insurance that pays if the event insured against occurs and does not pay if the event does not occur. However, some insurance companies offer an additional cost rider, which acts on an experience refund principle. Unlike life insurance, this rider pays if the experience on an individual policy is favourable (as opposed to a favourable experience on a block of policies). This rider is called the return of premium (ROP) rider.



The ROP rider is not inexpensive. Often it will add 50% to the cost of the policy. But it refunds much more than its cost at various milestones, if the insured is fortunate enough not to become disabled. There are several structures this rider can take, but for explanation purposes, we'll highlight one that costs 50% of premium and returns 70% of total premiums after the 10th year*. Here's what would happen, assuming no claims:

Annual policy premium without ROP	\$ 1,000
ROP premium (50% of \$1,000)	<u>\$ 500</u>
Total policy premium with ROP	\$ 1,500
Total premium paid over 10 years	\$15,000
Amount of ROP benefit payable (70% of \$15,000)....	\$10,500

In the above example, the policy owner has paid \$500 per year for the ROP rider, or \$5,000 in total over a 10 year period. The refund generated if no claims were made would be \$10,500. If you pay for your policy personally, this amount is tax-free, which equates to over a 13% tax-free return. Note that currently the banks are paying about 5% on long-term money, and this return is taxable. To do as well as the ROP rider with a taxable investment, most people would have to realize over a 26% return on investment.

Another way of looking at this is that a review after the 10th policy year shows the net cost of 10 years' insurance was \$4,500 and the average annual cash outlay was \$450. Without ROP this average cost would have been \$1,000 per year, totaling \$10,000.

* Note the return periods after the first 10 years are shortened to 8 year intervals, and there is a final return at the expiry of the policy (usually age 65).

For those who feel this is too good to be true, there is a catch. There must not be a claim. If there is a claim, any money paid for the ROP rider to the date of the claim is lost. This is what allows the insurance company to provide such a high return – people who claim and people who lapse their policies all contribute to those who make it to the end of the 10th year without a claim. It's somewhat like the TV show "Survivor". However, unlike Survivor, about 90% of the contestants who appear on this program actually get the ROP benefit at the end of the show.

The decision on whether or not to add a return of premium rider to a disability policy is one that should only be made after the decision to purchase disability insurance has been made. Let's face it, disability insurance is the important issue. Disability insurance pays during a life-altering event. The return of premium rider simply rewards those who are fortunate enough to not have to use the policy for its intended purpose. The rider does, however, add a 100% guarantee that the disability policy will pay a benefit – either a disability benefit or an ROP benefit - assuming the policy stays in force for 10 years.