



Risk Management **Protecting Your Income**

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When someone shares a story with you about a friend or relative that has suffered an accident, illness or injury,

have you ever noticed how easy it is to think of other people you know who have suffered a similar fate? Often times we respond by sharing our own story about someone we know, just to show we can relate. So we all know these things can happen, we just never think they are going to happen to us.

We haven't talked much about disability lately, but roughly 3 in 10 workers will have an illness or injury at some point in their careers that keeps them out of work for 3 months or more, according to the Council for Disability Awareness, and 1 in 7 can expect to be disabled for five years or more. For many, the ability to earn an income is their most significant asset and the foundation of their Financial Plan. It not only allows them to pay key bills such as mortgage, food and clothing, utilities, automobile payments and insurance premiums, but it is also the source that funds their retirement plan and investments.

When someone becomes disabled and is unable to work, a couple of key questions come to mind such as: What income will you receive if you cannot work? How long will that income last? What asset are you willing and able to draw on to pay your bills and maintain your lifestyle? In 2005, 48% of home foreclosures in the U.S. were strictly due to the homeowner's disability¹. It can be very difficult to qualify for a loan or a second mortgage if you are disabled and not working.

Many employees are fortunate to work for an employer that provides group disability insurance which would replace a portion of the employee's income, on short and or long term basis, should he or she become disabled. After a short waiting period this coverage would typically replace about 60% of an employee's income up to a monthly cap of say \$6,000 to \$15,000 depending on how the employer structured the benefits.

On the other hand, self-employed individuals, statutory and other employees, who may not have disability coverage through an employer, are prudent to purchase an individual Disability Income policy for themselves. The premium for an individual policy typically equates to just a small percentage of annual earned income, about 3% on average, depending on underwriting. Using 3% of your income to guarantee you will continue to receive income in the likelihood you are disabled is not a bad trade off.

In companies that provide group disability coverage, the owners, partners, executives and other high income earners may not be adequately covered by the group benefits. For example, an executive earning \$350,000 per year would not be sufficiently covered by a group policy whose benefit caps out at \$10,000 per month. The group benefit replaces only 34% of his monthly income. In this case it is wise to supplement the group disability policy with an individual disability policy designed to bring the percentage of income being replaced up to 60% to 75%.

Business owners and partners also want to make sure they have separate disability contracts to protect and maintain the normal operation of the business and to properly fund the disability portion of their buy-sell agreement. The first is accomplished with a Business Overhead Expense (BOE) policy. This is a reimbursement contract that provides a monthly benefit for the disabled person's share of the operating expenses. The purpose is to ease the loss of an owner from the business and keep the doors open while the disabled person recovers or transitions leadership and ownership to a successor.

The second is for situations where there are two or more owners whose properly structured buy-sell agreement should be funded for both death and disability. The purpose of this Disability Buy Out (DBO) contract would be to provide the non-disabled partner funds to purchase the disabled person's share of the business, in the event the disability lasts more than an agreed upon time, usually 12 to 24 months.

To understand Disability Insurance, just think of it as a health insurance policy that pays you when you are sick or injured and unable to work. I realize no one likes to consider the prospect of being disabled, but

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this coverage is essential to make sure your earning ability, family and business is protected in good times and in bad. Properly structured Disability Insurance, like all risk management, helps you preserve control and independence, as well as protect cash flow and assets in the event of adverse circumstances. ■