5 Frequently Asked Questions About Disability Insurance

Disability insurance provides critical financial protection to American workers. Yet it's a highly misunderstood form of insurance. You probably have health insurance, home or renter's insurance, and car insurance. But what about your need for income protection insurance?

Disability insurance pays you a portion of your income when an injury or illness takes you out of work for an extended period of time. It's [a critical form of insurance] for most working Americans – because it means if you have to miss work for weeks or months at a time, you will have a financial safety net in place to help cover the bills.

Here are six frequently asked questions about disability insurance:

1. Do I really need it?

Most people hear the word "disability" and assume this form of insurance only applies to very serious injuries and illnesses – yet many common injuries (like fractures) or chronic conditions (like back, hip, or knee problems) can result in your not being able to do your job and earn a paycheck.

According to the U.S. Social Security Administration, more than one in four of today's 20-year-olds can expect to be out of work for at least a year because of some disabling condition before they reach age 67 (the normal retirement age). Will you have an ability to pay your bills if you need to miss work for several months? If you don't have access to that much in emergency savings, or friends or family that can help pay your bills when you need to take time off work, disability insurance makes a lot of sense.

2. What's the difference between short term and long-term disability insurance?

Short-term disability (STD) insurance plans generally protect your income for up to three or more commonly six months. Some plans can run even longer than that. Short-term plans typically cover between 60 and 70 percent of your pay, depending on the policy.

Long-term disability (LTD) insurance protects your income if you need to miss work for longer than three to six months. It usually covers 40 to 70 percent of your income. It costs more than short-term disability insurance because it's a policy that will protect you for a significantly longer time. The time your coverage pays benefits will range depending on your policy. It can be for a specific period – ranging from two to five or ten years – or until your Social Security retirement age. The waiting period for most LTD policies is three or six months – so you'll need a plan to cover costs before the payments begin (usually this time is covered by your STD plan or your savings.)

3. Does disability insurance cover all disabilities?

Every plan will have its own definition of disability, so you'll need to review the definition in your particular policy. In general, many policies do not include the following disabilities:

- A disability resulting from participation in a riot
- Injuries which are intentional and a result of self-infliction
- War or any act of war
- Any period of disability during incarceration
- A disability resulting from a crime in which the individual has been convicted
- Pre-existing conditions (definition varies by policy)
- For short-term disability: occupational sickness or injury (as this is generally covered by Worker's Compensation)

4. Can I work part-time and still collect benefits?

Your insurance contract will specify if you can receive benefits while working part-time. Many policies allow you to work, but take the amount you earn and subtract it from your benefit. If your policy has a lifetime benefit cap, working part-time may extend the life of your benefits.

5. How much disability insurance should I get?

Insurance companies typically do not sell disability insurance policies which replace all of your income. But, they do sell policies which can replace up to 70 percent of your income. If your employer does not offer a disability plan with 70 percent coverage, you may want to look for supplemental insurance coverage to offset the difference.

One major benefit of owning your policy: When you pay premiums yourself, you are paying with after-tax dollars. Therefore, any benefits will likely be tax-free. Tax-free benefits paying 70 percent of your income comes close to being 100 percent of your take-home pay. If your employer pays the premiums and the cost is not included in your taxable income, then benefits will likely be subject to taxation.

A good rule of thumb is 70 percent coverage, but, as with all insurance needs, it depends on your circumstances and what you can afford. Regardless, seek out a qualified advisor if you need help crunching the numbers.

Disability insurance is a good idea

Just think how devastating the loss of income would be for you and your dependents. Then think how much worse it would be to lose the *ability* to earn an income. This is a circumstance you can avoid with proper planning and an action plan.