



America's Health
Insurance Plans

Disability Insurance: A Missing Piece in the Financial Security Puzzle



A chart book prepared by

America's Health Insurance Plans

Society of Actuaries
Disability Chart Book Task Force

and funded by

The Actuarial Foundation



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October 2004

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CONTENTS

INTRODUCTION	1
EXECUTIVE SUMMARY	2
SECTION 1. RISK OF DISABILITY	4
Figure 1.1 The risk of disability is greater than the risk of premature death.	5
Figure 1.2 The risk of becoming disabled during your working years is significant.	7
Figure 1.3 The majority of disabilities are caused by illnesses, not accidents.	9
Figure 1.4 Many workers never return to work following a disability.	11
SECTION 2. FINANCIAL CONSEQUENCES OF DISABILITY	12
Figure 2.1 The potential loss of earnings from disability is significant.	13
Figure 2.2 Disability can disrupt retirement savings.	15
Figure 2.3 Most workers' savings would only see them through a few months of disability.	17
SECTION 3. PUBLIC DISABILITY INCOME INSURANCE PROGRAMS – AND THEIR LIMITATIONS	18
Figure 3.1 SSDI definition excludes many workers who qualify for private disability benefits.	19
Figure 3.2 SSDI benefits alone do not replace enough pre-disability income for most families.	21
Figure 3.3 Most long-term disabilities are not covered by workers' compensation.	23
Figure 3.4 The few states with temporary disability programs provide only limited benefits.	25
SECTION 4. PRIVATE DISABILITY INSURANCE COVERAGE: MET AND UNMET NEEDS	26
Figure 4.1 Typical forms of private disability insurance coverage.	27
Figure 4.2 Disability insurance is one of the less expensive insurance coverages.	29
Figure 4.3 Employees are less likely to have long-term disability coverage than other insurance benefits.	31
Figure 4.4 Most small employers do not offer long-term disability benefits.	33
Figure 4.5 Less than one in three U.S. workers has private long-term disability coverage	35

INTRODUCTION

What are the chances that I will become disabled at some point during my working years and what could happen to my personal finances if I become disabled?

This chart book will help answer questions such as these. It is intended to provide general information about your likelihood of disability and what financial resources may be available if you become disabled.

Consumers, policymakers, and media professionals are likely to find this chart book useful in understanding more about how disability can affect the average American worker.

For more information about your situation, please contact a professional financial advisor. This booklet should not be used as a substitute for legal or professional advice.

EXECUTIVE SUMMARY

The risk of disability during a worker's career is significant and the consequences for individual and family financial security can be severe. Yet, a handful of factors conspire to give disability insurance the dubious distinction of being a “missing piece in the financial security puzzle.”

Too often the public underestimates the risk of suffering a disability.

The risk of a disabling illness or injury that prevents a worker from doing her or his job is significant, but generally far from one's mind. The public often ignores or under-appreciates the risk of suffering a disability that prevents an employee from staying on the job.

The financial risk of disability is great.

For most workers, the ability to earn a living is their most significant financial resource. A disabling illness or injury stops income, imposes additional costs, and prevents building a retirement nest egg. Most workers' savings will only see them through a few months of disability.

We may overestimate the help that is available from public disability insurance programs.

Public programs – chiefly Social Security Disability Insurance (SSDI), state workers' compensation, and state-mandated short-term disability programs – provide some safety net disability income protection. But workers cannot rely on these programs to ensure their financial security.

- ▶ The SSDI definition of “disability” makes it hard to qualify for benefits from this program.
- ▶ SSDI does not pay enough to maintain the standard of living for those who do qualify.
- ▶ Workers' compensation benefits cover only disabilities caused by injury or illness arising on the job – only an estimated 4% of long-term disabilities.
- ▶ Only a handful of states have temporary disability programs. Even when available, they have very limited benefits.

We are more likely to seek out insurance coverage for risks other than disability.

Though the financial risk of disability is as great as or greater than other risks which are routinely insured, workers and employers place the financial risk of disability a distant fourth on the list of risks addressed by employee benefits. Workers and employers are far more likely to consider health, life, and dental insurance before giving thought to the need for disability income coverage.

Private disability coverage can help meet disability income needs.

Private disability income insurance, available through an employer or directly to individuals, is designed to meet the financial risk of disability.

For More Information About Protecting Your Family and Yourself Against the Financial Risk of Disability.

- ▶ Ask your employer about disability insurance coverage.
- ▶ Consult a financial advisor or insurance professional. To find an insurance agent or financial advisor who has earned the Disability Income Associate (DIA) designation, call AHIP's Insurance Education Program at 202.778.8471.
- ▶ Visit the consumer information section of the AHIP web site at www.ahip.org or call toll-free 877.291.2247 for a free *Guide to Disability Income Insurance*.

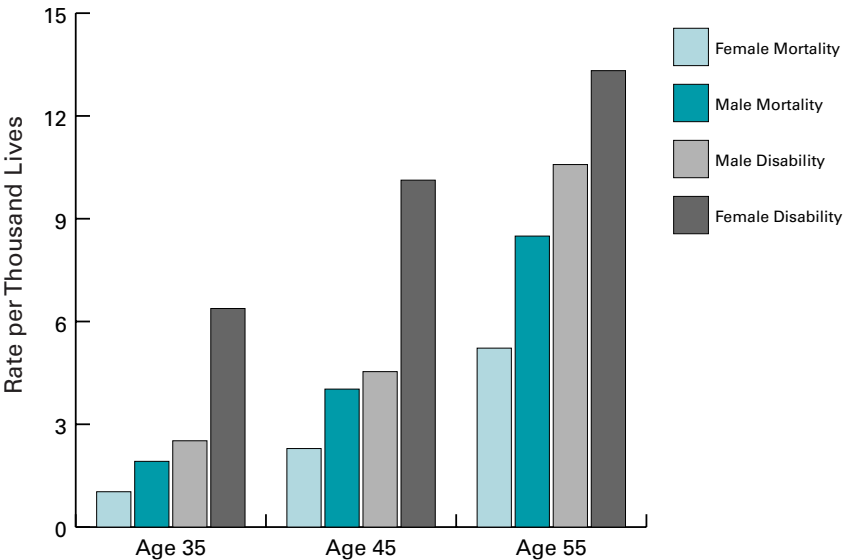
SECTION 1. RISK OF DISABILITY

Anyone can become disabled. An automobile accident, a weekend sports injury, or any of a number of chronic or sudden illnesses can limit a person's ability to work.

The risk of becoming disabled is greater than most people think. In fact, the risk of disability is greater than the risk of premature death, which people routinely insure.

In general, older people are more likely to become disabled than younger people, and females are more likely to become disabled than males.

Figure 1.1 THE RISK OF DISABILITY* IS GREATER THAN THE RISK OF PREMATURE DEATH.

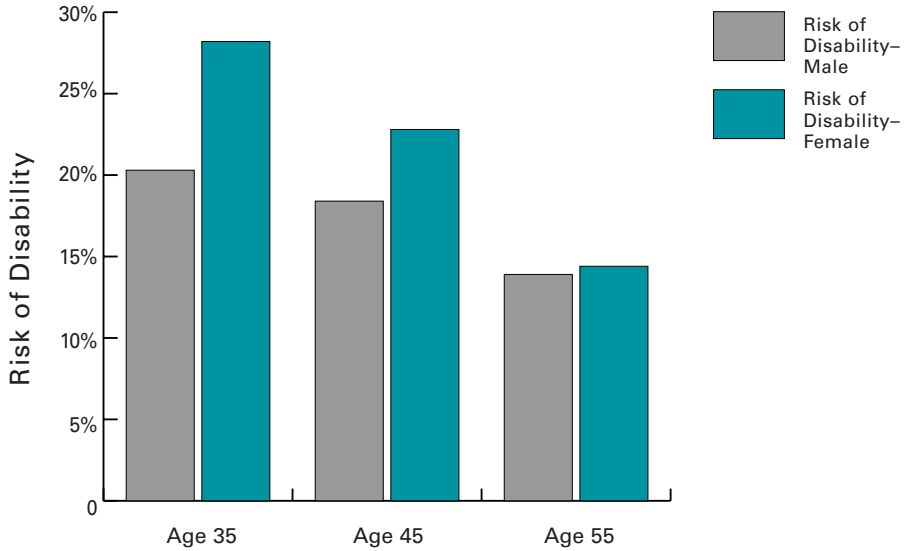


**Disability lasting 90 days or longer*

Sources: National Association of Insurance Commissioners (NAIC) Commissioner's Individual Disability Table A (1985); Statistical Abstract of the United States

The likelihood of a worker experiencing at least one period of long-term disability (i.e., a period lasting at least 90 days) during his or her working career is significant.

Figure 1.2 THE RISK OF BECOMING DISABLED* DURING YOUR WORKING YEARS IS SIGNIFICANT.



** Disability lasting 90 days or longer*

Source: National Association of Insurance Commissioners (NAIC) Commissioner's Individual Disability Table A (1985)

It is common for people to associate disability with serious accidents, but in reality the majority of disabilities are caused by illnesses. Even people who don't have a high-risk job are at risk of disability from muscular, cardiovascular, cancer, psychiatric, or other illnesses.

Figure 1.3 THE MAJORITY OF DISABILITIES ARE CAUSED BY ILLNESSES, NOT ACCIDENTS.

Diagnosis Category	Average % New Claims Submitted	
	Long-Term Disability	Short-Term Disability
Accidents	10.1%	14.4%
Illnesses		
Infectious/Parasitic Diseases (excluding AIDS/HIV)	1.8%	2.4%
AIDS/HIV	0.3%	0.1%
Neoplasms	14.0%	5.5%
Mental Disorders	8.7%	4.6%
Substance Dependencies	0.3%	0.4%
Nervous System Diseases	6.9%	3.4%
Circulatory System Diseases	10.0%	5.7%
Respiratory System Diseases	2.9%	4.3%
Digestive System Diseases	2.9%	7.6%
Chronic Fatigue Syndrome	0.9%	0.5%
Fibromyalgia	1.2%	0.1%
Reproductive/Urinary Diseases	2.4%	6.1%
Pregnancy (Complications)	4.0%	5.8%
Pregnancy (Normal)	4.8%	15.7%
Muskoskeletal System/Connective Tissue Diseases	21.9%	15.0%
All Other	6.9%	8.4%
	100.0%	100.0%

Source: JHA 2002 U.S. Group Disability Rate and Risk Management Survey

There are currently more than 1.5 million people who have left the U.S. workforce due to a disabling condition. Once disabled, many people are never able to work again.

Figure 1.4 MANY WORKERS NEVER RETURN TO WORK FOLLOWING A DISABILITY.

Of those workers who experience a serious disability – one lasting at least 90 days – many remain unable to return to work for years afterwards.

Percentage of Disabled Remaining Disabled Over Time.

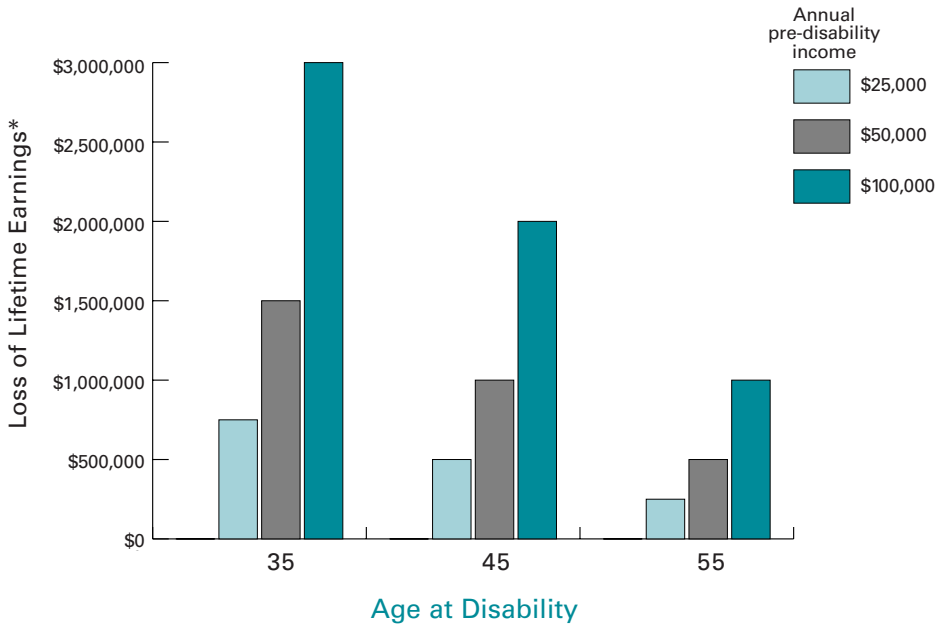
		Age of Disability Onset		
		35	45	55
Years After Disability Onset	1	56%	65%	77%
	2	39%	50%	66%
	3	32%	44%	60%
	4	29%	41%	57%
	5	27%	39%	54%
	10	22%	32%	44%

Source: Society of Actuaries 1987 Group Long-Term Disability (GLTD) Basic Table

SECTION 2. FINANCIAL CONSEQUENCES OF DISABILITY

As seen in Section 1, the risk of disability is relatively high. In fact, workers at age 30 face almost a one-in-three chance of suffering a disability lasting three months or longer at some point in their working careers. Some of them will never be able to return to work. For most workers, the ability to earn a living is their most significant financial resource. A lengthy disability can be financially devastating to workers and their families.

Figure 2.1 THE POTENTIAL LOSS OF EARNINGS FROM DISABILITY IS SIGNIFICANT.



* This graph assumes no future changes to salary, and disability to a retirement age of 65, for simplicity. (Note: Estimates of potential earnings loss often take into account additional factors, such as interest, inflation and likelihood of recovery).

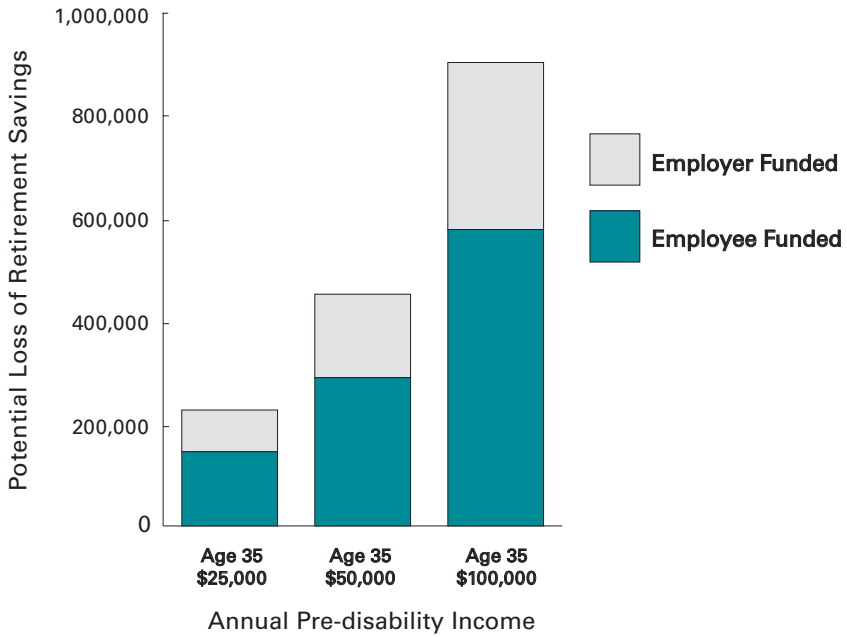
This chart shows, for instance, that a 45 year-old, currently earning \$50,000 per year and suffering a permanent disability, could lose \$1,000,000 in future earnings.

A disability frequently turns a breadwinner into a dependent, drastically reducing income while increasing expenses. When people are disabled and can't work, they don't just lose their current income, they also lose the ability to save for retirement, as well as other employee benefits such as employer-sponsored medical benefits.

A serious disability can also lead to higher living expenses due to greater health care needs, the need for assistance in performing routine functions, and other costs. While leaving the workforce can reduce expenses such as commuting and wardrobe costs, these are likely to be small compared to the additional expenses incurred.

The facing chart shows that if a 35 year-old worker, currently earning \$50,000 a year, suffers a permanent disability, he or she would likely forgo over \$400,000 of retirement benefits. Both employer-funded and employee-funded benefit accruals would be affected.

Figure 2.2 DISABILITY CAN DISRUPT RETIREMENT SAVINGS.

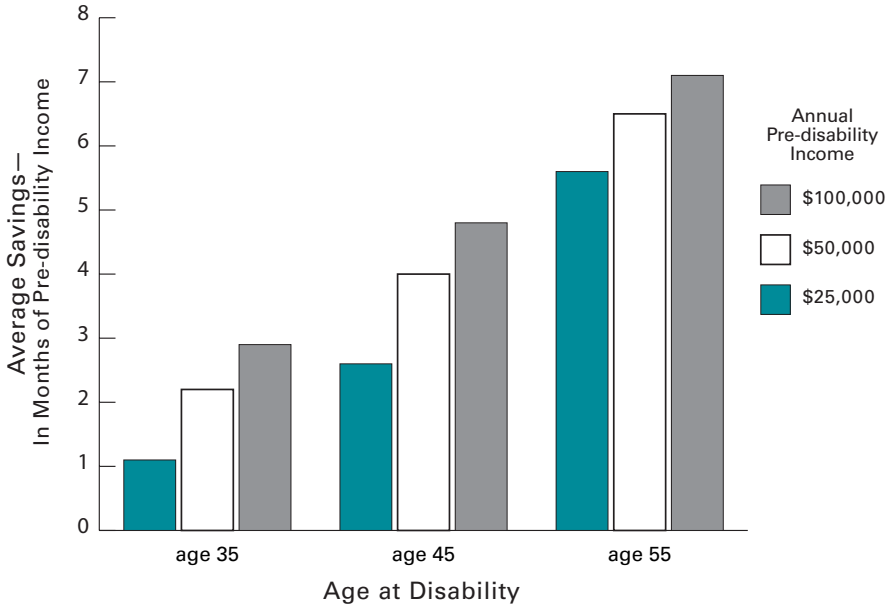


Source: U.S. Census Bureau

Few workers have adequate savings available to support themselves during an extended disability. Most workers' savings are equal to only a few months worth of their pre-disability income.

In this chart, savings includes investments in stocks and mutual funds, as well as interest-earning assets.

Figure 2.3 MOST WORKERS' SAVINGS WOULD ONLY SEE THEM THROUGH A FEW MONTHS OF DISABILITY.



Source: U.S. Census Bureau Survey of Income Program and Participation

In the absence of adequate insurance, many disabled employees could become dependent on public programs. Section 3 discusses the adequacy of public disability income programs, and Section 4 discusses the coverage available from private disability insurance programs.

SECTION 3. PUBLIC DISABILITY INCOME INSURANCE PROGRAMS—AND THEIR LIMITATIONS

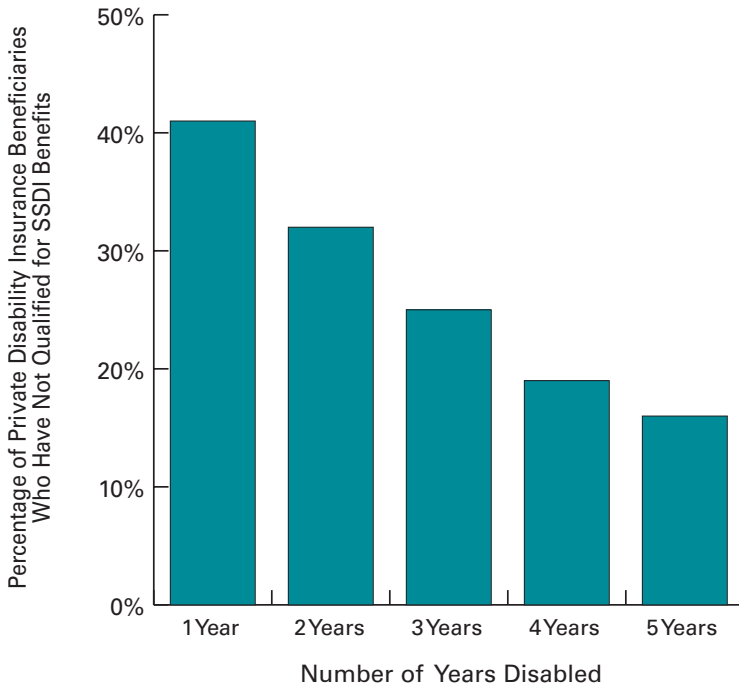
Public disability programs, which include the federal Social Security Disability Insurance (SSDI) program, state workers' compensation programs and, in a handful of states, mandated short-term disability coverage, provide some safety-net of protection against loss of income due to disability. However, these programs come with restrictions and limitations and cannot be relied upon to provide for adequate, comprehensive disability income coverage.

Social Security Disability Insurance (SSDI)

Though SSDI is an important source of disability income protection, the definition of disability under SSDI is very restrictive. In order to qualify for SSDI benefits, individuals must have significant physical or mental impairments that prevent them from engaging in any substantial gainful activity (defined for 2004 as earning \$810 per month). Furthermore, to qualify for benefits, the disability must be expected to last for at least one year or result in death. Finally, the administrative process required to gain approval for SSDI benefits may take many months—or even years.

To illustrate the relative difficulty of qualifying for SSDI benefits, Figure 3.1 presents data on the percentage of individuals who have qualified for private long-term disability benefits (through employer-provided LTD), whose disabilities have not been approved for SSDI disability benefits.

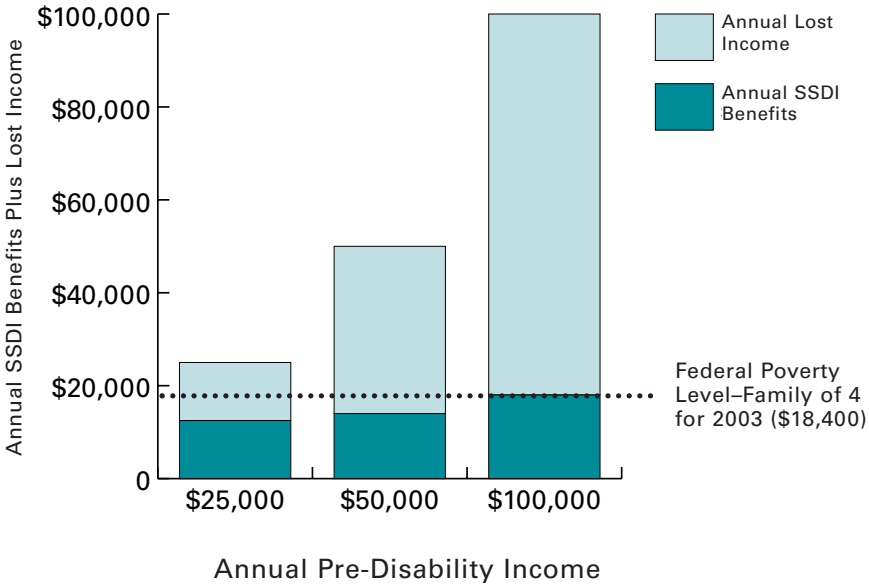
Figure 3.1 SSDI DEFINITION EXCLUDES MANY WORKERS WHO QUALIFY FOR PRIVATE DISABILITY BENEFITS.



Source: Principal Life Insurance Data, 1997–2002

In addition, SSDI benefits alone often do not provide sufficient income replacement to maintain pre-disability standards of living, especially for higher-income workers. Figure 3.2 compares SSDI benefit levels to pre-disability income for different income levels. The official 2003 Federal Poverty Level (FPL), for a family of four, is also presented for comparison purposes. For many workers, relying on SSDI benefits alone would leave their family below the Federal Poverty Level.

Figure 3.2 SSDI BENEFITS ALONE DO NOT REPLACE ENOUGH PRE-DISABILITY INCOME FOR MOST FAMILIES

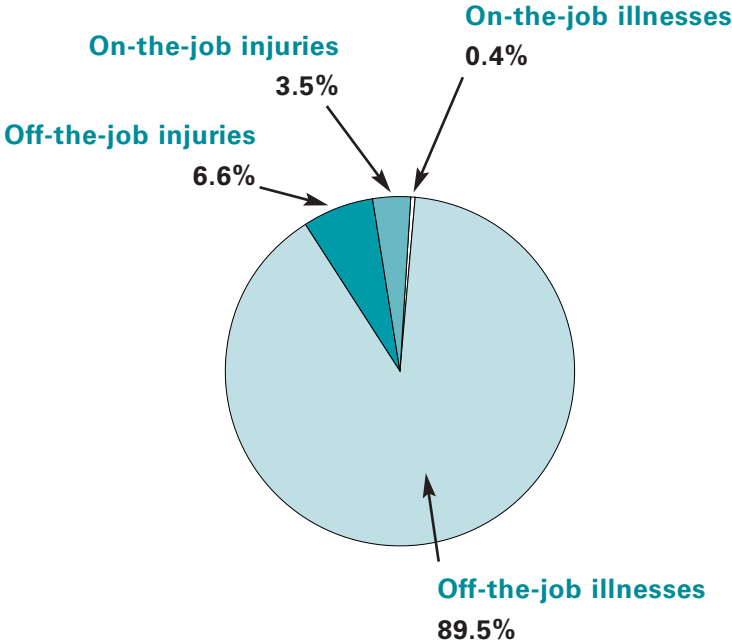


Source: Social Security Administration, U.S. Department of Health and Human Services

Workers' Compensation

All states require employers to provide workers' compensation coverage to most workers. Under these programs, workers who become injured or sick on the job are entitled to limited disability income benefits. Typically, these benefits are equal to two-thirds of pre-disability income, subject to various state maximums. However, workers' compensation does not provide disability income for those whose injuries or illnesses are not job-related. This means that most people who become disabled will not be entitled to workers' compensation benefits. Figure 3.3 shows the sources of long-term disabilities, including the estimated share attributable to off-the-job causes.

Figure 3.3 MOST LONG-TERM DISABILITIES ARE NOT COVERED BY WORKERS' COMPENSATION.



Sources: National Safety Council; JHA 2002 U.S. Group Disability Rate and Risk Management Survey

State Temporary Disability Programs

A handful of states – California, Hawaii, New Jersey, New York, Rhode Island, as well as Puerto Rico – provide for temporary disability benefits. Entitlement to these temporary disability benefits does not require that the disability arise out of job-related injury or illness. However, these temporary disability benefits typically continue for no longer than 26 weeks and have restrictive caps on maximum benefit amounts.

Figure 3.4 THE FEW STATES WITH TEMPORARY DISABILITY PROGRAMS PROVIDE ONLY LIMITED BENEFITS.

State	Maximum Benefit Amount (per week)	Maximum Benefit Period (weeks)
California	\$728	52
Hawaii	\$418	26
New Jersey	\$459	26
New York	\$170	26
Puerto Rico	\$113	26
Rhode Island	\$588	30

Sources: California, Hawaii, New Jersey, New York, Puerto Rico, and Rhode Island Temporary Disability Programs as of July 1, 2004

SECTION 4. PRIVATE DISABILITY INSURANCE COVERAGE: MET AND UNMET NEEDS

Private disability insurance coverage can be used to supplement public disability income programs and overcome some of their inherent limitations. Disability insurance can be bought on a group basis through an employer or purchased individually.

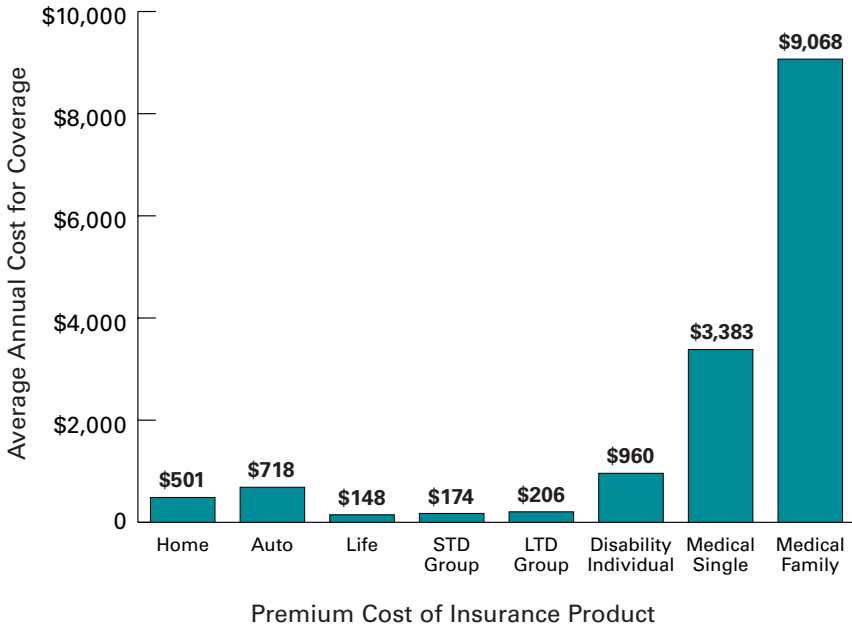
The facing chart outlines some typical provisions of private plans. There are many variations to each of the typical provisions shown.

Figure 4.1 TYPICAL FORMS OF PRIVATE DISABILITY INSURANCE COVERAGE

	Group		Individual	
	Short-Term Disability (STD)	Long-Term Disability (LTD)	STD (Usually Blue Collar)	LTD (Usually Professional)
Benefit Start	1-30 days after disability	90-180 days after disability	7-30 days after disability	30-90 Days after disability
Benefit End	90-180 days after disability	Age 65	2-5 years after disability	Age 65 or Lifetime
Premiums	<ul style="list-style-type: none"> • Often less expensive than individual • Rates can change each year • Usually paid by the employer, sometimes with an employee contribution 		<ul style="list-style-type: none"> • Often more expensive than group • Rates are often guaranteed so premiums usually start higher but stay the same each year • Paid by the insured individual 	
Benefits	<ul style="list-style-type: none"> • Benefits increase annually with salary • Benefits are tied to salary, such as 60% of pay; often overtime, bonuses and commissions are not covered • Benefits are reduced for Social Security and workers' compensation 		<ul style="list-style-type: none"> • Benefits are fixed at issue • Overtime, bonuses and commissions may be eligible for coverage • Benefits are not usually reduced for Social Security or workers' compensation 	
Portability	Employee may lose coverage when employment terminates (some employer plans let you take your policy with you)		Coverage continues if you change employers	
Tax Treatment	Usually premiums are tax deductible while benefits are taxable		Usually premiums are not tax deductible while benefits are tax free	

Group short-term disability (STD) and long-term disability (LTD) coverages generally cost less than coverage for other risks routinely insured against. Individual disability coverage tends to have a higher premium than group LTD due to higher insured amounts, higher expenses, and guaranteed level premiums.

Figure 4.2 DISABILITY INSURANCE IS ONE OF THE LESS EXPENSIVE INSURANCE COVERAGES.

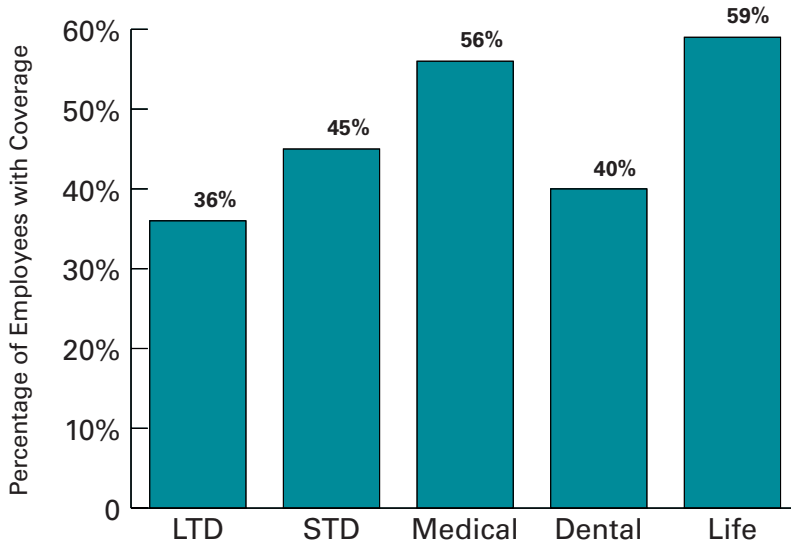


Note: Average costs represent total annual cost, whether paid by insured or employer.

Sources: Kaiser Family Foundation, Employee Health Benefits; LIMRA surveys; NAIC website; Best's Review; 2001–2003 data.

Despite the lower cost, employees are less likely to have disability benefits, especially long-term disability, than other employee benefit coverages. In large part, this is because fewer employers provide or offer it.

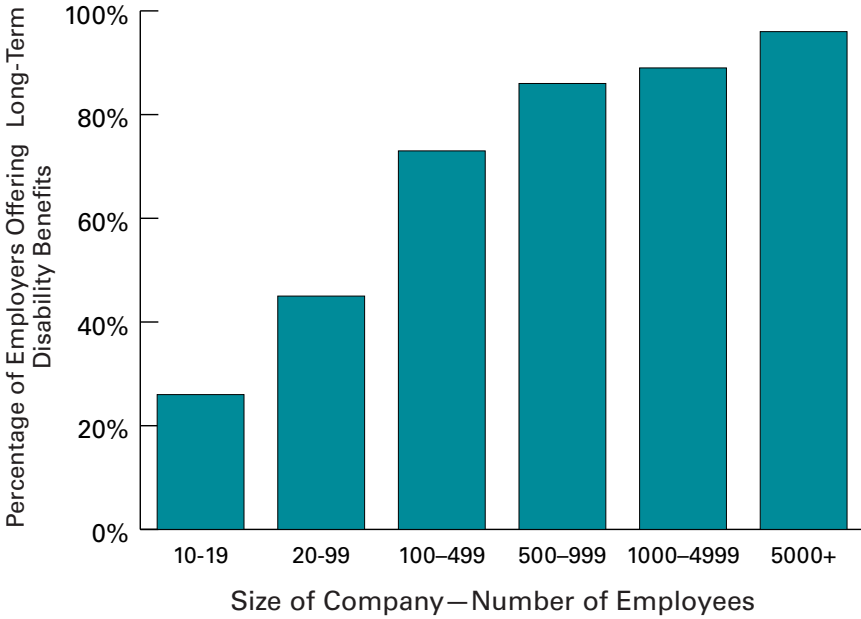
Figure 4.3 EMPLOYEES ARE LESS LIKELY TO HAVE LONG-TERM DISABILITY COVERAGE THAN OTHER INSURANCE BENEFITS.



Source: National Compensation Survey: *Employee Benefits in Private Industry in the United States*, 2003. U.S. Department of Labor, Bureau of Labor Statistics (full-time employees only)

In general, the smaller the employer, the less likely they are to offer long-term disability coverage to their employees.

Figure 4.4 MOST SMALL EMPLOYERS* DO NOT OFFER LONG-TERM DISABILITY BENEFITS.



Source: LIMRA, “The Changing Group Insurance and Healthcare Marketplace,” 2003

*Employers with fewer than 100 employees

When disability coverage is offered, employers often pay the entire premium. However, it has become increasingly common for employers to offer arrangements under which employees pay some or all of the premium. In cases where the employee would have to pay for a portion of the coverage, employees may choose not to participate.

Figure 4.5 LESS THAN ONE IN THREE U.S. WORKERS HAS PRIVATE LONG-TERM DISABILITY COVERAGE.

Percentage of employees with disability coverage

Type of Program	All Employees	White Collar: Professional, Technical, and Related Employees	Blue Collar: Clerical and Sales Employees	Service Employees
Short-term Disability Coverage	37%	40%	44%	20%
Long-term Disability Coverage	28%	40%	20%	10%

Source: National Compensation Survey: *Employee Benefits in Private Industry in the United States*, 2003. U.S. Department of Labor, Bureau of Labor Statistics. (includes part-time employees)

For More Information About Protecting Against the Financial Risk of Disability

The risk of disability during a worker's career is significant and the consequences for financial security can be severe. If you think you might need more protection against the financial risk of disability or just want to learn more about how to protect yourself and your family, here are some steps you can take:

- ▶ Ask your employer about disability insurance coverage.
- ▶ Consult with a financial advisor or insurance professional about disability income coverage. They are prepared to help you determine how much and what kind of coverage is right for you.
- ▶ To find a disability insurance agent or financial advisor near you who has earned the Disability Income Associate (DIA) designation, call AHIP's Insurance Education Program at 202.778.8471.
- ▶ Visit the consumer information section of the AHIP web site at www.ahip.org. Or call toll-free 877.291.2247 for a free *Guide to Disability Income Insurance*.

Note: Figures in this chart book were derived from source material data as referenced.

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The Actuarial Foundation, a 501(c)(3) organization, was established in 1994 to help facilitate and broaden the profession's contribution to society. The Foundation explores innovative ways to apply actuarial skills in the public interest and brings together broad partnerships of individuals and organizations to address social problems in creative ways. The Actuarial Foundation provided funding for the development of this consumer piece.

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