

Getting into the Financial Wellness Zone

Eight Steps to Financial Freedom and Lasting Security

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STEP 3: GUARD WHAT YOU HAVE AND THOSE YOU LOVE PART TWO: DISABILITY INSURANCE

WHY YOU SHOULD PLAN FOR A DISABILITY

Business owners and their employees meticulously plan for retirement because they consider it an achievement, but some fail to plan for death or disability. Although it can be uncomfortable to think about your death or disability, failing to plan for what might happen is foolish.

The number of non-fatal, preventable injuries are staggering. In 2017 alone, there were 47.2 million injuries — one in seven U.S. citizens — where the injured sought medical attention. Motor vehicle accidents accounted for 4.2 million of those injuries; 4.5 million were work related; 25.3 million happened at home; and 13 million were public space injuries.¹ According to the Social Security Administration, more than a quarter 20-year-olds become disabled before reaching retirement age.² And according to a CNBC report, medical bills are the number one cause of bankruptcy.³

Getting injured in any given year is a materially significant risk you must plan for, because the risk is high that you will be injured over the course of your career.

Workers and business owners should always plan ahead for the possibility of a disability or death. It's a planning priority, just as important as planning for retirement. In my previous article in this series, *Life Insurance: Why Not Invest the Premiums For a Better Return?*, I scratched the surface on the importance of life insurance, but what happens if you fail to plan for a disability? Consider the following:

- What might happen if you suffered an injury or illness and couldn't work for days, months or even years?
- What happens if you become physically unable to work?
- Who pays the bills?
- How would you continue to afford your lifestyle if you become disabled?
- If you're single, do you have other means of support?



INDIVIDUAL DISABILITY POLICIES

- Highest cost.
- Bought through an insurance agent.
- Underwriting criteria must be met for vocation, health, habits and avocations.
- If purchased with after tax dollars, benefits are paid tax free.
- May include flexible benefits like COLA (cost-of-living) adjustments and partial benefits.
- Premiums are typically level, and coverage doesn't drop over the life of the policy.

- If you're married, could your spouse's income support your whole family?
- What happens to the business if the owner with a special skill or knowledge becomes disabled?
- What happens if the disabled partner, proprietor, or majority owner is dissatisfied with their income and wants to dissolve the business?
- What happens if the other owners tire of performing all of the services while continuing to make income payments to the disabled owner?
- What happens if there is an unsatisfactory agreement between the disabled owner and the operating owners?

WHAT IS DISABILITY INSURANCE?

Disability insurance pays a benefit when the insured becomes sick or injured. Policies are structured to pay a sizable portion — usually about two-thirds — of your current earned income.

HOW DISABILITY INSURANCE PAYS BENEFITS

Disability insurance is usually broken down into two categories — short-term and long-term.

If you should happen to become disabled, your disability contract typically has an elimination period, which is the amount of time until benefits can be paid. Short-term disability insurance usually pays benefits for 90 to 180 days after an elimination period of seven to 14 days; the elimination period for long-term disability is usually 90 to 180 days. Long-term disability insurance pays benefits to age 65.

Many employers offer short-term and long-term disability insurance in their benefit packages. It's critical to meet with your financial planner to review your coverages for any coverage time gaps and to ensure the amount is enough to cover your living expenses.

Some disability insurance policies offer a rider that pays a partial benefit if you aren't completely disabled and can work part time. It's also possible to buy lifetime disability coverage, but these policies can be cost prohibitive.

BUYING DISABILITY INSURANCE

Disability insurance is available from private insurance companies. You may be able to take advantage of your employer's group policies or choose to buy your own policy. The U.S. government also provides insurance, though typically it is less comprehensive than private insurance. Private insurance companies offer individual disability income policies, group policies, group association policies and disability income attached as a rider to life insurance policies. Individual disability insurance usually offers the highest level of coverage, albeit at a greater cost. You should contact both your employer and

EMPLOYER PROVIDED GROUP DISABILITY POLICIES

- Benefit received from employer.
- You may pay or employer may pay.
- You have to be employed.
- Low group insurance rates.
- Short-term or long-term.
- No proof of insurability.
- Not flexible, not portable; premiums increase with age.
- Narrow definition of disability compared to individual policies.
- Benefits offset by SSDI, Worker's Comp., etc.

your financial planner to discuss what options are available to you. A good financial planner will review your existing coverage with you and help you decide whether you need more disability coverage.

GOVERNMENT BENEFITS

Worker's compensation and Social Security are the best-known disability insurance programs. Civil Service workers, military and government employees (federal, state or local) may have disability programs already offered to them as a benefit.

Although government benefits are available, they typically offer only a modest amount of money and come with a lot of restrictions. Benefits are paid according to very narrow definitions of disability, making it difficult to qualify. It would be an error to rely on government benefits as a main source of income in the event of a disability. Relying on this type of insurance can be dangerous for you and your family. Benefits are limited and likely inadequate for your needs.

- Social Security Disability Insurance (SSDI) is a government benefit available to qualified individuals under the age of 65 regardless of their income.
- Supplemental Security Income benefits are available to qualified individuals with limited income. To get benefits, your mental or physical impairment must last for at least a year or is expected to be the cause of your death. The impairment must prevent you from doing any substantial gainful activity. In other words, you can't work. There is a list of impairments considered severe enough to qualify. The Social Security Administration is very strict and looks into your age, education, work history, skill sets, experience and medical condition. There are income limitations, and if you exceed the threshold, you won't qualify. In addition, you need to have earned enough work credits to qualify. You typically earn about four credits per year. The older you get the more credits you need to qualify.

HOW MUCH DISABILITY INSURANCE SHOULD YOU BUY?

How much income do you need if you are disabled? How much can you afford to spend on premiums? How much disability insurance does the insurer offer?

If you become disabled, you might be able to save money on gas, car maintenance, eating out and clothing, but your fixed expenses will likely stay the same, and your medical expenses will likely increase. If you have a long-term disability, you may have to leave your job, and you may lose your group medical insurance coverage. Your employer may offer COBRA as a way to continue getting health insurance, but you will bear the full cost. You also may need to buy specialized medical equipment and supplies or even change your living space to make accommodation for your disabilities. You may have to hire help to mow the lawn, clean your home and cook. If you have children, you might have to think about child care expenses. If your significant other becomes disabled, they may not be able to provide child care. Or if a spouse is currently taking care of children, they may no longer be able to. Meet with your financial advisor to review the coverage

ASSOCIATION OR ORGANIZATION GROUP POLICIES

- Policy purchased through associations like National Association of Social Workers or Financial Planning Association.
- You must be a member of the group sponsoring the insurance.
- Low group insurance rates.
- Less intensive underwriting requirements, if any.
- Not flexible; premiums increase with age.
- Narrow definition of disability compared to individual policies.
- Contract may be terminated by association or insurance company.

available to you — including any group disability policies you currently are covered by — and to help you decide whether you need more disability coverage.

HOW MUCH DISABILITY INSURANCE CAN YOU BUY?

A general rule of insurance is if premiums are paid with after-tax dollars, benefits are received tax-free. If you pay premiums with pretax dollars through a payroll deduction, your benefits could be taxable. Based on your income, health, age and other disability coverage you have, most company-provided disability insurance will replace 50 to 70 percent of your monthly pretax income.

GETTING BACK TO WORK

If you are able to recover from your disability, getting back to work may be a priority for you. Many disability plans are flexible and offer rehabilitation and return-to-work incentives. Plans may offer workplace modification, rehabilitative services, Social Security coordination assistance and a work incentive benefit.

WHY SHOULD BUSINESS OWNERS OWN DISABILITY INSURANCE?

If you are a business owner, disability insurance has several functions. It can be used to protect your own income, purchased on key employees whose disability may affect your business, and can be used to buy out your partner's interest in the business if they become disabled.

Some issues that arise for business owners:

- The business owner loses his or her main source of income and the other owners continue to draw an income.
- The disabled business owner owns an illiquid asset.
- The other owners have to take on additional responsibilities or hire a replacement.
- The income of the business is reduced due to the business owner's absence.
- The business is sold and the other owners are not happy with the sale.

DISABILITY BUY-SELL AGREEMENTS

Corporate buy-sell agreements are a great tool for business owners. The buy-sell is a legal document that outlines the terms of a purchase and sale of the business. The agreement should include provisions for both death and disability. Because the chances of disability are high, all buy-sell agreements should really include a provision for both death and disability. Buy-sell agreements can be designed as cross-purchase agreements or stock-redemption plans. With a cross-purchase agreement, each shareholder agrees to purchase the designated shares of the disabled shareholder's stock. In a stock-redemption plan, the corporation is required to redeem the disabled shareholder's stock. The main purpose of the buy-sell agreement is to provide the business owner with a guaranteed market in the event of disability or death. With valuations being determined in advance, there is a higher chance fair proceeds will

HOW TO FUND THE DISABILITY BUYOUT

- Disability income insurance.
- Disability buyout insurance.
- Life insurance waiver-of-premium insurance.
- Life insurance cash value.
- Life insurance dividends.
- Life insurance death (If disabled owner dies before the completion of the buy).

be received by the impaired partner — or in the event of death, their family. This helps provide the business with continuity and solves many issues that can arise due to the remaining owners becoming unhappy with having to support the disabled owner or having the business forcibly sold or liquidated.

The disability buy-sell agreement typically has an elimination period, which is the time before a purchase may occur. This is referred to as the trigger date. The provision also may define the terms where a purchase becomes mandatory. There may be provisions for salary continuation payments or the eventual recovery of the business owner.

The buy-sell agreement must be funded, or it really doesn't have any teeth. Disability income protection insurance and specialized disability buyout insurance policies can be utilized to fund the agreement. The purchaser, payor and insured are all specified. When the buyout is triggered, a provision in the agreement determines how the remaining policies on the other owners are disposed or distributed. There should also be provisions for the premature death of the disabled owner during the buyout. The life insurance covering the owners under the "deathtime" provision should be continued until the installment payments are completed. Death may either trigger accelerated payments or create a lump-sum payment to the survivors.

FINAL THOUGHTS

Preparing for the unexpected is a key step toward financial freedom and security. Disability insurance will help you protect what you have and those you love in the event of your own disability. Disability coverage is a key piece in your financial plan and will help you to achieve a higher level of personal financial security.

This article intends to provide an overview of disability insurance. Please feel free to contact me with questions about your own personal situation.

¹National Safety Council, *Injury Facts*.

²The Social Security Administration, *The Facts about Social Security's Disability Program*, 2019.

³CNBC, *Medical Bills Are the Biggest Cause of US Bankruptcies: Study*.

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