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The Disability Dilemma

Companies are cutting back on disability insurance, just as the country is seeing a surprising jump in long-term illnesses and injuries.

Here's how to protect yourself against this hidden threat to your financial security.

By Dawn MacKeen

The disease crept into James Shrader's life slowly and steadily. Its advance was as slow as some of his days are now, when the 50-year-old father of three struggles to get out of bed, quiet his tremors, recall a specific memory. What began as a lone spasm in his left leg reverberated, and intractable fatigue soon followed. The illness affected his output at work, too. From a high of assembling 20 computers an hour for Dell near his home in Round Rock, Tex., Shrader slipped to 18. Then 15. Then 10. And finally, to none.

Early-onset Parkinson's can do that to a person. Seven years after those first symptoms appeared, Shrader's neurological disorder continues to take a little more of him. Each morning he remains frozen in his bed until his medication takes effect. He can no longer work, and on some days he has trouble articulating his thoughts. His illness, and its emotional ramifications, remain only part of the problem: The bills are piling up. But he is lucky in one respect. When he initially joined Dell, he signed up for disability insurance almost as an afterthought. "Lots of people don't think it's going to happen," he says. "I was the main provider for the family." His monthly $7.95 premium now translates into a $1,270 monthly check. That's vital support for someone who may never again earn an income.

Still, if Shrader had known, he would have undoubtedly stitched together a bigger safety net. For, as he's learning, long-term disability is one of the most devastating threats to a family's financial security. An illness or injury can start a downward slide that sweeps almost every asset along with it. A family can lose its main source of income, and then its savings, as it shoulders the often unbearable costs of medical or custodial care. Even if a disability doesn't drive you permanently out of work—and most don't—it can do irreparable damage to your finances. Indeed, a recent academic study suggests that disability and related health care costs now account for half of all personal bankruptcies—a fate Shrader and his family are struggling to forestall.

Though it sounds counterintuitive in a nation with one of the world's most advanced health care systems, incapacity threatens more of us than ever. In 1990 roughly 43 million Americans were disabled; now that's grown to 54 million, according to the National Council on Disability. At the same time, disability insurance has become much less common in the workplace. And even seemingly secure nest eggs are vulnerable to long-term ailments. Danbury, Conn., financial planner Morris Armstrong estimates that a middle-class family could blow through $50,000 a year in savings if an illness or injury cost them their income. Financially, "disability is worse than death," says Armstrong. "It's an ongoing drain."

Still, disability is easily dismissed as a problem of society's oldest and poorest: That may help explain why only 28 percent of working Americans have long-term disability insurance, compared with 48 percent who own life insurance. But those figures reveal a widespread misunderstanding of the odds. According to the Society of Actuaries, the chance of an adult dying before the age of 65 is one in seven, while there's a one in three chance of that adult missing three months of work or more due to illness or injury, meeting the definition of a "long-term" disability.

Many people don't think about this threat until it's too late—when they can no longer work or qualify for a policy. But it's more important than ever to plan ahead. A thoughtful insurance plan can help insulate against life's more common ailments—cancer, complications from pregnancy, heart disease—and help prevent tough times from becoming financial catastrophes.

More Injury, Less Certainty

While the erosion of health benefits in the workplace has commanded attention for years, disability insurance has quietly shadowed its decline. So you can't assume you'll get the coverage through work anymore. Increasingly, employers are scaling back the amount they contribute toward these benefits, dropping them completely or not providing them in the first place. In 1998, 63 percent of employers offered long-term disability coverage; by 2002 that fell to 40 percent. "[The job market] was red hot, and they were trying to attract and retain employees," says Anita Potter, assistant vice president of Limra International, an insurance trade group. "It has dropped off."

At the same time, the definition of a disability has undergone a metamorphosis. In the early 1990s, a doctor's conclusion that a person was disabled was often enough to excuse him or her from work indefinitely, allowing some to collect benefits until they were 100 percent healthy. Policies like these helped trigger huge losses for disability insurers, encouraging a wave of consolidation that reduced the number of carriers selling individual policies from 66 to 31 over the past decade. Today insurers define disability more strictly. That same doctor's form now asks all sorts of questions about the person's ability to function: Can he stand for long periods, sit, walk, crouch? What's more, insurers are partnering with companies on "return to work" programs that bring patients back to their jobs—and replace some of their insurance benefits with wages.

Even as insurance becomes harder to find, the population that needs it is growing. The number of people in their 30s who can't feed or take care of themselves rose 50 percent between 1984 and 1996, according to the think tank RAND Corp., and preliminary analysis of subsequent studies shows the trend continuing. Severe disability rates are rising for fortysomethings, too. To some degree, the increase may be the product of new drugs and medical technologies, which prolong the lives of patients whose diseases might have quickly killed them two decades ago. But the supersizing of America through obesity may share the blame. Indeed, joint, muscle and connective-tissue conditions, and back injuries—all potentially related to obesity—are the second and fourth leading causes of long-term disability claims.

Of course, not all disabilities are permanent: Among people in their early 40s who went on disability, only 39 percent were still claiming benefits after five years. But the financial toll of even a seemingly manageable medical problem can be severe. Five months into Lisa Roy's second pregnancy, she learned that she needed surgery to correct a problem with her cervix. The Buffalo, N.Y., fundraiser found herself bedridden for 11 weeks, stuck surfing the Web and watching daytime TV. In the middle of a snowstorm this January, she gave birth prematurely to Louis, and then she took six weeks off to care for the infant. If she hadn't had disability coverage, Roy estimates, she would have lost $14,000 out of pocket. "It definitely helped," Roy says. "I know there are some mothers who did have to quit their job and had no income."

The strain on a family increases the longer a medical condition lasts. And so does the likelihood that the disabled person will lose health coverage. The Family and Medical Leave Act requires larger employers to continue benefits during an absence of up to 12 weeks a year. But increasingly, employers are cutting off those benefits as soon as they can. In fact, 41 percent of employers in 2004 ended health benefits as soon as long-term leave began, up from 32 percent in 2000, and another 29 percent terminated benefits after about a year, according to a survey of employers by Mercer Human Resource Consulting and Marsh, an insurance-services company.

Without another medical policy to fall back on, such as a spouse's, the financial repercussions can be grave. The law requires larger employers to offer Cobra, a continuation of health coverage, for 18 months in most cases. But Cobra can easily cost a family $10,000 a year—potentially prohibitive for a household that has lost income. Other insurers won't underwrite someone with a "preexisting condition," or if they do, the price can be exorbitant. There is Medicare, but to qualify, the person has to be officially deemed disabled and then endure a two-year wait before coverage begins. "Medicare is like a prize, if you can finally get it," says Deane Beebe of the Medicare Rights Center, an advocacy group.

With their income and health benefits gone, people can lose almost everything they have. Many land in bankruptcy court, where half the filers are there because of medical-related costs, according to a recent report in the journal *Health Affairs*. In this pool, says Elizabeth Warren, coauthor of the study and a Harvard law professor, almost none had disability insurance. Three-quarters started out with health insurance, but many quickly lost it. And with no supplementary income, making the monthly mortgage payment can become impossible. "The families who go bankrupt in the wake of illness look just like other middle-class families," Warren says. "They have good educations, decent jobs, homes, kids. But they were less well prepared for a serious bump."

Under these circumstances, sometimes even being prepared is not enough. Six months after James Shrader began his medical leave, he received a letter saying that Dell was terminating him. (Dell says it's company policy to end employment after six months of absence, regardless of the cause.) With that, he lost his health insurance. He now receives it through the Department of Veterans Affairs, but many of his medical expenses are out of pocket, like a recent $1,500 trip to the emergency room. His wife, Patti, works, but her income combined with his disability check is insufficient to pay the stack of bills. They have cut back on almost all their expenses, including his daughter's gymnastics and dance lessons. "Financially, we are struggling; it's living one paycheck to the next and barely doing it at that," Shrader says. As a result of his illness, he spends many of his days in his three-bedroom house, but now he is in danger of losing that, too.

A Do-It-Yourself Safety Net

Many of us think of the government as the insurer of last resort; after all, 6.2 million disabled people receive benefits through the Social Security system. But the program isn't a reliable cornerstone for anyone's planning. Working-age adults have to be unable to work for more than a year in order to qualify: Of those who apply, only 37 percent are approved. The monthly payment averages only $894, and some of the proposals under discussion in the political debate over Social Security reform could make those benefits shrink, relative to wages, in the years ahead.

In figuring out the protection you need, your first stop should be your employer's HR office. Some companies don't pay for long-term insurance, but offer it to employees at a group-plan rate that's cheaper than what they'd find elsewhere. Meanwhile, workers whose companies do insure them need to understand the nuances of their policy—how much it pays, how long the payments last and how the policy defines a disability. (For details about what else to look for, see "The Disability Basics")

The next step is evaluating your personal expenses to figure out how much coverage you need, and how to live on less. Eliminating credit card debt is a must, and keeping necessary expenses—such as the mortgage, groceries and utilities—below 50 percent of your salary can help you stay solvent should a disability occur. This is especially important since insurance plans pay, on average, 60 percent of your pretax income if you have to stop working. Many insurers cap the amount they'll pay at $7,000 a month. Getting coverage that pays more is pricey and sometimes impossible: Insurers don't want to create an incentive for customers to stay out of work. In addition, it's vital that you understand how your benefits will be taxed. If your employer pays all or part of the premiums, the corresponding proportion of your benefits will be taxable. By contrast, if you're paying the premiums yourself, the payouts won't be taxed.

Those who can't get disability insurance through their employer—or can't get enough—will want to consider buying coverage on the individual-policy market. Here, figuring out what to buy can involve taking a family's savings into account. Policies usually have an "elimination period" specifying how long the policyholder will wait before it starts paying benefits. The longer the wait, the cheaper the policy—so if there's enough money in the bank to cover three to six months or more without an income, a family can cut its annual premiums. For example, a 45-year-old man who makes $100,000 a year could replace 60 percent of his income with a policy that pays $5,000 a month. An UnumProvident policy with a 90-day elimination period, and benefits payable to age 65, would cost approximately $2,400 annually. That same policy with twice as long an elimination period would cost about $325 less a year.

As Shrader's plight illustrates, maintaining medical insurance is crucial not only to your health but to your finances. Employees should find out whether their company will terminate coverage in the event of a long-term disability. And if someone suffers a disability that's permanent, the family needs to observe some key deadlines. To receive Social Security benefits, workers should apply as soon as possible. If Social Security judges someone to be disabled, the worker can qualify for an extra 11 months of Cobra coverage (for a total of 29 months) while waiting for Medicare to kick in. And it's vital to either choose Cobra or find other coverage immediately, because any break of more than 63 days in your insurance coverage can make it nearly impossible to obtain an affordable policy afterward. At that point there's little most people can do, "other than to be aware of what rights you have . . . and hopefully have a pile of money around to pay the premiums," says Karen Pollitz, project director at Georgetown University's Health Policy Institute.

Challenging Definitions

Just because you pay for disability benefits doesn't mean you'll always get them. That can be especially true for people whose illnesses defy easy physical diagnosis—those with chronic fatigue syndrome, for example, or cognitive delay from a brain injury. Mental illness and substance abuse problems are particularly hard to insure against: Many policies stop payments to workers with these conditions after two years. Margaret Scott Lynch of Raleigh, N.C., went on leave from her job for knee surgery, and after complications resulting from that procedure, she had what her

THE DISABILITY BASICS

Despite recent cutbacks, the workplace remains the easiest place for most people to find disability insurance. Just make sure you ask the right questions:

Am I covered? Many people may assume they automatically get insurance through their jobs, but that's not usually so: A 2002 survey found that only 40 percent of companies offer long-term coverage, down from 63 percent in 1998.

What's my short-term situation? Some companies pay during the first 90 days of a long-term medical absence. Know your deadlines, because you won't need your long-term insurance to start paying until this coverage expires.

How are the benefits taxed? If your company pays all or part of your disability premiums, you'll owe tax on the corresponding proportion of your benefits–which could leave you short on money for necessities.

How long will my health insurance last? Only 31 percent of companies continue medical coverage for disabled employees for the entire time they're on leave. Find out your company's cut-off date so that you can make plans to buy other coverage once it ends.

doctors called a psychotic episode. When the 46-year-old signed up for disability coverage three years earlier, she didn't realize her policy had such a ceiling, but she recently hit it and saw her benefits cease. "No one ever told me how hard it would be to get it, how easy it would be to lose it," says Lynch, who has been diagnosed with depression. UnumProvident, the largest disability insurer, sells policies without the cap, but they cost 10 to 25 percent more.

For the many disabled people whose afflictions aren't completely incapacitating, insurers increasingly encourage the use of return-to-work plans. Four years ago, 32 percent of companies surveyed had such plans in place, according to Mercer; today that figure's up to 58 percent. These programs are hardly altruistic: Companies and carriers lose money when an employee is out on disability. But they can restore some much-needed normalcy to a worker's life—and help employees sustain their income even if they can't perform their predisability jobs.

Dianne Beauchamp, 52, has had just such an experience. A medical technician at California's Lawrence Livermore National Laboratory, Beauchamp knew something was wrong when the numbers on her blood-pressure gauge became difficult to read—and sixes looked like eights. She was soon diagnosed with multiple sclerosis. Seven and a half years later, she still struggles with her vision, but she has continued to work, using special glasses and a computer with a modified screen. "I have good days and I have bad days," says the Tracy, Calif., resident. "I could have those bad days at home, sitting and feeling sorry for myself, or I could be at work and still be productive." Ⓢ

LEARNING THE LANGUAGE

Whether you're buying a policy at work or on your own, you'll encounter some unfamiliar jargon. Below, we've translated some of the most important terms.

Benefit period: This outlines how long you will receive payments if you're disabled. Typically, insurers pay benefits until age 65, when Social Security or pensions kick in; a few pay until death. Some policies stop payment after shorter periods, such as five years, and they can cost 20 to 30 percent less per year.

Elimination period: The term defines the time that elapses before benefits begin. Getting a 180-day elimination period instead of a 90-day could save 10 to 20 percent a year, according to insurer UnumProvident. If you have substantial savings you can tap in case of an illness, the tradeoff may be worthwhile.

"Own" versus "any" occupation: For someone with highly specialized skills, such as a surgeon, an "own occupation" policy pays benefits as long as you can't return to your specific job—even if you take lower-paying work in another field. Such policies cost about 15 percent more than "any occupation" coverage, which lies at the other end of the scale: If you can work at all, benefits cease.

Noncancelable and guaranteed renewable: If possible, you want both. Sure, it costs about 25 percent less to buy just a guaranteed renewable policy, but you risk having your premiums go up. A noncancelable policy locks in your rates, but people who work in fields that are considered risky—including electricians, carpenters and contractors—can have a tough time getting one.

High-risk policy: For people with health conditions or occupations that scare insurers away—or for an executive who makes a lot of money—policies can cost 25 to 100 percent more in premiums and the choice of insurers is limited. Lloyd's is the main player in this field. **—D.M.**