SURGEONS Capital Management

Preserving more of your earnings

DISABILITY INSURANCE

Quick Guide






Surgeons Capital Management (SCM) is a private wealth management firm that works solely with surgeons and surgical practices. Our focus is in providing wealth and investment management, estate planning strategies, asset protection, and credit protection strategies to our clients.

- Because we work exclusively with surgeons and professional groups, we can provide some additional benefits and programs that are only available to our client surgeons — often at lower cost.
- Recognizing your time constraints, we are available to work around the clock, seven days a week.
- We are there for you when you need us, not when it's convenient for us. We can meet with you virtually, or in person — whatever your preference.

We seek to understand your highly specialized and complex financial needs and, using tax-advantaged planning strategies, we strive to provide lasting value to you and your family.

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It's Part of Your Financial Foundation

Disability, major illness or injury, and death can create havoc and cause serious financial hardship—if you're not properly insured. Properly managing major life risks means having the right protection so a debilitating illness doesn't put an end to your income, a life-saving medical procedure can be performed without regard to cost, and your loved ones have money to live on when you're no longer here.

These catastrophes happen to every one of us. . . sooner or later. If a major illness, disability, or death happens while you're still working, lack of protection—and even the wrong protection—can mean a lifetime of savings lost. If all your money is lost, what will happen to your life or the lives of others who depend on you?

Investing for your financial future is essential before you start investing money for your retirement or your child's education. The building blocks in a strong financial foundation consist of having three to six months of living expenses in an emergency fund, minimal consumer debt, and adequate insurance protection (life, disability, health, property, liability). Having enough—and the right type—of insurance significantly reduces your risk of a future financial emergency turning into a financial catastrophe.

This section will focus on the kinds of insurance that reduce or eliminate the risk of catastrophic financial loss as a result of illness or injury, disability, and death.

Big Picture Preview

Here are the key considerations when reviewing your insurance needs:

Disability Insurance. Does my employer have an income replacement plan if I get sick or injured and I can't work? Am I covered . . .for what and for how long? Can I get disability coverage that I can afford? Should my spouse also have coverage?

Life Insurance. What is the best way to determine if I need life insurance? If I do need it, how much should I buy? What about my spouse and children? Should I buy the type that only pays a death benefit or one where my cash grows and is available to me? Does it make sense to get it through my employer?

Medical Insurance. How can I tell which type of medical plan is best for me? Should I choose coverage under my employer's plan or my spouse's plan? How can I keep my medical out-of-pocket expenses as low as possible?

Other Types of Insurance. How do I make the right coverage choices for automobile insurance coverage? What about homeowner's insurance? Do I need an umbrella policy? Should I consider purchasing Long-Term Care insurance?

Prioritizing Insurance Needs. What if I can't afford as much insurance as I need? How do I prioritize the different types of insurance?

Make Sure You Are Protected

Don't ever assume you're covered under an employer plan. Take the time to read your employee benefits book. Determine if there is a waiting period before your benefits begin. If you leave your job, will you be able to pay for company-provided insurance coverage once you're gone?

Also take the time to understand how any privately owned insurance works.

The best way to make sure you have enough protection is to consult with your financial professional, who can provide these services:

- Assess what coverage you have
- Determine what you really need
- Advise you how to make up the difference

To make sure that you're not paying too much, you have to know the following:

- Understand what type of insurance you own and how it works
- Understand what it does and doesn't do
- Determine whether the payoff in the short- and long-run is worth the cost today

Here's the rule: Insurance is something you buy when you don't need it so you'll have it when you can't get it. You can't get it if you're uninsurable or a tragedy strikes. It has no value to you after the fact. If you're underinsured, you're putting yourself and your loved ones at high risk for financial loss.

Why You Can't Be Without It

A serious illness or injury doesn't discriminate against singles and couples … or those with children or dependent parents. The fact is everyone needs disability insurance. Be careful not to skimp on disability coverage to increase your other insurance coverages.

Disability insurance is the most overlooked form of insurance, yet it protects your most important asset: your ability to earn income.

Did you know that:

- Your chances of becoming disabled (three months or longer) are much greater than your chances of dying while you're still working (assuming you stop working at age 65).
- A disability lasts an average of three years.

So why do most people consider life insurance before insuring their income?

- Individuals who work for large corporations believe their companies, or the government, will take care of them if they get sick or injured.
- Deep down inside, they believe it will happen to the next guy, not to them.

Simply put, as long as they have a job, they take their income for granted. That's a big mistake!

Here are some general rules about disability insurance:
1. At a minimum, your disability insurance should replace 60% of your current monthly income.
2. When an employer allows you to purchase more disability insurance, purchase as much as you can (not as much as you can afford). You can't afford to be without it.
3. If an employer does not offer a plan, or if your employer-sponsored coverage doesn't cover at least 60% of your current monthly income, consider purchasing individual disability insurance.
4. If you're married and both of you are employed, it is important to have disability insurance for both of you (not just for the higher earner). After all, it takes two paychecks to support your current lifestyle.
5. Hospital Indemnity policies are not a substitute for disability insurance. These policies pay you a fixed dollar amount, for example, $50 per day during your hospital stays. These are not disability income policies and we suggest that you avoid purchasing them. If you have one, consider applying those premium dollars instead to a policy that will replace your income when you're disabled—and doesn't require you to spend time as a patient in a hospital.

To begin with, you need to know where the money will come from if you can't work; there are several possible sources of disability income that you may be able to take advantage of. You need to recognize that company plans are only part of the solution, and you need to be realistic about your lifestyle in determining how much is enough.

Disability insurance doesn't have to cost an exorbitant amount; you can make choices about the kind of insurance you get that will hold down the costs. You also need to know how to shop for a policy, and whether or not your disability benefits would be taxable.

If You Can't Work, Where Will the Money Come From?

Depending on the type of illness or injury you have that prevents you from doing your job, a portion of your income may be replaced by workers' compensation, Social Security disability benefits, an employer's disability program, or other programs.

Workers' Compensation

If you get hurt on the job, the workers' compensation laws in your state will govern how much you receive. The maximum you can receive is 66.6% of your pre-disability gross wages or 80% of your take-home pay, up to a specified limit.

Veterans Disability Benefits

If you have a disability resulting from an injury or illness you sustained while on active military duty, you may be eligible for Veterans benefits. You may also receive additional money for your dependants, depending on the Veterans Administration's (VA) evaluation of your service-connected disability.

You may even be eligible for a disability that is not service-related if you qualify based on your income and the size of your estate. For more information on Veterans Disability Benefits, call your local Veterans Administration.

State Mandatory Disability Plans

California, Hawaii, New Jersey, New York, Rhode Island, and Puerto Rico all have state-mandated, short-term disability plans. Employees who have a non-work related illness or injury can receive weekly income benefits, generally for up to 26 weeks. There is a maximum benefit, based on your pre-disability earnings, which varies from state to state. Employers may exceed this maximum if they have their own plans.

Company Plans

Most companies today are offering short- and long-term disability plans to employees.

Short-Term Disability

Companies that have short-term disability plans consider you disabled if an illness or injury prevents you from engaging in the regular duties of your job, and pay benefits for a fixed amount of time. Your length of service with the company may determine whether all or a portion of your salary is replaced.

Long-Term Disability

Company long-term disability (LTD) benefits begin if you are still disabled after your short-term disability period, and you meet the definition of long-term disability under the plan. We have identified some key areas to make it easier for you to understand how these plans work, and what to look for when reviewing your policy. This should make it easy for you to evaluate the strengths and weaknesses of your own company's plan and take action if you would like to enhance your coverage.

How does the plan determine if you are disabled? It depends on how the plan defines disability. Some plans have more restrictive definitions than others. Many plans use a split definition for total disability.

For example, a split definition might be: You must be totally disabled as a result of an illness, accidental injury, or pregnancy. You are totally disabled if you are under a doctor's care and meet these conditions:

– You are unable to perform the regular duties of your job or a similar one for the first 24 months.

– After that, you will only be considered disabled if you can't perform the duties of any job for which you are or may reasonably become qualified by education, training, or experience.

– You are not working at any other occupation.

Make sure to check your plan's definition of disability.

- **How much will the plan pay?** Long-term disability benefits generally replace between 40–60% of your pay.
- **Can you buy more disability insurance from your company if you need it?** Some plans will allow you to purchase additional long-term disability if you wish. Some of these plans will allow you to bring your disability coverage up to 70% of your annual compensation.
- **When do the benefits begin and how long will they last?** Most company LTD plans begin after 26 weeks and pay you a benefit until age 65, as long as you continue to meet the definition of disability.

Benefit periods may also be limited, depending upon when disability begins. The following is an example of an LTD benefit schedule:

If Your Disability Begins at This Age:	Your LTD Benefits Will Continue for This Length of Time*:
Before age 62	Until age 65
62	42 months
63	36 months
64	30 months
65	24 months
66	21 months
67	18 months
68	15 months
69 and older	12 months

*The length of time listed here is provided only as an example to demonstrate how benefit period may vary depending on when the disability begins. The numbers of months do not represent the minimum requirement of LTD benefit period by regulations.

- **How does the plan determine pre-disability earnings?** Does the company include salary, plus overtime and bonuses? What time period prior to disability do they use in their calculation?
- **Who pays the insurance premiums?** Your employer may pay the premiums for your short term disability and will probably pay the premiums for a base amount of your LTD.
- **Are your benefits taxable when you receive LTD payments?** The portion of the benefits you receive from premiums paid by your employer is fully taxable to you. The portion of the benefits you receive from premiums you paid with pre-tax dollars is also fully taxable to you. Benefits you receive from premiums you paid with after-tax dollars are not taxable.
- **What if you receive other disability benefits?** Most company plans reduce the company LTD benefits you receive by the amounts you might receive from other third-party insurers, including Social Security and workers' compensation. Your benefits are typically not reduced by benefits you would receive from an individual disability policy.
- Are there certain restrictions or limited benefits if your disability is caused by a mental or nervous disorder? Every plan has certain restrictions for disabilities that stem from emotional disorders or substance abuse.
- **What rehabilitation services are offered to you through your employer's plan?** Many insurance companies that issue long-term disability coverage through employers are taking more rigorous steps to get employees back to work. It is important to know what assistance you can get while you are disabled.

Social Security Disability Benefits

While you may qualify for LTD benefits under your employer's plan, you may not be eligible to receive disability benefits from Social Security. Social Security has the most restrictive definition of disability. A note from your physician alone won't qualify you.

To qualify for Social Security disability benefits, you must have a severe physical or mental impairment that is expected to keep you from doing any substantial work for at least 12 months, or to result in your death. The jobs they say you can perform don't even have to be available in your immediate area, as long as they are available in the national economy.

Here are just a few other important points about Social Security disability benefits:

- Benefits do not begin until the sixth full month of disability; they then continue for as long as you are unable to do substantial work. Your claim is reviewed periodically.
- The maximum family benefit you can receive depends on your age and history of earnings. Widows and widowers with disabilities can qualify for benefits based on their spouse's Social Security record; disabled children 18 years and older might be eligible for benefits based on their parent's Social Security record.
- If you receive workers' compensation disability benefits, your Social Security may be reduced. The total disability payments you and your family receive cannot exceed 80% of your pre-disability earnings.

Company Plans Are Only Part of the Solution

If you think the disability insurance that your employer provides is all that you need, you may be in for a surprise.

- All your disability benefits may generally not exceed 60–70% of your pre-disability earnings. While you think you may need less to live on, your actual living expenses could go up as a result of your disability. How will you make up for the shortfall? We don't recommend tapping into your savings.

IMPORTANT NOTE: Under current law, 401(k) plans, Keoghs, SEP-IRAs, and IRAs allow you to withdraw money before age 59½ without paying a 10% penalty tax if you become disabled. However, you will have to pay ordinary income tax on the taxable portion of the withdrawal. If the withdrawal is made from a Roth IRA, and the Roth IRA was held for five years, the withdrawal will be tax-free. Taking money out of a retirement plan puts your future retirement income in jeopardy.

IMPORTANT NOTE: When your regular wages stop and disability payments begin, contributions to company retirement plans might not continue. Future lost savings mean you'll have significantly less income in retirement. While you're disabled, you should plan on saving a portion of your disability income.

You should also consider these factors:

- Your company disability plan probably does not have cost-of-living increases, which means your fixed-income will be worth less every year.
- The company plan probably doesn't have any provisions to pay you if you are partially disabled.

Here are some additional disability insurance options to consider:

- A policy you purchase on your own can offer you a plan that pays for partial loss of income (residual disability) and adjusts your benefit for annual increases in inflation (this may be costly).
- A less expensive option is to consider purchasing disability coverage through an association. Association policies tend to be more restrictive, but they are less expensive.
- And while you're considering options for yourself, don't forget to make sure that your spouse also has adequate disability coverage if he or she is employed.

There are additional financial basics that are equally important in reducing your risks of catastrophic financial loss when a disability strikes. Here are some things you should do before a disability strikes:

- Establish an emergency fund to cover at least three to six months of expenses.
- Work towards maintaining minimal consumer debt.
- Understand how your company's medical insurance plans will be affected in the event you cannot continue to work. If your coverage is terminated after a period of time, you'll need to know what options are available to handle your medical expenses during a disability.

How Much Is Enough?

Your goal should be to replace as much of your pre-disability gross earnings as possible. The maximum amount of company disability insurance you can carry will generally only replace 60–70% of your gross income. You should consider purchasing the maximum amount of disability insurance through your employer, and, if necessary, purchase more insurance from a private carrier.

What If You Need More Disability Insurance?

If you only have the minimum disability coverage provided by an employer or you are self-employed, you can purchase an individual policy from an insurance company, enroll in a group plan offered through an association, or, if available, purchase more disability coverage from the employer. Here are some things to consider:

- Additional disability coverage from an employer is generally the most affordable way to purchase coverage. You're generally eligible to buy additional coverage, if offered, during annual enrollment periods. It is much less expensive than a private policy and often less than association coverage.
- You may be able to get a more liberal definition of disability in a private policy than the one in an employer's plan, but it will cost you considerably more.
- Individual policies are paid with after-tax dollars so the benefits are tax-free to you. If a company-sponsored plan is paid for with pre-tax dollars, the benefits will be taxable to you.
- If you buy an individual policy, it is portable. You will have coverage no matter where you are employed.
- The individual policy is generally not considered in income that will reduce the benefits from a company plan.
- If you or your spouse is self-employed, make sure that you have adequate disability coverage.

Policy Options: Looking for an individual policy is much like buying a car. The base sticker price on the car depends on the make and model. A disability policy has a base sticker price, too. And it comes with options (riders) that you can add on, which can more than double the original price.

So what do you really need? Are you into basic transportation or do you need a luxury model? When it comes to disability insurance, we suggest you use basic transportation to get good mileage out of your premium dollars.

Definition of Disability

The most important feature in a disability policy is its definition of disability—when you are considered disabled for the purpose of collecting benefits. You can be disabled for 1) any occupation, or 2) your own occupation, or 3) you can be insured using a split definition:

- An **"any occupation" definition** is the most restrictive because you are only considered disabled if you are unable to engage in any gainful occupation for which you are reasonably fitted by education, training, and experience.
- An **"own occupation" definition** is the most liberal because you are considered disabled if you cannot perform the substantial and material duties of your regular occupation. While this is good for you, it will also cost you the most to have.
- With a **"split definition"**, you are considered totally disabled if you are unable to perform the substantial and material duties of your regular occupation (own occupation) for a period of time (typically 2 years or longer based on your profession), then you are considered totally disabled only if you are unable to engage in any gainful occupation (any occupation) for which you are reasonably fitted by education, training, and experience.

SUGGESTION: Policy definitions of disability are typically based on your occupational class. Unfortunately, definitions tend to be more restrictive the more hazardous your occupation. When shopping for your own policy, your best bet is to find one that has an 'own occupation' definition for two to five years. Beyond that, the insurance company may not issue you one and the policy can get quite expensive.

Every policy is issued with an elimination period and a benefit period. The elimination or waiting period is the time between when you become disabled and when your benefits begin. The longer the elimination period, the less costly the policy. We recommend that you have no shorter than a 90-day elimination period. If you have a sufficient emergency fund, extending your elimination period to six months could reduce your premium by as much as 30%. Remember, you are protecting yourself in the event of a catastrophic disability.

SUGGESTION: When choosing an elimination period, take into consideration how long your emergency funds will last. Also look at the short-term disability benefits you are eligible to receive.

The benefit period is the length of time you will receive benefits. Common benefit periods are two years, five years, and until age 65. Some policies are also issuing ten-year benefit periods. Policies with lifetime coverage are very rare and very expensive. Since you are insuring yourself against catastrophic disability, we recommend your benefit period last until age 65 (or the longest benefit period you are eligible for excluding one that lasts your lifetime).

How to Shop for an Individual Policy

There's no question that once you've found a policy that offers all the important features you need, the cost of the policy becomes a major consideration. But another consideration that is equally important is the claims-paying ability of the company. Make sure the insurance company has the financial strength to make payments as long as you're disabled.

Look for companies that are well-known for their line of comprehensive individual disability policies. The companies should be rated highly by rating services such as AM Best, Standard & Poor's, Moody's, and Duff & Phelps.

It is important that you understand what the ratings mean. Each of the rating companies has its own classification system for evaluating the claims-paying ability of an insurance company.

Policy Riders

In addition to the basic policy, disability insurance can be purchased with add-on features called "policy riders."

What You Need . . . What You Don't

In addition to the basic policy, disability insurance can be purchased with add-on features called policy riders. Most riders are expensive and may not be worth the extra cost. Remember, basic transportation is what's important. You're better off putting money into your retirement plans than adding frills to your disability program.

Disability policies are issued in two basic forms: Non-cancelable and Guaranteed Renewable.

- A non-cancelable policy cannot be canceled and the premium cannot be changed prior to its next due date.
- A guaranteed renewable policy cannot be canceled before a specified age. The premiums can be changed if all policyholders in your occupational class or state are raised.

The best type of policy is one that is both non-cancelable and guaranteed renewable. Your policy cannot be canceled and the premium remains fixed until you reach a specified age.

Here is a list of provisions and riders that may be available depending on the policy you purchase.

What You Usually Need	What You Usually Don't Need
Waiver of Premium—should be automatically included in your policy after 90 days of disability.	**Guaranteed Insurability Option**—allows you to buy specified amounts on certain future anniversaries without evidence of insurability. You should only be concerned with this if you have a family history of debilitating illness and you anticipate substantial increases in earnings.
Presumptive Disability—should be automatically included in your policy, will pay you full disability benefits if you lose the use of any two limbs, speech, hearing, or eyesight.	**Cost-of-living Adjustments (COLA)**—increases your monthly benefits by a fixed percentage or may be indexed to inflation. This kicks in generally after your first year of disability, not after the first year you own the policy. It could add 50% to the premium.
Residual Disability—usually written as a rider. If you sustain a loss of income (20% or more), you can receive a percentage (partial benefit) of the total disability benefit. Some policies only allow for this following a period of total disability. If possible, find a policy that pays residual benefits without first being totally disabled.	**"Own-Occupation" Rider**—that pays you a benefit even if you are gainfully employed in another occupation. It could add 10% to the premium. This rider is usually limited to higher occupational categories, including professionals and executives.
Social Security Rider—If you don't qualify for Social Security disability benefits, your monthly benefit can usually be increased.	**Accident or Hospital Income Benefit**—may be included in the policy but is not worth the extra cost if it is a rider.
Rehabilitation Benefits—usually included in the policy; if offered, the insurance company will pay for a rehabilitation program to get you back to work or train you for a new job.	**Refund of Premium**—a rider that will return all or a portion of your premiums if you don't submit any claims for a period of time, usually ten years or more. It can cost you up to 50% more.

Group Association Policies Can Save You Money

If you belong to an alumni, fraternal, or professional association, call the association's benefits administrator to see if they offer disability coverage. Since disability insurance offered through an association is written on a group basis, the rates are less than those for an individual policy. However, their underwriting requirements may be less flexible since they are dealing with large numbers of people. If you have any pre-existing conditions, you may be ineligible for coverage.

Many group policies have similar features to an individual policy. Here are some differences:
• Group policies may have more restrictive definitions of disability or may offer shorter benefit periods. Only take a five-year benefit period if you can't get one that pays until age 65.
• Group policy premiums go up every few years.
• Some individual policies are issued as non-cancelable, guaranteed renewable depending on your occupational classification. The rates remain fixed and the policy can't be canceled as long as you pay the premium.
• Group policies can be terminated. If you've developed a medical condition after enrolling in your group association plan and the insurer terminates the association plan, the association's new insurer may 1) not pick you up, or 2) may exclude any disability resulting from the medical condition.

Will Your Disability Benefits Be Taxable?

Both short- and long-term disability benefits are taxable to varying degrees, depending on the type of policy. Here are the rules under current law:

- Your short-term disability benefits are taxable or tax-free depending upon how the plan premiums are paid. States with statutory short-term disability plans have special rules.
- The portion of LTD benefits you receive that is paid by an employer is taxable to you. Federal, state, and local taxes are withheld; Social Security and unemployment taxes are excluded.
- The portion of LTD benefits you receive that is paid by you is tax-free, except if you pay with pre-tax dollars.

If you are an employee, self-employed, a partner in a partnership, or owner of a corporation and own an individual disability income policy, it's a good idea to check with your tax professional to determine whether your benefits are taxable. Also refer to the chart below to determine if your LTD benefits are taxable.

Individual Disability Policies:
Are Your Long-Term Disability Benefits Taxable?

Who Pays the Premiums?	Benefits Are Payable to Whom?	Who Owns the Policy?	Are the Premiums Tax-Deductible?	Are the Benefits Tax-Free or Taxable?
Individual	Individual	Individual	No	Tax-Free
Individual	Individual	Individual	Yes	Taxable
Employer	Individual	Individual	No	Taxable
Self-employed (sole proprietor)	Sole Proprietor	Sole Proprietor	No	Tax-Free
Partnership	Partner	Partner	No	Tax-Free
Partnership	Partnership	Partnership	No	Tax-Free
Corporation	Corporation	Corporation	No	Tax-Free

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DISCLAIMER: This Quick Guide is only presented as a non-specific overview of insurance. It contains information so that you can be better informed when you talk with a licensed insurance agent. In all cases where a discrepancy may exist between the information in this guide and the actual policy wording, the terms and conditions of the policy will always take precedence over the guide.