Long-term disability insurance: What you need to know

Les Masterson - Last updated: Jan. 17, 2020

Long-term disability isn't just for people with dangerous jobs. In fact, most long-term disability claims have nothing to do with the job.

The average long-term disability claim is nearly three years. Plus, one in four of today's 20-year-old will become disabled before they retire, according to the Council for Disability Awareness.

Those disabilities are usually for non-work-related injuries and illnesses. Common reasons for disability claims are:

- Neck and back pain
- Muscle and tendon disorders
- Foot, ankle and hand disorders
- Cancer

A disability can strip you of your ability to make a living. While some people can tap into their savings to get by without working for a few months, few people can afford to stop working altogether for a longer period of time.

That's where long-term disability insurance can help. Long-term disability policies provide you with income for an extended period. Most people who have long-term disability insurance get it through their employers, although you can buy individual long-term disability insurance on your own. Also, even if you have long-term coverage from an employer, the payouts are usually not enough to bridge the gap until you can return to work.

Cost of long-term disability insurance

Long-term disability insurance pays a percentage of your salary, usually 50 to 60%, depending on the policy. The benefits last until you can go back to work or for the number of years stated in the policy.

Some policies pay out as long as you are disabled until age 65. The average annual cost of a long-term disability policy is more than $2,000, but the exact cost varies based on many factors, including your salary. It's usually 1% to 3% of your salary.

When figuring out cost, an insurer looks at your:

- Income
- Age
- Health
- Gender
- Smoking status
- Occupation

Then, the company will review the length of the benefit period (how long you can collect) and elimination period (how long before you can start to collect after diagnosis). The payment type (level or graded) and riders also play a role in cost.

Three common long-term disability insurance riders are:

- Enhanced partial disability benefit rider, which provides partial disability payment if you become partially disabled. Most long-term disability policies have this rider.
- Cost of Living Rider (COLA) rider increases the policy's benefit with a minimum benefit adjustment of 3% annually. This helps assure that your disability benefits don't fall behind after years of inflation.
- Future increase option rider allows you to you get more long-term coverage later without having to go through the application process again.

A policy's disability definition also influences the cost. The more limited the definition, the less you'll pay. That includes the disability level (only collect if totally disabled or you can collect if partially disabled) and occupations you can work if you're disabled.

Employer long-term disability coverage

Some people get long-term coverage via an employer. If you pay your own premiums with after-tax dollars, your disability benefits will be tax-free. If your employer pays for the policy, most likely with pre-tax dollars, you'll have to pay income taxes on the benefits. Also, if you need to file a claim, any payments will also be taxable.

Even if you have employer-sponsored coverage, those benefits are more limited than individual coverage. For instance, you'll lose protection if you change jobs and payments are smaller in employer plans.

Most disability insurers will work with employers to help you return to work as quickly and safely as possible. While disability insurers want to see people healthy and rehabilitated, they also save money if a claimant quickly returns to work.

You'll most likely find your disability insurer managing the claim if you are "partially disabled" -- meaning you can still work but only in a job that pays substantially less. In cases where you're only able to earn less than 20% of what you previously made, you'll likely get full disability benefits that are based on your pre-disability income.

For example, if you worked in a warehouse and earned $40,000 annually, then hurt your back and had to take a part-time desk job that paid less than $8,000 a year, your long-term disability policy likely would pay you full benefits based on your pre-disability wages of $40,000. If the full benefit was 60 percent, you would get 60 percent of $40,000, or $24,000.

If, however, you were able to earn between 20 and 80% of your pre-disability income, you'd get a proportionate amount of income based on the percent you could earn. If you can earn more than 80% of your pre-disability income, most insurers do not consider you disabled.

A few insurers offer a dependent care reimbursement benefit, meaning they also reimburse the employee for child care expenses if the employee's spouse must go back to work as a result of the disability.

If you become disabled and begin receiving benefits, you will no longer have to pay premiums. Most policies contain a "waiver of premium" provision that states you can stop paying premiums if you are disabled for 90 days or longer.

Causes of new long-term disability claims

- Musculoskeletal/connective tissue disorders: 28.6%
- Cancer: 15.1%
- Injuries and poisoning: 10.3%
- Cardiovascular/circulatory: 8.7%
- Mental disorders: 8.3%
- Nervous system-related: 7.7%
- Pregnancy and childbirth complications: 5.9%
- Other: 15.4%

Source: Council for Disability Awareness Long-Term Disability Claims Review

Long-term disability exemptions

A long-term disability company may deny you based on your health or could include policy exclusions. These exclusions would mean you're not covered for those ailments and injuries.

Policy exclusions can include:

- Cancer
- Uncontrolled diabetes
- Back pain
- Obesity
- ALS
- Mental illness
- Alcohol or drug-related issues

Women usually can't get covered for pregnancy-related disabilities if they're already pregnant. Long-term policies consider that a pre-existing condition. You may still be able to get a policy, but it won't cover your pregnancy.

Your employer may be able to help if you're pregnant and you're looking for disability coverage. Employers may offer short-term disability insurance for maternity leave. That's not available in the individual market.

Buying individual disability insurance

If your employer doesn't offer group disability insurance, or if you think your group policy doesn't provide adequate coverage, you may want to consider buying an individual long-term disability policy. You can buy this through financial planners, the same agents who sell you life insurance or annuities, or sometimes through your mortgage company.

Most policies are sold on a "non-cancellable" or a "guaranteed renewable" basis, according to the Insurance Information Institute (III). With a non-cancellable policy (which requires an initial medical exam), the insurer cannot cancel the coverage or raise your premiums. If you buy a policy on a guaranteed renewable basis, the insurer cannot cancel the coverage as long as you pay premiums, but it can raise rates on a class or group of insured people who have the same policy, work at the same place or share another, non-risk-associated characteristic.

According to the III, most individual policies also have features that allow benefits to keep pace with inflation or gradual salary increases, such as a cost of living adjustment, which adds a percentage to your benefit each year.

Disability insurance is an important piece of your insurance portfolio that will help protect you during life's unexpected events. If you're dependent on your working income, make sure it is protected.