Understanding disability insurance for physicians

Physicians often pay attention to life insurance needs but fail to consider the possibility of a debilitating incident. A professional has a greater statistical probability of suffering a severe disability that impedes their ability to work, rather than to die prematurely. While some people have the financial resources to fund a disability on their own, most need disability income insurance to cover the risk.

Disability insurance planning has changed dramatically over the past decade. The insurance industry is offering many options to help professionals protect their most valuable asset—the ability to earn an income.

Purchasing high-quality disability insurance has never been easy. Although additional options available today create more flexibility, they also mean that the individual disability insurance marketplace has become even more complicated for professionals.

How disability policies are offered

Disability insurance can be purchased on an individual or group basis.

Individual insurance plans are typically purchased through a local insurance agent and, in some cases, can now be purchased over the phone or through a company's website. Most insurance companies will issue disability insurance coverage equal to approximately 60% of earned income.

Group insurance is usually provided by an employer or purchased individually through a sponsoring professional association. An individual whose employer makes group long-term disability (LTD) insurance available, or who is changing employers, may have the opportunity to supplement individual disability insurance coverage. Once purchased, an individual policy would not be affected by subsequently enrolling in a group LTD plan. If, however, an individual policy is not already at its maximum benefit level, this strategy might prohibit the insured from further increasing an individual policy.

Disability insurance policy benefits may be taxable or tax-free, depending on who paid the premiums.

Cost of disability insurance

Premium rates are based on factors such as the insured's age, gender, monthly benefit, optional riders and occupational classification. As a general rule, the younger the policy owner is, the lower the cost of insurance premiums.

The occupational classification assigned to a medical specialty by the insurance company will also affect premium rates, as will the policy provisions made available to the insured.

How much coverage is needed?

Most experts suggest that a physician's disability policies should cover approximately 60-65% of their after-tax income. At first glance, the calculation appears to be rather straightforward. A physician earning $300,000 per year generates $25,000 of monthly income, and would need disability benefits totaling $16,250 per month (65% of gross income). The physician purchases an individual plan with a $6,250 monthly benefit, and has an employer-group plan with a $10,000 monthly benefit. The total benefit of $16,250 should be sufficient—right? Not necessarily. Since the employer paid the premium for the physician's group coverage, the $10,000 benefit is taxable and would only create a net benefit of $6,000 (assuming a 40% tax rate). Therefore, the physician's disability plans only replace $12,250 of income – and is short $4,000.

The total coverage amount of your policies doesn't always tell the story when considering how much disability insurance to purchase. It's important that you understand the tax implications of the benefits paid, so the plans you purchase replace the actual income you might be losing if disabled.

Understanding recovery benefits

For self-employed professionals whose incomes are based solely on the number of clients or patients they see, it is important to understand how recovery benefits work. While some policies have an unlimited recovery benefit built into the residual disability rider, others make the recovery benefit available as a separate rider. A residual disability is typically defined as a loss due to a sickness or injury even when the injured person remains employed and is not completely disabled. The residual disability rider provides monthly supplemental income to match the loss of earnings in an attempt to repair the injured person's income.

Consider the example of a physician in a small group practice whose income is based solely on the business generated and number of patients seen. She had been totally disabled for 1 year; after a full recovery she has returned to the small group practice. She can now perform all of her job duties and work the same number of hours as before. However, the patients who had depended on her have gone elsewhere. Additionally, referral sources with whom she had built relationships had no choice but to refer clients elsewhere.

Rebuilding a practice might take years. Without a recovery benefit, the physician in this example would no longer qualify to collect any benefits at all. With an unlimited recovery benefit, the physician would continue to receive benefits until her income reached a level close to her pre-disability income. For a self-employed individual, this can mean the difference between surviving financially or not.

Disability insurance protection for retirement plan contributions

Group and individually owned disability insurance plans traditionally are designed only to replace a portion of the insured's current income, not to replace monthly contributions into company or individual defined contribution retirement plans. Nevertheless, a few disability insurers have developed programs designed specifically to replace lost retirement savings when you become disabled.

Retirement protection disability insurance helps you continue saving for retirement in the event of a disability. If you become disabled, the policy pays a benefit in the amount of your retirement plan's monthly contribution into a trust specifically for the insured's benefit. The money in the trust is invested at your discretion until you reach age 65 and then distributed to help supplement retirement income. These policies typically offer monthly benefits up to $3,800—and can be added to existing coverage (with many carriers).

Policy benefits and trust earnings are subject to the normal rules that govern the taxation of trusts and individual disability income insurance. Trust earnings are generally taxable to the insured as the beneficiary of the trust.

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