Estimating the Disability Insurance Needs of Client Households

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The possibility that a household head could become unable to work is a financial shock most households do not currently plan for. Even though it is likely that any Social Security disability benefit would likely be less than anticipated spending needs, the possibility seems remote enough for individuals to avoid planning for it. However, in June, 1999, 4,783,000 workers were receiving Social Security disability payments (Social Security Administration, 1999). Additionally, others were receiving disability payments from state and local government systems as well as from private companies. Therefore, the total number of workers qualifying as disabled and not able to work was over five million. "Insurance industry statistics show that the odds of suffering a debilitating injury or illness are far greater than dying during one's working years. Yet more people are likely to have life insurance than disability insurance – roughly 70 percent versus 40 percent, according to the Health Industry Association of America" (Marino, 2000). Given the number of individuals who receive some level of disability benefits, financial planners need to have a method which provides a reasonable estimate of disability insurance needs. Discussion of disability insurance in textbooks has been quite limited compared to coverage of life insurance. For instance, Garman and Forgue (2000) have just over four pages (pp. 323-327) devoted to disability insurance, compared to a 34 page chapter on life insurance, even though a much higher proportion of working age households need to consider disability insurance than need to consider life insurance. A senior level financial planning course at Ohio State university involves students preparing comprehensive financial plans for an actual client household. One aspect of this planning process is to complete a risk management profile for the household. The purpose of this poster is to explain the methods used by the students to analyze the amount of disability insurance coverage required for their clients.

The method for determining the need for private disability insurance plan has some similarities to methods used in to estimate life insurance needs, but also a major difference, in that disability insurance is priced and sold as a monthly benefit. Since the amount needed is not a lump sum amounts, one cannot simply take the present value of monthly needs and subtract the present value of resources. Hanna, Gutter, & Gibbs (1999) provide a detailed account of a method to determine the ability of the client to financially cope with the loss of income that stems from one household head becoming unable to work. The first step in the analysis is to determine the monthly spending in the event of disability. There were 99 client households. Students typically persuaded relatives, friends, or co-workers to be clients. Based on a sample of 89 non-retired clients with appropriate information, 48% had some need for additional disability insurance. Of the 48%, the average amount of monthly coverage needed by a disability insurance plan was $1,181, the minimum amount was $37, and the maximum was $3,565. Clients with low gaps were not seen as needing to take action but clients with significant gaps were advised to reconsider disability spending issues and/or look into the possibility of purchasing private disability insurance. The results of the needs analysis suggests the importance of stressing disability insurance estimation.

References

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Endnotes

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