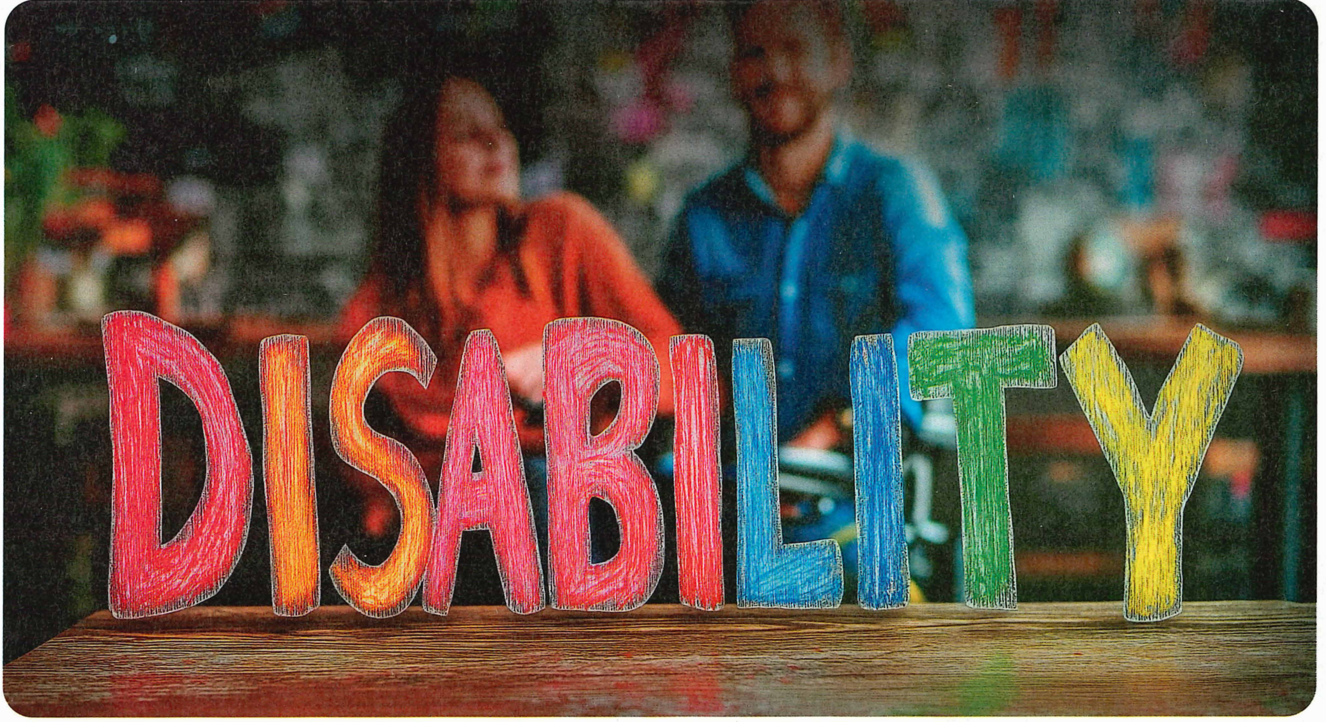

Why DI remains the best option to fund disability costs

Dispelling three common myths surrounding disability insurance for ultra-high-income earners.

By Frank Zuccarello

Our lives are marked by a multitude of daily choices: Should I wear the blue shirt or the tan shirt? Take the highway or the back roads to work? Order hot or iced coffee at Dunkin'? Deciding how to fund the cost of a disability may not be an everyday choice, but like your coffee order, it comes with multiple options.

Over the years, several well-tested choices have been used to help cover disability expenses for individuals: annuities, dipping into investment portfolios (stocks, bonds, etc.), savings (emergency funds), pension plans and real estate investments. While the suitability of these choices depends on an individual's net worth, let's take a closer look at what each option offers.

Annuities: An annuity is a financial product that provides a steady stream of income, usually during retirement. It's a contract that's issued and distributed by an insurance company and bought by individuals. The insurance company pays a fixed or a variable income stream to the purchaser. Annuities can be either immediate or deferred. Annuities can provide steady income, but a fixed payout may fall short of covering the increased expenses often associated with a disability.

Investment portfolios: Building a diversified investment portfolio can provide a source of income through dividends, interest and capital gains. These stocks, bonds and mutual funds work together to create a balanced approach to income generation. Although an investment portfolio can be a helpful supplement, a market downturn could dramatically reduce a portfolio's value when a stable income is vital to cover expenses.

Savings: Having an emergency fund has long been essential for financial stability — ever since the days when people tucked cash into mattresses or stashed it in jars on a cupboard shelf. An emergency fund's purpose is to cover unexpected expenses or income loss without going into debt. Experts recommend saving at least three to six months' worth of living expenses. However, more than 1 in 5 Americans have no emergency savings, and those with some savings often face higher monthly expenses — making it all relative.

Pension plans: Pension plans provide a predictable source of income for retirees and are typically funded by employers. They can be either defined benefit

plans (guaranteeing a specific payout) or defined contribution plans (dependent on investment performance). However, pension plan participation dropped from $27 million in 1975 to less than $13 million in 2019. Given the decline in pension plans and the constraints they impose, they may not provide the stability and flexibility needed to fully cover income loss during a disability.

Real estate investments: Investing in real estate can generate rental income, and the property may appreciate over time. This can be a solid strategy for those looking to create additional income streams. Here are a few key factors to consider when relying on real estate investments to fund disability costs: liquidity challenges, market volatility and ongoing maintenance costs.

All these choices come with pros and cons. However, I believe the superior option for clients of all income levels is disability insurance. Although the solutions listed previously may "supplement" income, DI truly replaces lost income. The other financial tools aren't designed to protect your clients in the event they suffer a disability — it's simply not their purpose. After all, you wouldn't hire an ophthalmologist to perform knee surgery. So why rely on alternative financial solutions to fund the costs of a disability?

DI serves as a financial safety net when an individual is unable to work due to a disability. According to 2024 Social Security Administration data, 1 in every 4 working adults will experience a disability before reaching retirement. For highly compensated individuals, the financial stakes are exceptionally high. These individuals are often the primary breadwinners for their families and play a pivotal role in their organizations. If they were to suffer a disabling illness or injury, their income stream could abruptly cease.

In such cases, DI steps in to replace a portion of the individual's income, ensuring that they can maintain their lifestyle and continue to build their legacy. Without DI, the consequences of a sudden loss of income can be financially devastating.

When it comes to DI, the most critical factor in determining benefits is the level of income replacement. For rank-and-file employees, a 60% income replacement ratio is the standard, as it roughly reflects their typical take-home pay. Group long-term disability and supplemental individual disability insurance offered by domestic markets only scratch the surface for individuals with seven-figure incomes. So it's essential to have a policy that can replace a substantial portion of their income if they become disabled.

High-limit DI is tailored to meet the specific needs of highly compensated individuals. These policies provide higher benefit limits, ensuring that even those earning $1 million or more annually can maintain their financial stability during a disability. High-limit disability coverage is typically purchased to supplement traditional DI, bringing an individual's income replacement ratio up to par.

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DI often faces skepticism among high-income earners, who may believe they are immune to such risks. Let's dispel three common myths surrounding disability insurance for ultra-high-income earners.

Myth 1: Heart disease is the leading cause of long-term disability claims

Reality: Although heart disease may top the charts as the leading cause of death in the U.S., it surprisingly ranks fifth in terms of new long-term disability claims. This can be attributed to the proactive steps Americans take to prevent heart disease, such as managing cholesterol levels, quitting smoking and staying active.

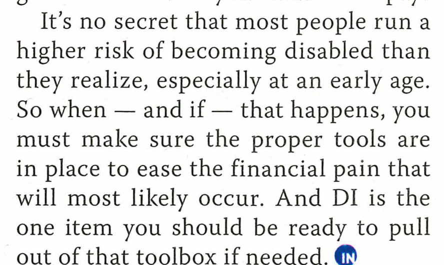
Myth 2: No options for clients who have maxed out the traditional DI market

Reality: For the average worker, a standard benefit of a 60% income replacement ratio can be met with group long-term disability and supplemental individual DI coverage. However, when it comes to highly compensated individuals, these traditional options may fall short. What many advisors may not realize is that there exists a third layer of disability insurance in the excess and surplus markets, such as Lloyd's of London. With monthly benefit limits reaching up to $250,000, this coverage can cater to individuals earning $5 million annually, providing a deeper level of protection.

Myth 3: DI is too expensive

Reality: Imagine your client, a thriving 45-year-old earning $1 million annually with another 20 years of work ahead. This translates to a staggering $20 million future asset that remains underinsured. A savvy advisor will pose the question, "What asset do you own worth $20 million that left uninsured or underinsured?" The likely answer — nothing!

For a relatively healthy individual in their mid-40s, the premium for DI is typically less than 1% of their yearly earnings. This investment not only safeguards their generational wealth but also secures their legacy. And if you reverse the math, wouldn't you want to be guaranteed 99% of your take-home pay?



It's no secret that most people run a higher risk of becoming disabled than they realize, especially at an early age. So when — and if — that happens, you must make sure the proper tools are in place to ease the financial pain that will most likely occur. And DI is the one item you should be ready to pull out of that toolbox if needed.

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