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Smart Money: Disability insurance is the most important part of a complete financial plan

a day ago By: Brad Brain / Smart Money

Brad Brain: "Virtually all the things you are working toward – retirement, a real estate purchase, paying off debt, a family vacation, a new vehicle, whatever – rely on your ability to earn income. Take away that ability to earn income and you will see how quickly your priorities change." | Getty Images

I am not much for generalizations or rules of thumb when it comes to personal financial planning. Everybody has their own goals and resources and risk tolerance, so one-size-fits-all solutions are not always optimal.

But let's say, for discussion purposes, of all the different components of financial planning, we wanted to identify the most important one.

What is the single most important financial planning concept? This is the type of question that will generate different responses.

Some people will say the most important thing is to establish an emergency fund. This would be money that you could get your hands on fast if you really needed it. A classic example would be to set aside enough to cover roughly three months of essential expenses.

Others might say the most important thing would be to contribute to your Registered Retirement Savings Plan. One day you are going to want to stop working, and when that day comes, the money is going to need to come from somewhere. The RRSP can be a compelling strategy to prepare for retirement in a tax-advantaged way.

Still others may laud the wonderful benefits of the Tax Free Savings Account. The TFSA has impressive flexibility and offers some unique planning options that can minimize not just taxation and but also the clawback of income-tested benefits.

Don't get me wrong. All these things, and more, are solid, worthwhile concepts.

But if I was to pick just one thing as the single most financial planning concept, I would have to say it would be to have a proper disability insurance policy, which will replace your income if you couldn't work due to illness or injury.

Think about it. Virtually all the things you are working toward – retirement, a real estate purchase, paying off debt, a family vacation, a new vehicle, whatever – rely on your ability to earn income. Take away that ability to earn income and you will see how quickly your priorities change.

Paradoxically, a proper disability insurance policy is often one of the most neglected aspects of financial planning. You may have noticed that I have said a "proper" disability insurance policy. I say this because not all disability insurance contracts are the same.

You may have some disability insurance through your group benefits. You may have disability insurance on your loans. And these types of disability insurance are better than no coverage at all.

But often group disability coverage, and especially mortgage insurance coverage, can have some restrictive clauses in the contract. This is one of those circumstances when it pays to read the fine print.

Here's an example of how not all contacts are created equal, and why it matters. One definition of disability is the "own occupation" definition, which will pay an income replacement benefit if you cannot perform the substantive duties of your regular occupation. Contrast that with the "any occupation" definition, which will only pay if you cannot do any work that you could reasonably be expected to perform. "Own occ" gives you much better protection than "any occ."

Here is what I mean. If you have seen the movie *Dr. Strange* you probably remember that spectacular car crash early in the movie where surgeon Dr. Stephen Strange loses the use of his hands.

If Dr. Strange had an own occupation disability contract, he would receive a tax-free disability benefit because, without the use of his hands, he can't operate. If he had an any occupation disability contract, he wouldn't be eligible for income replacement because he could still do something else.

Now, if disabilities were rare, I wouldn't put this as the single most important thing. But they are not rare. For a 35-year-old male non-smoker the odds of being disabled for at least three months prior to age 65 are 36%. For a 35-year-old non-smoking female they are 40%.

How would you like to suffer a serious illness or injury, and then have your group insurance or mortgage insurance provider say to you, "Yeah, that is really too bad about your situation, but you can still do something, so we ain't paying"?

Talk to an insurance professional about proper disability insurance as part of your complete financial plan.

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