Luke and Jen Smith

DISABILITY
November 24, 2010

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Basics of Disability Income Insurance

Prepared for Luke and Jen Smith

Disability planning should be part of a comprehensive insurance or risk management analysis. It is important to consider the financial risks of certain unforeseen events such as a prolonged illness or a disability that could result in being unable to work.

Proper insurance coverage is the foundation of a comprehensive financial plan. Understanding the amount and types of insurance you require should be the result of sound analysis and reasoned considerations. The following reports look specifically at your disability risks and will help you gain an understanding of your current disability coverage, if any, and how it may compare to your desired coverage.

Items to consider when analyzing your disability income insurance coverage include:

Methodologies

There can be different methodologies when analyzing disability insurance coverage. The income protection method simply attempts to compare your current coverage with a desired income protection objective. The cash flow method is more complex and attempts to see if your current coverage would allow you to maintain positive portfolio assets for your lifetime.

Income Protection Gap Percentage

This is the amount of lost income you want to protect with insurance in the event you are disabled. A common rule of thumb is to protect between 60% and 80% of your income. Factors to consider when determining your protection percentage are the tax status of existing policies, spousal and other income that is expected to still be available, social security benefits if qualified, and the amount of mandatory expenses due to lifestyle.

Benefit Inflation

While level benefit policies are less expensive, it is generally suggested that a policy with some level of inflation adjustment be purchased. It is very important to have your policy benefits maintain its purchasing power over time. (This is typically a rider and additional cost may be associated.)

Definition of Disability

There are different ways to determine if someone is disabled. It is important to understand how your policy defines disability. For example, some policies will not pay benefits if you can perform another job for which you are reasonably trained. Other more liberal policies will pay benefits if you can no longer perform the duties of your own occupation. The fact that you could reasonably perform another job based on your training is irrelevant. The extra premium for the more liberal policy might be money well spent based on your specific situation.

Taxation of Benefits

Disability policies are generally purchased in one of two ways: individually or through your employer as a benefit. You pay the premium on individual policies but receive non-taxable benefits. Benefits from employer provided policies are taxable to the extent that your employer paid the premium. For example, if your employer pays half of the premium then half of the benefit is taxable. Also, policies through your employer may not be portable if you change jobs.

Cost of Disability

Base Facts with Disability Occurs - Client

Prepared for Luke and Jen Smith

For most people their greatest financial asset is the ability to earn a living. Without your current income, your lifestyle and family goals could be in jeopardy. What type of impact could a disability event have upon your finances?

The disability event for Luke is assumed to start in **2010** at age **55** and last through lifetime (**2045**) . **Luke's** lost income starts at **$150,000** in **2010** and reaches a cumulative lost income of **$1,761,336**.

Additional health care costs due to the disability during this period are assumed to be **$10,000** (in today's dollars) and will grow at **3.52%** beginning **immediately**, reaching a cumulative additional expense of **$702,796**.

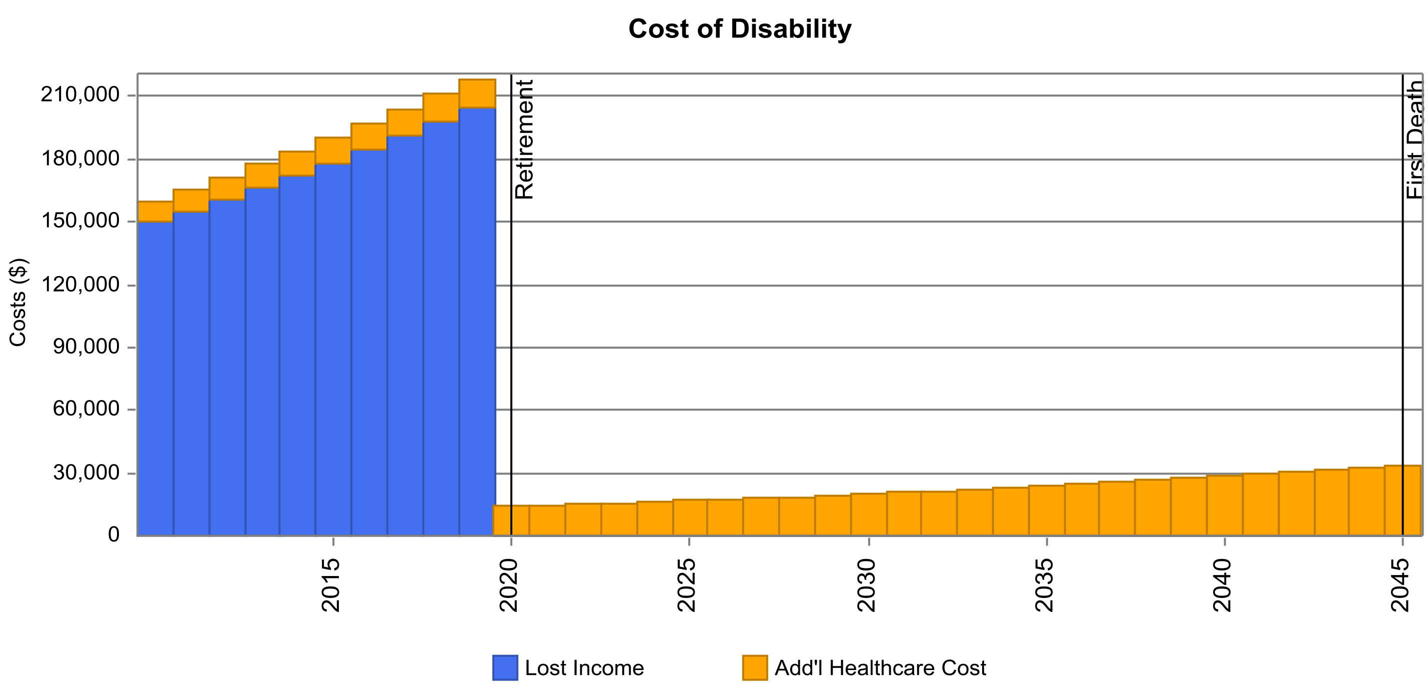
This disability event results in **$150,000** reduction in income for **Luke** in **2010** and a total cost of disability of **$2,464,132**.

SUMMARY
Income Lost (2010) **$150,000**
Income Lost (2010-2045) **$1,761,336**
Additional Costs **$702,796**
Total Cost of Disability **$2,464,132**

The total cost of disability is the total of all income lost plus any additional costs during the disability period. Only salary and bonuses in **Luke's** name are taken into account when calculating lost income.

Total Cost of Disability

The chart below illustrates the mounting costs of a disability event, showing the lost income and any additional costs if they exist. The total cost of disability for this scenario is **$2,464,132**.



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Disability Wealth Effect

Base Facts with Disability Occurs - Client

Prepared for Luke and Jen Smith

The true cost of disability is not limited to the lost income from being unable to work or any extra medical costs. There is also an opportunity cost resulting from not being able to invest and grow any of that money. This report looks at the overall wealth that could be lost due to a disability event.

The defined disability event for Luke results in a direct cost of **$2,464,132** offset by cumulative disability benefits of **$0** for a net cost of **$2,464,132**.

Year	Portfolio Assets without Disability	Portfolio Assets with Disability
Start of Disability Event (2010)	$1,932,094	$1,932,094
End of Disability Event (2045)	$6,692,496	($1,380,094)
Last Death (2048)	$7,077,690	($2,185,208)

The defined disability event for **Luke** could result in the depletion of **$9,262,898**, or **over 100.00%**, of portfolio assets by **2048**.

SUMMARY

Total Costs (2010-2045)
$2,464,132

Disability Benefits (2010-2045)
$0

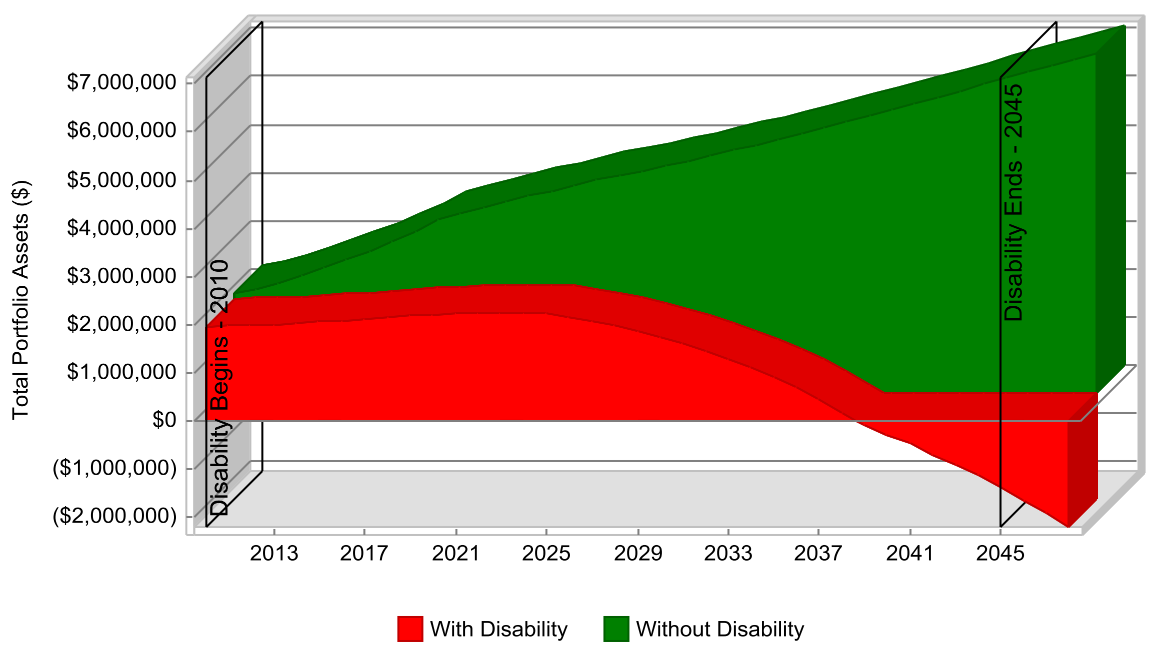
Net Cost (2010-2045)
$2,464,132

Wealth Reduction
$8,072,590 (2045)
$9,262,898 (2048)

Wealth Effect of Disability

The effect of disability on wealth can be significant due to the lost investment potential of assets. The chart below illustrates this wealth reduction by comparing total portfolio assets with and without the defined disability event.

Disability Wealth Effect



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Income Protection Objective

Base Facts with Disability Occurs - Client

Prepared for Luke and Jen Smith

Regardless of their wealth, most people want to have some level of income protection in the event of a disability. Your protection objective is the amount of lost income you want to protect in the event of disability. A common rule of thumb is to protect between 60% and 80% of earned income.

In the event of Luke's disability, there are factors that can help determine an appropriate protection objective including taxation of disability benefits, family income that is still available, and possibly Social Security benefits.

Luke's lost income starts at **$150,000** in **2010** and reaches a cumulative lost income of **$1,761,336**.

The income protection objective of **70%** requires **$105,000** of benefits in **2010** and a total of **$1,232,935** through **2019**. Currently, there is no existing disability insurance coverage.

SUMMARY

Protection Obj. (70%)
$105,000 (2010)
$1,232,935 (2010-2019)

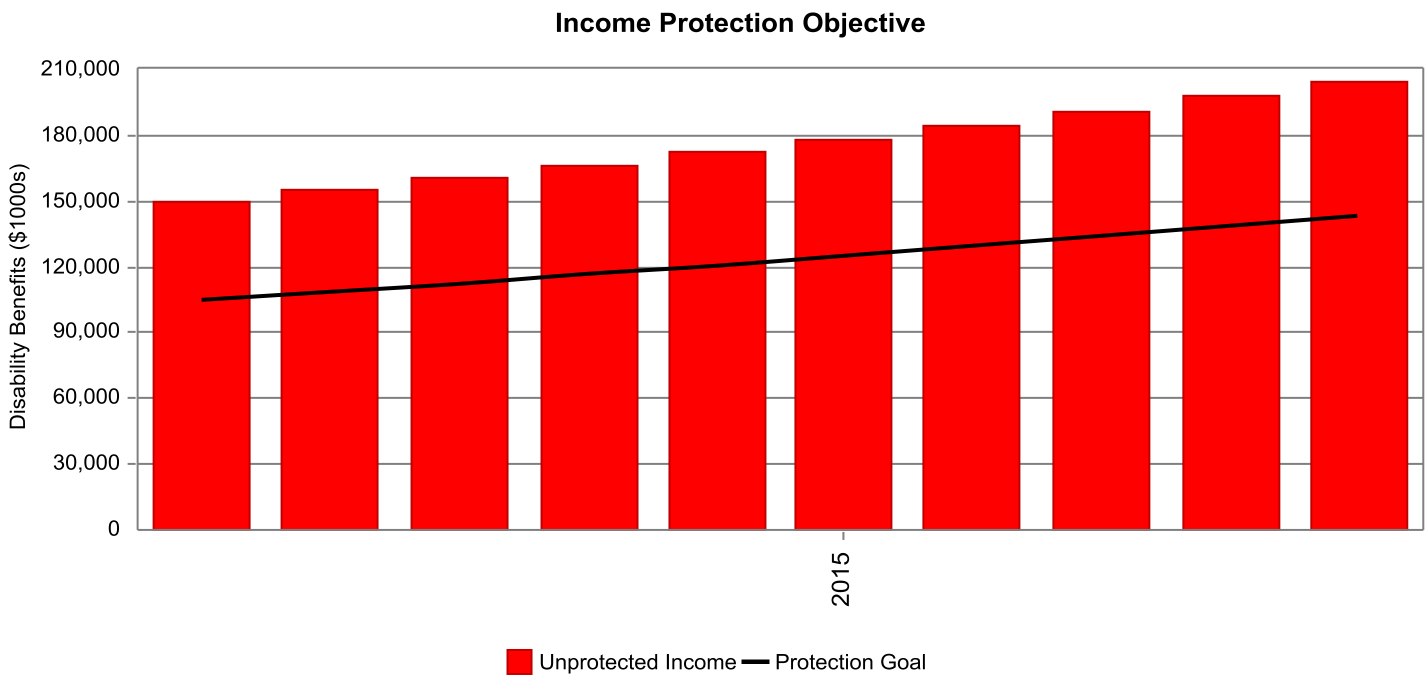
Existing Disability Coverage
$0 (2010)

Lost Income Protected
0% (2010)
0% (2010-2019)

Existing benefits are projected to protect **0%** of lost income in **2010** and **0%** of lost income over the entire disability period, which **does not** meet the protection goal of **70%**.

Protection Objective and Current Insurance

The chart below compares the current disability benefits to the amount of lost income and protection objective through **2019**.



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Income Protection Objective

Base Facts with Disability Occurs - Client

Prepared for Luke and Jen Smith

Year	Age	Lost Income	Income Protection Objective	Existing Insurance Benefits	Total Benefits	Shortfall Amount	Protection Percentage
2010	55/52	$150,000	$105,000	$0	$0	$105,000	0%
2011	56/53	155,280	108,696	0	0	108,696	0%
2012	57/54	160,746	112,522	0	0	112,522	0%
2013	58/55	166,404	116,483	0	0	116,483	0%
2014	59/56	172,261	120,583	0	0	120,583	0%
2015	60/57	178,325	124,828	0	0	124,828	0%
2016	61/58	184,602	129,221	0	0	129,221	0%
2017	62/59	191,100	133,770	0	0	133,770	0%
2018	63/60	197,827	138,479	0	0	138,479	0%
2019	64/61	204,791	143,354	0	0	143,354	0%
Totals		**$1,761,336**	**$1,232,936**	**$0**	**$0**	**$1,232,936**	**0%**

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Disability Gap Analysis

Base Facts with Disability Occurs - Client

Prepared for Luke and Jen Smith

This analysis reflects the cash flow gap created by a disability event, as well as the potential insurance solution to cover all or part of that gap.

The disability event for Luke is assumed to start in **2010** when **Luke** is age **55** and last through lifetime (**2045**). Additional health care costs due to the disability during this period are assumed to be **$10,000** (in today's dollars) and will grow at **3.52%** beginning **immediately**, reaching a cumulative additional expense of **$702,796**. Desired assets remaining at death are **$3,000,000**.

Existing disability insurance benefits in **2010** are projected to be **$0** after your Social Security reduction is applied.

> Your cash flow and remaining asset goal may be achieved with additional coverage providing **$53,000** per year when disability starts.

The result above assumes a policy with the following characteristics:

- Reduced by Social Security
- Maximum Benefit Period To Age 65
- Cost of Living Adjustment 3.00% (Compound)
- Benefit is Not Taxable

SUMMARY

Disability Period
Age 55 - 90 (2010-2045)

Existing Benefits (2010)
$0

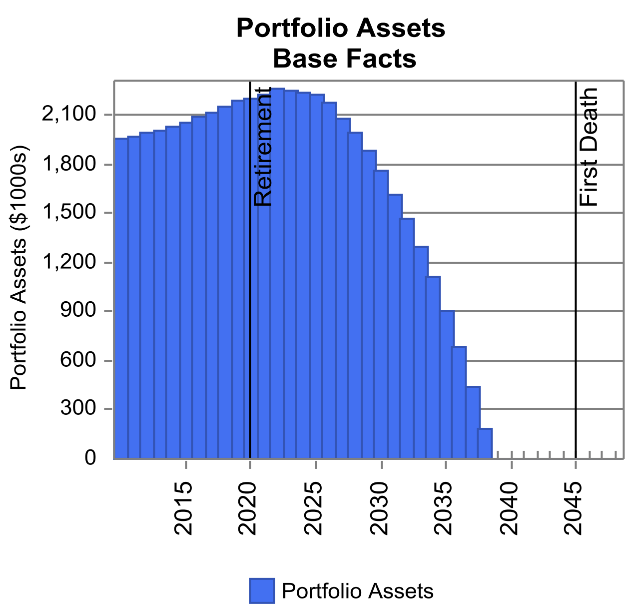
Additional Coverage
$53,000

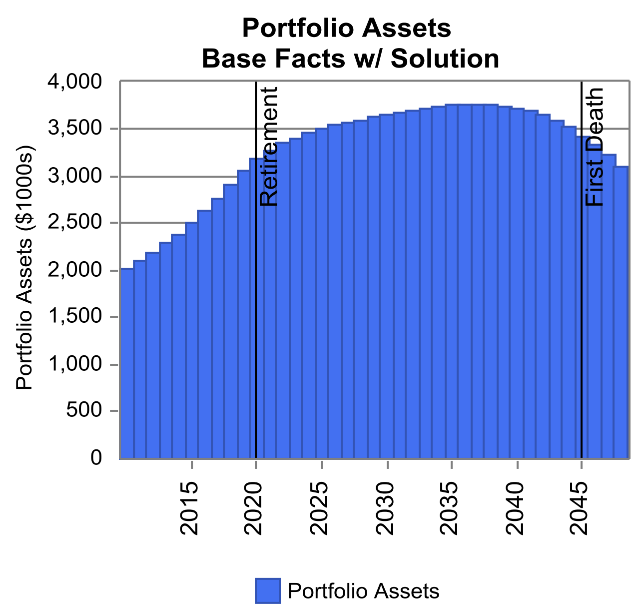
Unfunded Years
10 (current)
0 (new)

Remaining Assets (2048)
($2,185,208) (current)
$3,096,914 (new)

Portfolio Assets

The charts below show the amount of portfolio assets you can expect to have in each of the disability scenarios, one using current assumptions and the other using the above result.





Disability Gap Analysis

Base Facts with Disability Occurs - Client

Prepared for Luke and Jen Smith

Year	Age	Income Flows	Social Security Disability	Investment Income	Planned Distributions	Other Inflows	Existing Disability Benefits	Additional Disability Benefits	Total Inflows	Total Expenses	Total Outflows	Total Portfolio Assets
2010	**55/52**	**$80,000**	**$0**	**$0**	**$0**	**$40,292**	**$0**	**$53,000**	**$173,292**	**$235,064**	**$235,064**	**$2,017,003**
2011	56/53	82,816	0	0	0	40,308	0	54,590	177,714	246,128	246,128	2,100,347
2012	57/54	85,731	0	0	0	40,324	0	56,228	182,283	247,554	247,554	2,191,536
2013	58/55	88,749	0	0	0	40,341	0	57,915	187,005	252,569	252,569	2,287,542
2014	59/56	91,873	0	0	0	40,359	0	59,652	191,884	256,021	256,021	2,392,939
2015	60/57	95,107	0	0	0	40,378	0	61,442	196,927	260,082	260,082	2,507,970
2016	61/58	98,455	0	0	0	40,398	0	63,285	202,138	264,827	264,827	2,632,914
2017	62/59	101,921	0	0	0	40,419	0	65,184	207,524	270,180	270,180	2,768,164
2018	63/60	105,509	0	0	0	40,441	0	67,140	213,090	276,092	276,092	2,914,211
2019	64/61	109,223	0	0	0	40,464	0	69,154	218,841	282,523	282,523	3,071,645
2020	**65/62**	**118,227**	**0**	**13,466**	**0**	**40,489**	**0**	**62,721**	**234,903**	**290,239**	**290,239**	**3,194,609**
2021	66/63	149,088	0	14,449	0	40,515	0	0	204,052	306,882	306,882	3,277,683
2022	67/64	154,336	0	15,503	0	40,542	0	0	210,381	313,338	313,338	3,366,198
2023	68/65	65,135	0	16,634	0	40,571	0	0	122,340	273,654	273,654	3,412,300
2024	69/66	67,428	0	17,848	0	40,601	0	0	125,877	278,287	278,287	3,461,107
2025	70/67	69,801	0	19,150	0	40,632	0	0	129,583	283,310	283,310	3,512,627
2026	71/68	72,258	0	20,548	81,984	40,666	0	0	215,456	311,029	311,029	3,544,591
2027	72/69	74,802	0	22,048	86,479	40,701	0	0	224,030	319,073	319,073	3,575,610
2028	73/70	77,435	0	23,657	91,217	40,738	0	0	233,047	327,552	327,552	3,605,481

Year	Age	Income Flows	Social Security Disability	Investment Income	Planned Distributions	Other Inflows	Existing Disability Benefits	Additional Disability Benefits	Total Inflows	Total Expenses	Total Outflows	Total Portfolio Assets
2029	74/71	80,161	0	25,384	96,210	40,777	0	0	242,532	336,462	336,462	3,634,008
2030	75/72	82,982	0	27,237	101,470	40,818	0	0	252,507	345,810	345,810	3,660,990
2031	76/73	85,903	0	29,225	107,010	40,861	0	0	262,999	355,610	355,610	3,686,218
2032	77/74	88,927	0	31,358	112,314	40,907	0	0	273,506	365,727	365,727	3,709,631
2033	78/75	92,057	0	33,647	118,432	40,954	0	0	285,090	376,462	376,462	3,730,882
2034	79/76	95,297	0	36,103	124,231	41,005	0	0	296,636	387,519	387,519	3,749,923
2035	80/77	98,651	0	38,739	130,275	41,058	0	0	308,723	400,937	400,937	3,764,688
2036	81/78	102,124	0	39,673	136,568	41,114	0	0	319,479	413,122	413,122	3,773,310
2037	82/79	105,719	0	39,843	143,114	41,173	0	0	329,849	424,571	424,571	3,774,939
2038	83/80	109,441	0	40,003	149,911	41,235	0	0	340,590	436,438	436,438	3,768,888
2039	84/81	113,294	0	40,140	156,964	41,300	0	0	351,698	448,703	448,703	3,754,420
2040	85/82	117,282	0	40,253	163,155	41,368	0	0	362,058	461,095	461,095	3,731,026
2041	86/83	121,410	0	40,314	169,453	41,441	0	0	372,618	473,847	473,847	3,697,896
2042	87/84	125,684	0	40,313	175,834	41,517	0	0	383,348	486,960	486,960	3,654,163
2043	88/85	130,108	0	40,240	182,272	41,597	0	0	394,217	500,432	500,432	3,598,899
2044	89/86	134,688	0	40,084	188,731	41,681	0	0	405,184	514,256	514,256	3,531,119
2045	**90/87**	**139,429**	**0**	**39,830**	**193,460**	**41,770**	**0**	**0**	**414,489**	**527,989**	**527,989**	**3,435,202**
2046	91/88	76,086	0	39,424	168,349	41,863	0	0	325,722	471,062	471,062	3,342,732
2047	92/89	78,764	0	37,581	174,327	41,962	0	0	332,634	485,025	485,025	3,230,016
2048	93/90	81,536	0	35,836	178,707	42,065	0	0	338,144	499,080	499,080	3,096,914

Disability Summary

Base Facts with Disability Occurs - Client

Prepared for Luke and Jen Smith

The following is a summary of the general details of the selected disability event. It also displays lost income sources and disability policies, as these are the main items that impact disability analysis.

Disability Event Definitions

Disability Occurs to Luke Smith

Starts: When Luke is 55 (2010)	Additional Expenses: $10,000 Annually
Ends: Luke's Death (age 90 in 2045)	Indexed at: Inflation (3.52%) beginning Immediately
Include Social Security Disability?: No	

Income Sources Impacted

Knit Shoppe Salary

Owner: Luke Smith	
Annual Amount: $150,000	Indexed at: Inflation (3.52%) beginning Immediately
Starts: Calendar Year 2010	Ends: Luke's Retirement (age 65 in 2020)

Social Security Disability Benefits

Source	Starts	Ends	Amount in Start Year	Indexed at
Not included in analysis				

Existing Disability Insurance

Disability from Employer Group

Insured: Luke Smith	
Policy Type: Group Long Term	Institution:
Benefit: 50% of Salary	Reduce by Social Security?: Yes
Elimination Period: 0 Days	Benefit Period: 10 Years
COLA: Custom (2.00%)	Benefit is Taxable?: Yes
Annual Premium: $2,400	Premium Term: 0 years