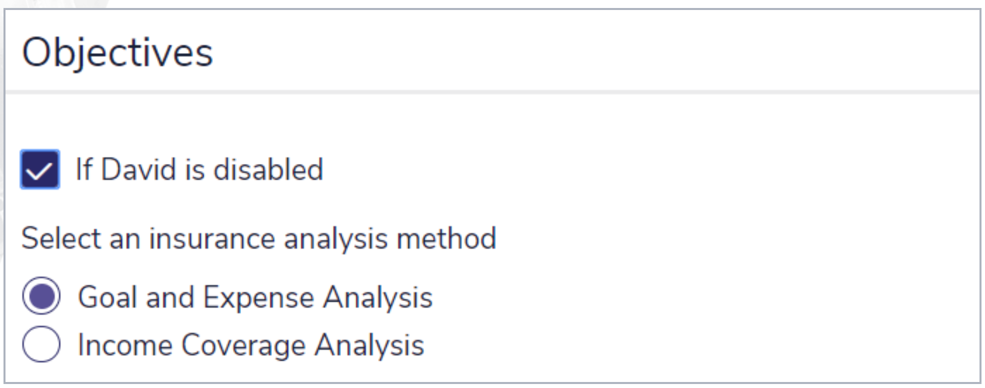
NaviPlan®
by Advicent

Comparing Disability Insurance Analysis Methods

Functions addressed in this document:

- What is the Goal and Expense Analysis method?
- What is the Income Coverage Analysis method?
- What factors could be considered when selecting an insurance analysis method?

Important! Unless otherwise indicated, items and locations referenced throughout this document are in the **Set Goals** section – **Disability Income** category – **Client/Co-Client Objectives** page



Set Goals – *Disability Income – Client Objectives*

When analyzing disability income needs, NaviPlan® simulates disability by discontinuing the disabled client's income and then analyzing the projected cash flow. When cash flow deficits occur, NaviPlan® recommends disability coverage equal to the average monthly deficit.

Because cash flow deficits result in additional recommended coverage, a disability income analysis should be performed on a completed plan that includes all of the clients' incomes, expenses, and goals. Since this may not always be possible, NaviPlan® provides two methods to analyze the clients' disability income needs in a Level 2 Plan: **Goal and Expense Analysis** and **Income Coverage Analysis**.

When using the **Goal and Expense Analysis** method, NaviPlan® evaluates the clients' disability needs from the standpoint of providing disability resources to meet all of the clients' expenses and goals. The **Income Coverage Analysis** method evaluates the analysis from the perspective of replacing the disabled client's income.

By default, NaviPlan® uses the **Goal and Expense Analysis** method. The default can be changed for all subsequent plans on the **Settings** menu - **Plan Settings**dialogue box – **Insurance** tab, or on a per-plan basis on the **Client/Co-client Objectives** page.

Regardless of the analysis method used, NaviPlan® analyzes disability needs from January 1 of the year after the plan year. The disability analysis ends on December 31 of the year prior to the year entered in the **Analyze Disability Through** field located on the **Assumptions** tab. For analysis purposes, only one client can be disabled at a time.

What is the Goal and Expense Analysis method?

The objective of the **Goal and Expense Analysis** method is to preserve the family's economic security by providing enough coverage to meet the clients' expenses and goals. When using the **Goal and Expense Analysis** method, NaviPlan® uses a more detailed approach for the disability analysis. This method fully integrates the clients' plan and recommends an amount of disability insurance large enough to meet all of the clients' defined goals and expenses in combination with any modifications and additional expenses entered.

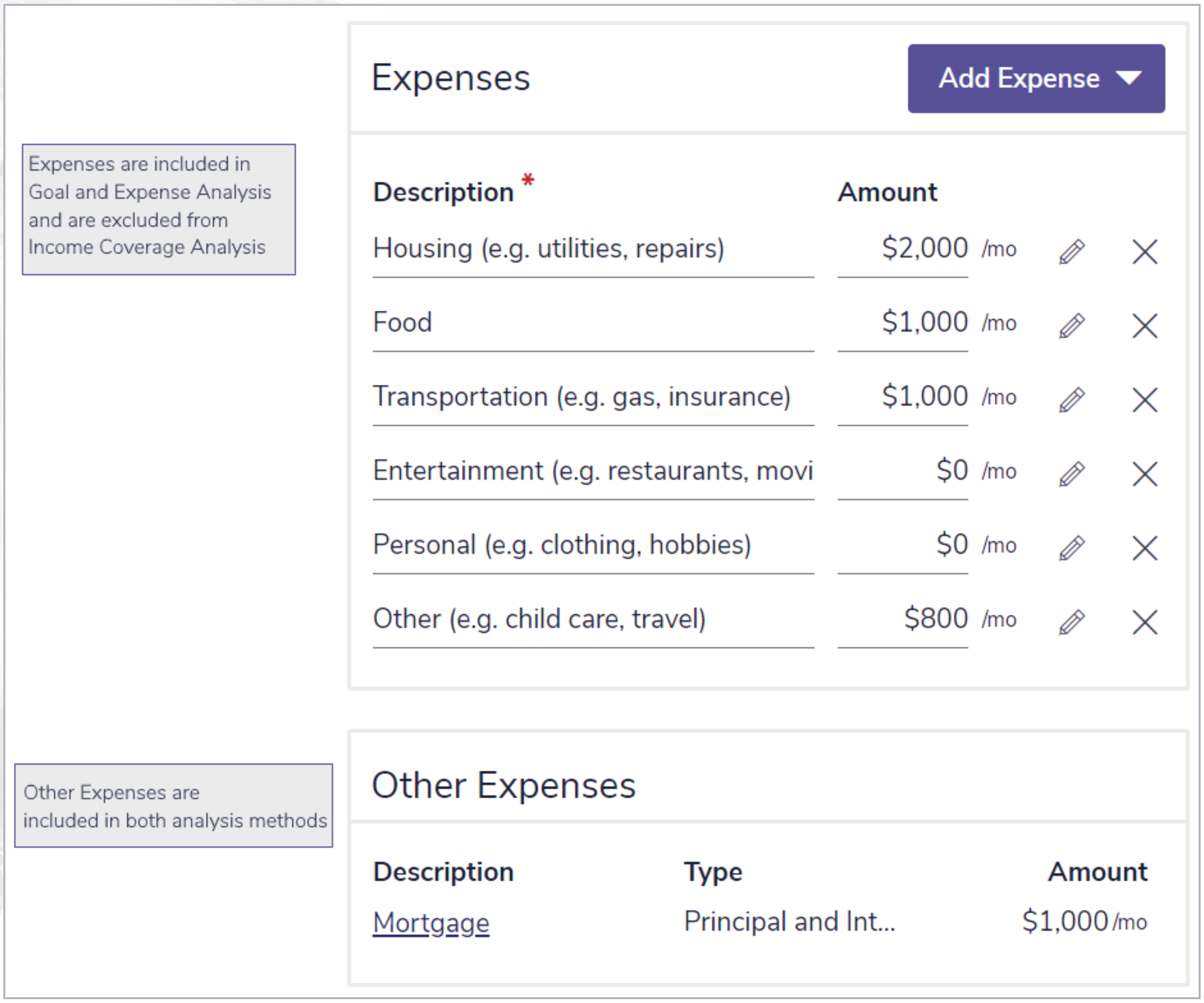
Because the **Goal and Expense Analysis** method fully integrates the clients' plan, it requires a completed plan that accurately reflects the clients' cash flow, particularly lifestyle expenses and goals. If the plan is incomplete, any changes made to the current plan (such as modifying goals or additional expenses) may cause the insurance need to change as these expenses may occur during the disability period. For more information on the **Goal and Expense Analysis** method, see *Other sources on this topic* in this document.

What is the Income Coverage Analysis method?

The **Income Coverage Analysis** method differs from the **Goal and Expense Analysis** method in that its objective is to provide enough coverage to replace specified income needs.

When using the **Income Coverage Analysis** method, NaviPlan® applies a more simplified approach that replaces income needs specified on the **Annual Income Needs** tab. This tab only appears when the **Income Coverage Analysis** method is selected and the income specified on the tab only applies during the disability analysis.

Also, unlike the **Goal and Expense Analysis** method, when using the **Income Coverage Analysis** NaviPlan® does not fully integrate the clients' plan. The key items that are not integrated are the lifestyle expenses entered under **Expenses** on the **Cash Flow** page (**Enter Financial Data** section – **Cash Flow** category).



Enter Financial Data — Cash Flow

Instead, NaviPlan® only integrates cash flow items such as liabilities and insurance premiums, which are listed under **Other Expenses** on the **Cash Flow** page. On the **Lump Sum Needs** tab, the **% to Cover** value for major purchase goals defaults to 0%, and for education goals on the **Annual Income Needs** tab, the **% to Cover** value defaults to 100%. In plans where these defaults do not meet the disability income needs, different percentages can be entered in the **% to Cover** field.

Because this approach does not fully integrate the plan, it is best applied to plans where the clients' cash flow information is incomplete or the clients' goals are likely to change (or are not yet finalized) and the objective of the disability analysis is to replace lost income. These annual income needs are stated as a current year pre-tax value, which NaviPlan® converts into an equivalent current year after-tax expense using the average tax rate entered on the **Assumptions** tab.

When using the **Income Coverage Analysis** method, it is important to consider the other cash flow items, such as liabilities, that will be integrated into the analysis when entering an amount on the **Annual Income Needs** tab. While cash flow is the basis of the disability income analysis, the objective of each analysis method differs, along with the cash flow items included in each. The table below outlines some of the common cash flow item differences.

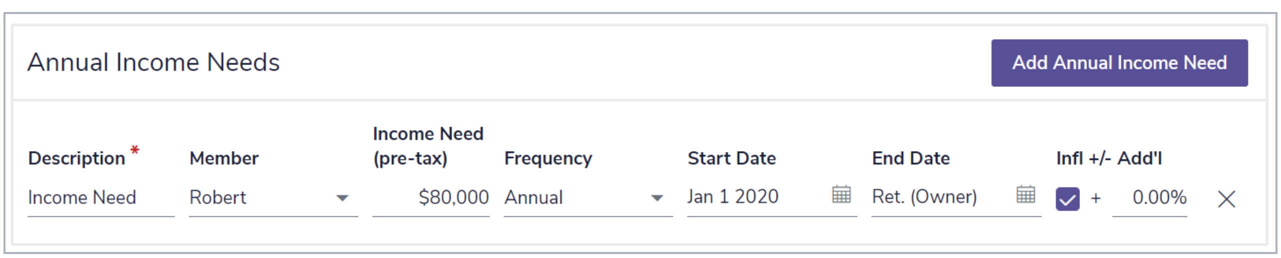
Common cash flow items that differ between the two insurance analysis methods	Goal and Expense Analysis	Income Coverage Analysis
Lifestyle expenses (**Enter Financial Data – Cash Flow – Cash Flow**)	Included	Excluded
Other expenses **Enter Financial Data – Cash Flow – Cash Flow** • Liabilities • Insurance premiums (disability premiums insuring the disabled client are discontinued) • Savings strategies (except for contributions to registered accounts owned by the disabled client, which cease) are included as another expense but not listed under **Other Expenses**	Included	Included

DID YOU KNOW? Liabilities entered on the **Assets/Liabilities** page (**Enter Financial Data — Net Worth**) appear on **Client/Co-client Objectives – Lump Sum Needs**. If the option associated with the liability is selected when performing an **Income Coverage Analysis**; the liability will be paid in full on January 1 of the year after the current plan year.

To understand how NaviPlan® converts the stated income need to an equivalent expense, as well as understand the differences in the analysis methods, we will analyze the disability income needs of Robert and Sarah, using the **Detailed Cash Flow if <client> is Disabled** report for 2012 (the first year Robert is disabled).

Example: Robert earns $80,000 and is the sole income earner. Robert and Sarah jointly own their home and have monthly mortgage payments of $1,000. In addition, Robert and Sarah have lifestyle expenses which are indexed for inflation totalling $4,000 per month for housing, food, and transportation, as well as $500 annually for insurance premiums. In the example that follows, for the **Income Coverage Analysis** method, we have entered an **Income Need** (pre-tax) of $80,000, which is equal to Robert's income.

Using the **Detailed Cash Flow if <client> is Disabled** report for 2012 (the first year Robert is disabled) for both analysis methods, we can see the differences in the cash flow items included in the analysis. In particular, as indicated previously, when analyzing the disability needs using **Income Coverage Analysis**, where the primary objective is income replacement, NaviPlan® ignores lifestyle expenses entered in the plan and instead creates an expense by converting the stated income need.



Set Goals — Disability Income — Client Objectives

Cash Inflows	
Total Cash Inflows	**$0**
Cash Outflows	
Lifestyle Expenses	
Lifestyle Expenses	$62,944
Subtotal	**$62,944**
Loan Payments (principal/interest)	
Mortgage (Joint)	$12,000
Subtotal	**$12,000**
Savings Allocated to Goals	$500
Subtotal	**$500**
Total Savings Allocated to Goals	**$500**
Total Cash Outflows	**$75,444**
Surplus/(Deficit)	**($75,444)**

Quick Actions – Reports – Insurance – Disability Insurance – Detailed Cash Flow if <client> is Disabled report (Income Coverage Analysis method selected)

Income Coverage Analysis method

In the **Detailed Cash Flow if <client> is Disabled** report, we can see that NaviPlan® ignores lifestyle expenses included in the plan. Instead, it creates an expense, called **Lifestyle Expenses**, by converting the stated income need. In the example on the left, the analysis includes an $80,000 income need (pre-tax). In Robert and Sarah's plan, the average tax rate is 21.32% so the after-tax expense is calculated as follows:

$80,000 x (1 – 21.32%) = $62,944

	Robert
Cash Inflows	
Investment Income	
Retirement Fund	779
Subtotal	**779**
Total Cash Inflows	**779**
Cash Outflows	
Lifestyle Expenses	
Housing (e.g. utilities, repairs)	24,720
Food	12,360
Transportation (e.g. gas, insurance)	12,360
Subtotal	**49,440**
Loan Payments (principal/interest)	
Mortgage (Joint)	12,000
Subtotal	**12,000**
Savings Allocated to Goals	
Retirement	
Retirement Fund (Joint/Non-Reg.)	15,289
Subtotal	**15,289**
Life Insurance	500
Subtotal	**500**
Total Savings Allocated to Goals	**15,789**
Reinvestments Allocated to Goals	
Retirement	
Retirement Fund (Joint/Non-Reg.)	614
Subtotal	**614**
Total Reinvestments Allocated to Goals	**614**
Total Cash Outflows	**78,008**
Surplus/(Deficit)	**77,229**

Although the analysis doesn't include lifestyle expenses (e.g., housing, food, and transportation), other expenses (e.g., mortgage and insurance premiums) are included.

Goal and Expense Analysis method

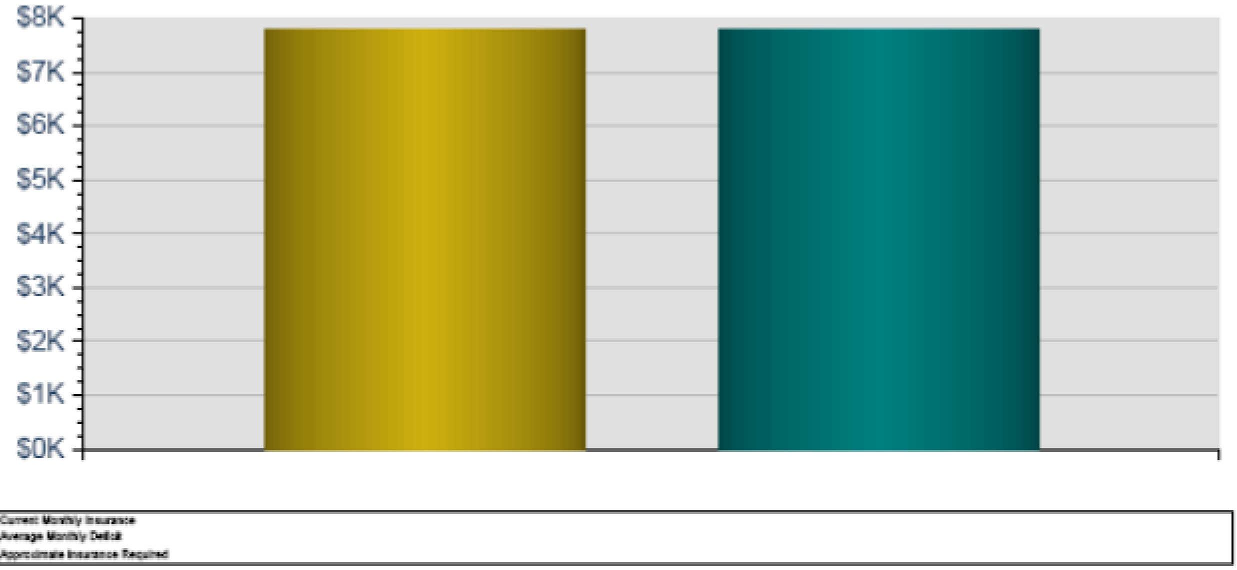
When using the **Goal and Expense Analysis** method, NaviPlan® includes expenses that were not included in the **Income Coverage Analysis** method.

In the report on the left, we can see that NaviPlan® has included lifestyle expenses for housing, food, and transportation.

It has also included savings required to meet a retirement expense and investment income earned on the savings.

As with the **Income Coverage Analysis**, the **Goal and Expense Analysis** includes other expenses such as mortgage payments and insurance premiums.

If Robert becomes Disabled



If Robert becomes Disabled

Current Monthly Disability Insurance	$0
Average Monthly Deficit	$7,788
Approximate Monthly Disability Insurance Required*	$7,788

*Depending on the circumstances, you may or may not be able to purchase this amount of disability insurance.
These projections are based on current asset mix and rate of return.

Consider the Following

- You may not want to rely solely on group policies at work. Should you change jobs or your employer change to another insurer, you may no longer be eligible for group benefits.
- Review your existing policy's monthly disability benefit, definition of disability, waiting period, and duration of benefits.
- Review the coverage periodically and adjust it according to changes in your income and expenses.

Results — Legacy Report — Legacy Report — Financial Needs Assessment

While the cash flow items included in the disability income needs analysis differ depending on the analysis mode selected, the additional recommended coverage always represents the average monthly deficit during the disability period. Using the **Financial Needs Assessment** client report, we can see how NaviPlan® displays the results of the disability needs analysis.

What factors could be considered when selecting an insurance analysis method?

Ideally, a completed plan that includes all of the clients' incomes, expenses, and goals should be used to analyze disability income needs, but this is not always possible. An incomplete plan often relates to the clients' stage in the financial planning life cycle, and often the plan becomes more complete as clients move through this life cycle.

Since the primary objective of the **Income Coverage Analysis** method is to replace lost income, it is a good choice to use for clients in the early stages of the financial planning life cycle, where their goals are undefined or may change because of lifestyle changes. For example, young couples who have only just started saving for retirement, but in the future may have children, may need to consider education goals.

In contrast, since the primary objective of the **Goal and Expense Analysis** method is to preserve the family's economic security (or more specifically provide enough coverage to meet their goals and expenses), it is often an ideal choice when the clients' plan is complete and their goals and expenses are relatively stable. This is often the case when the clients are in the accumulation stage, such as clients whose primary focus is retirement but whose plan also includes education goals for their children.

Because clients move through the stages of the financial planning life cycle, NaviPlan® allows for an easy transition from one analysis method to the other by allowing users to simply select a different option under Select an insurance analysis method (on the **Client/Co-client Objectives** page), and then to review and possibly update specific data.

DID YOU KNOW? When transitioning between analysis methods, selections on the **Asset Availability** tab carryover.