

# Product Profile

## DISABILITY BUY-OUT INSURANCE

### OVERVIEW

**Disability Buy-Out (DBO) insurance provides benefit payment(s) to help with the purchase of a totally disabled business owner's interest under a buy-sell agreement.**

A DBO insurance policy from Principal Life Insurance Company allows remaining owners to continue the business without:

- Using business cash flow
- Obtaining loans from financial institutions
- Selling shares of the business to get working capital

Typically, smaller businesses, because of the amount of responsibility shared among relatively few owners, are better suited for DBO insurance than larger businesses. A three-person professional partnership with equal ownership is an example of an ideal DBO opportunity.

For each DBO case, ownership structure, agreement documentation and buy-out objectives are reviewed carefully. Because of the increased risk of anti-selection, family businesses involving spouses or parent-child relationships are generally not considered. Also, business owners with large age differences may be uninsurable.

#### PROFILE OF DBO PURCHASERS

- Ages 30 to 49
- Majority of policies sold to 3A/3A-M and above occupation classes
- Often sold to corporate executives, accountants/CPAs, attorneys, business owners, dentists and medical professionals

## Did you know?

- Business owners ranked business protection as their **#1 financial priority**.<sup>1</sup>
- **59% of owners** don't have a written business continuation plan for death, disability or retirement.<sup>1</sup>
- **83% of business owners** with written exit plans do not have Disability Buy-Out Insurance in place.<sup>1</sup>

### PRODUCT AND UNDERWRITING GUIDELINES<sup>4</sup>

#### The owner(s)/full-time professional(s)

- **Issue ages:**<sup>2</sup> 18-60 (18-57 in California)
- **Occupation classes:** 6A,<sup>3</sup> 5A/5A-M, 4A/4A-M, 3A/3A-M, 2A, A (A class not available in CA)
- **Minimum business ownership requirement:**<sup>2</sup> 5%;<sup>4</sup> all eligible owners of the business must apply
- **Minimum earned income:** \$15,000/year as indicated on federal tax returns
- Must not be over insured for personal disability income insurance
- **Minimum number of years in business:**
  - Service professionals (e.g., attorneys, CPAs, medical professionals): 1 year
  - Other business owners: 3 years

#### The business

- **Number of owners<sup>2</sup> (by occupation class):**
  - 6A,<sup>3</sup> 5A, 5A-M, 4A and 4A-M: 2 to 10
  - 3A, 3A-M and 2A: 2 to 8
  - A: 2 to 6 (not available in California)
- **Valuation:** If the business is valued at more than \$10 million, contact your underwriter. Businesses valued at more than \$20 million are typically not eligible for DBO coverage.

## PRODUCT AND UNDERWRITING GUIDELINES (CONT.)

### About the policy

- **Elimination Periods:** 365, 540 and 730 days
- **Benefits:** lump sum, monthly installments of 24, 36 or 60 months, or a combination of a lump sum and monthly installments
- Conditionally renewable to age 65 or 67<sup>5</sup> with guaranteed premiums
- **Rates:** Sex-distinct (unisex in CA and MT)

### FINANCIAL VERIFICATION

Business valuation documentation is required for:

- One-Way Buy-Out policies<sup>2,3</sup>
- Any application not using TeleApp
- Applicants over age 50
- Total aggregate benefit amounts applied for that are more than \$360,000, regardless of age

Documentation required:

- Year-to-date profit and loss (income) statement
- Past two years' business federal income tax returns
- Current balance sheet

DBO MAXIMUM ISSUE <sup>2</sup> AND PARTICIPATION LIMITS					
Elimination Period	Occupation Classes				
	6A, <sup>3</sup> 5A, 4A, 3A	5A-M, 4A-M	3A-M	2A	A*
<b>Lump Sum</b>					
365 day	\$1.5 million	\$1.25 million	\$1.25 million	\$750,000	\$250,000
540 day	\$1.75 million	\$1.5 million	\$1.5 million	\$1 million	\$500,000
730 day	\$2 million	\$1.5 million	\$1.5 million	\$1.25 million	\$750,000
<b>Monthly Benefit Factors 24 and 36</b>					
365 day	\$1.75 million	\$1.5 million	\$1.25 million	\$1.25 million	\$500,000
540 day	\$2 million	\$1.5 million	\$1.5 million	\$1.5 million	\$750,000
730 day	\$2.5 million	\$1.5 million	\$1.5 million	\$1.75 million	\$1 million
<b>Monthly Benefit Factor 60</b>					
365 day	\$2 million	\$1.5 million	\$1.25 million	\$1.5 million	\$500,000
540 day	\$2.5 million	\$1.5 million	\$1.5 million	\$1.75 million	\$750,000
730 day	\$3 million	\$1.5 million	\$1.5 million	\$2 million	\$1 million

\*The A occupation class is not available in California.

Note: For combination lump sum/monthly payments, the aggregate benefit limit (lump sum plus monthly payments) is the maximum Issue and Participation limit for the monthly benefit factor selected. The combination lump sum amount cannot exceed the lump sum limit for the selected elimination period and occupation class.

### CROSS SELL DBO TO LIFE INSURANCE CLIENTS

If your clients currently have buy-sell agreements funded by life insurance, talk to them about the importance of funding DBO insurance, too.

### AVAILABLE FEATURES

#### Riders/Provisions

- Benefit Update (no-cost rider)
- Benefit Update Valuation (no-cost rider)<sup>3</sup>
- Employment in firm (CA only<sup>4</sup>)
- Full Benefit Continuation<sup>3</sup>

#### Discounts<sup>5</sup>

Certain discounts can be used together, providing even greater savings:

- Multi-Life:<sup>6</sup> 20% (not available in OH)
- Preferred Business Owner:<sup>3</sup> 5%
- Select Occupation:<sup>7</sup> 10%
- Association:<sup>8</sup> 10%

#### Sales Programs

- Multi-Life<sup>6</sup>
- Association<sup>8</sup>
- Simplified underwriting

### BUILT-IN POLICY COMPONENTS<sup>6</sup>

- Accounting/Legal Fee Benefit
- Death Benefit
- Exchange Privilege
- Military Suspension
- Reinstatement
- Transfer Privilege
- Waiver of Premium Benefit

### SALES IDEAS



#### One-Way Buy-Out

*An industry changer!* Available with the new DBO insurance policy (HH794<sup>3</sup>) a key employee has the opportunity to fund a single owner buy-sell agreement with DBO insurance. Check out JJ2166 for details.



#### Coverage at a discount

With the Multi-Life Discount,<sup>6</sup> business owners and their employees can receive a 20 percent discount on Principal Life Individual Disability Insurance policies.

**Example:** Two owners of a business purchase DBO policies and pay premium on a Disability Income (DI) policy for an employee (who is not an owner).

**DBO + DBO + DI = 20% discount<sup>6</sup>**

## TYPES OF BUY-SELL AGREEMENTS

Buy-sell agreements come in many forms and should be written to cover a variety of triggering events, such as death, disability, divorce, bankruptcy and retirement. In the event of a disability, the buy-sell agreement protects:

- Disabled business owners – by obligating those listed in the agreement to buy out the disabled owner’s interest.
- Remaining nondisabled owner(s) or key employee – by providing them with the opportunity and funding to purchase the disabled owner’s interest. DBO insurance helps provide the necessary funding to transfer that interest.



There are two common structures for buy-sell agreements:

### 1 Cross Purchase<sup>2</sup>

Each business owner purchases and owns a DBO insurance policy on each of the other business owners.

Benefits for remaining owners:

- They receive a step-up in basis when they buy out the disabled owner.
- Their additional investment in the business helps offset their profit and tax liability if they eventually sell the business for a gain.
- Policy benefits are not available to creditors of the business.

### 2 Entity Purchase

The business purchases and owns the DBO insurance policies and pays the premiums (which are not tax-deductible). If a total disability occurs, the business purchases the disabled owner’s business interest and receives tax-free reimbursement.

- This arrangement is often preferred when multiple owners are involved.
- It is not recommended if any owners expect to sell shares of the business during their lifetimes as no one will receive a step-up in basis.

### COMPLIMENTARY BUSINESS PLANNING SERVICES

Take advantage of these services from Principal Life to open doors with business owners:

#### Buy-sell Reviews

Help ensure clients’ buy-sell agreements are effective and properly funded.

#### Informal Business Valuations

Provide valuations of clients’ businesses to help identify next steps for business continuation planning.

## POINTS TO DISCUSS WITH CLIENTS

### Business Continuation

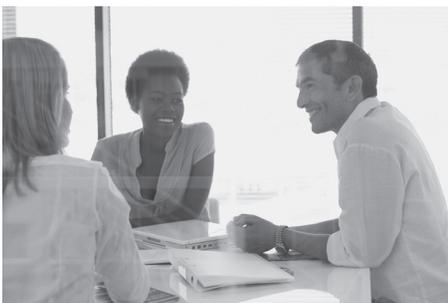
Unless they’ve agreed beforehand, owners and key employees may have different priorities for their business if one of them becomes totally disabled.

Ask these questions:

- What would happen to the profits of your business if a disabled owner is not contributing to its operation?
- Are you prepared to let a spouse, relative or outsider step into the business if one of the partners becomes disabled?
- Do you feel a financial obligation toward a disabled partner? Would you have the means necessary to buy out his/her share or would you be forced to sell the business?

### Taxation

- DBO premiums are not deductible and benefits are received income tax free.
- A transfer from the nondisabled party to the disabled owner may be considered a capital gain if there is an increase from original basis.
- The payout can be structured as a non-compete or severance pay, which is viewed as tax-deductible.
- The disabled owner is taxed on the gain from the sale of the business. Any portion of the payout that is structured as a non-compete or severance pay may be taxed differently. The gain may be considered an installment sale if at least one payment is received after the close of the tax year in which the sale was made.



## FOR MORE INFORMATION

Contact your local representative.

Not all benefits, features and riders are available in all states or to all occupation classes.

<sup>1</sup> 2015 Business Owner Market Study, conducted by Harris Interactive® for The Principal®.

<sup>2</sup> Guidelines, limits and required documentation vary for single business owner DBO policies. For more details, refer to the One-Way Buy-Out Market Profile (JJ2166).

<sup>3</sup> Available for HH794 policies only; new as of September 2015; not approved in all states. Visit [www.principal.com/distateapprovals](http://www.principal.com/distateapprovals) for details.

<sup>4</sup> Business owners with at least 5%, but less than 10% ownership interest in the business are eligible if there are at least four active owners and no one owner has more than 80% ownership interest; otherwise, 10% ownership is required.

<sup>5</sup> May not be available in all states.

<sup>6</sup> Available when three or more individuals with a common employer purchase Individual Disability Insurance coverage from Principal Life. In OH, only Individual Disability Income insurance and DI Retirement Security receive the discount or count toward the three-person minimum. Discount on DBO insurance is based on sex-distinct rates; unisex rates in written states of CA and MT.

<sup>7</sup> Not available for HH794 policies.

<sup>8</sup> Not approved in all states; not available in CA. For more information, visit [www.principal.com/distateapprovals](http://www.principal.com/distateapprovals).



WE'LL GIVE YOU AN EDGE®

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