Unit 7: Business Disability Products

Pre-Class Assignments

- Read this unit and complete the quiz.
- Review the following portions of the Field Underwriting Guide:
  - Business Disability Products
  - Financial Underwriting
  - Business Products Guidelines
  - Tax Treatment of Disability Insurance Products
- Business Products Producer Guide (Pub5743BL-A)
- Rebecca's Story Consumer Brochure (Pub5121BL)
- Learn About the Business Fact Finder (Pub5774BL)
- Forbes Article, "When Your Employee Coughs, Do You Catch the Cold?"
- Business Products Specimen Contracts, available on GuardianOnline
  - Overhead Expense, Form 4200 – Pub4390BL
  - Disability Buy-Out, Form 3200– Pub4393BL
  - *Note: Policy Form 3100 and 4100 are used in Florida.*

Unit Purpose

The purpose of this unit is to acquaint you with Guardian's DI products for small business owners. The unit will help you to identify several avenues of approach to the small business owners you have targeted. The unit covers three products: Overhead Expense, Business Reducing Term, and Disability Buy-Out.

Unit Topics

Section I: Products that Meet Unique Business Needs

Section II: Overhead Expense

A. OE Policy Basics
B. Optional Benefits
C. Other Important Details

Section III: Business Reducing Term

A. BRT Policy Basics

Section IV: Disability Buy-Out Policy

A. Buy-Sell Agreements
B. Policy Basics
   - Renewability
   - Payment of Benefits
C. Optional Benefits – Future Increase Option
D. Other Important Details
   - DBO Issue Limits
   - Eligibility for Disability Buy-Out Coverage
   - Financial Underwriting
   - Premiums & Discounts
   - Tax Considerations

Unit Objectives

After you have completed this unit, you will be able to:

- Describe Guardian's unique DI products targeted for business owners
- Define an approach to marketing our business disability products to small business owners

Section I: Products That Meet Unique Business Needs

Many of your preferred clients are self-employed professionals or owners of small businesses. You must become familiar with the products Guardian offers to meet specific business needs:

- Overhead Expense Policy Forms 4200 and 4100
- Business Reducing Term Policy Form AH55-A
- Disability Buy-Out Policy Forms 3200 and 3100

A business owner will tell you that his or her greatest investment is the business itself. It exists and thrives only through the expertise, creativity and hard work of the owner. Owners understand the risks to their investment, and so they typically carry a number of types of insurance, e.g. liability, property, business interruption, or malpractice.

What an owner may not understand is that the greatest risk to the business is the risk of his own disability. Of course individual disability insurance should first be obtained to protect the owner and the family. But the owner also needs to assure that ongoing business expenses can be met, that creditors can be paid, and that the value of the business interest will be preserved in case he or she can never return.

Section II: Overhead Expense

Every business owner understands the term “overhead.” It means all the ongoing expenses of keeping the business running. If the owner became disabled and unable to work, serious questions would arise:

- How long could you continue to meet ongoing expenses like rent, utilities, equipment leases?
- Could you be replaced? How long could the business afford to pay a replacement?
- How long could you afford to keep your employees?
- When would your customers begin leaving?

These questions are especially critical for owners who provide personal services, e.g. physicians, dentists, attorneys, CPAs, or independent consultants. Overhead Expense insurance helps to provide the solution. It reimburses normal ongoing business expenses incurred during the disability of the owner, including items such as:

- Rent
- Utilities
- Lease expense of furniture, equipment, etc
- Interest on debt
- Depreciation or scheduled installment payments of principal of debt
- Taxes on business property
- Salaries of employees who are not members of the insured’s profession
- Other normal, necessary and customary fixed business expenses.

Our Overhead Expense policy also provides a benefit (through a policy endorsement) to help cover the salary of a replacement hired to continue the services of a disabled professional. The cost of goods, merchandise or inventory is not considered a covered overhead expense.
Note that the Overhead Expense policy is not designed to cover the compensation of the insured. That is the purpose of an individual disability income policy. Overhead Expense coverage helps to keep the doors open until the owner can return to work; it also helps to preserve the value of the business, so that if the owner cannot return, he or she can receive a fair price for the ownership interest.

Overhead Expense insurance makes a terrific sequential sale to a personal DI sale. On the other hand, many prefer to lead with Overhead Expense, as the first disability sale to a business owner or professional in private practice. Keep in mind that "covered expenses" means only that portion of incurred expenses for which the insured is responsible. For a firm or practice that has joint ownership, each active principal should obtain his or her own policy.

A. OE - Policy Basics

The Overhead Expense policy is non-cancellable and guaranteed renewable to age 65; it may be renewed after that if the owner is working full time (at least ten months each year) and responsible for business expenses. The policy includes a true own-occupation definition of total disability.

Other policy basics:

- Issue ages: 18 - 60
- Available to classes 6 – 3; 6M – 3M
- Elimination periods: 30, 60 or 90 days. We recommend that you propose the 30-day elimination period, as business receivables can fall off quickly. (Also, our policy is very competitively priced for the 30-day elimination period.)
- Maximum benefit periods: 12, 18 or 24 months. If a disability lasts for one or two years, the owner will generally be looking to sell his or her business interest.
- Maximum issue limits.

Benefit Period	Maximum Monthly Benefit
12 months	$50,000
18 months	$40,000
24 months	$30,000

Note: In combination with our unique Business Reducing Term policy, total coverage of up to $55,000 per month is available.

The Overhead Expense policy is a reimbursement contract, not an indemnity agreement. This means that the actual covered monthly business expenses are reimbursed up to the stated maximum monthly benefit.

As monthly business expenses naturally fluctuate, there are likely to be months when the reimbursable expenses will be less than the maximum monthly benefit. When this happens, "unused" benefits can be carried over to a subsequent month (in the same claim), when expenses may be higher. Covered expenses will continue to be reimbursed during disability until the aggregate maximum benefit is paid, for up to twelve additional months.

Other Client-Friendly Benefits:

- Occupational Rehabilitation Benefit and Modification & Access Benefit
- Conversion to an individual DI policy, should the need for Overhead Expense coverage no longer exist
- Legal and Accounting Fee benefit of up to $5,000 for fees related to disability-related termination or sale of the business
- Waiver of Premium and Waiver of Elimination Period provisions similar to those found in ProVider Plus

Accelerated Benefit Endorsement

When doing research with business owners, we learned that, should they become disabled, they would like benefits made available as soon as possible. The Accelerated Benefit Endorsement is designed to help get money to the owner sooner, to help meet cash flow needs—an accelerated benefit amount may be paid before requiring proof of covered overhead expenses. This can normally take well over a month after the elimination period is satisfied. The Accelerated Benefit Amount equals one half of the maximum monthly overhead expense benefit.

To receive the benefit, the owner must be continuously totally disabled for the duration of the elimination period and provide proof of total disability. The no- cost endorsement does not waive the requirement for providing proof of covered expenses, and reduces the normal reimbursable expense amount in the first month.

Residual Overhead Expense Benefit

As you can imagine, not all disabilities are total. Even when the owner can work only part time, business expenses may continue at the same level. Residual benefits help to fill the gap; it pays a portion of the maximum monthly overhead expense benefit if the owner is residually disabled.

Residual disability is defined as suffering at least 15% loss of gross monthly revenue as well as loss of time or duties. The benefit payable under this rider equals covered overhead expenses for the month minus current gross monthly revenue.

B. OE - Optional Benefits

Supplemental Overhead Expense Benefit Rider

In a small business monthly expenses can fluctuate greatly. This unique rider is designed to help the owner more fully cover fluctuating monthly expenses. It provides an additional benefit that can be used for a total or residual disability at any time during the benefit period or any extension of benefits. The supplemental benefit equals one times the maximum monthly benefit. For example, assume a $30,000 monthly benefit and a benefit period of 12 months. The total “pool” of benefit available is $360,000. With the supplemental benefit rider the total pool available would be $390,000.

Professional Replacement Endorsement

When the Professional Replacement Endorsement is placed on a policy; 50% of a replacement's gross monthly salary is considered a covered overhead expense, and payable in addition to other covered expenses. We may issue up $10,000 per month or ½ the monthly maximum benefit, whichever is less. In order to qualify the owner must be totally disabled. Availability of the endorsement is subject to underwriting discretion. This rider helps the owner of a growing business or practice to keep overhead coverage current. Under the FIO the insured may apply for additional overhead expense coverage without proof of medical insurability (but subject to financial insurability). As with ProVider Plus we offer annual increase options on the policy anniversary each year until age 55.

The insured purchases a total option amount, of up to one times the policy's monthly benefit. On each policy anniversary up to age 45 the insured may purchase either a portion or the entire total option amount, depending on current overhead expenses. On or after age 45 he or she may exercise up to one-third of the original total increase option amount, or the remaining amount, if less than $1,000.

C. OE - Other Important Details

Premiums and Discounts

Overhead Expense premiums are level and are based on the insured's age-last birthday. They are also gender-distinct.

As with ProVider Plus we offer preferred, select and standard risk classes. A discount of 10% is available to pre-approved professional associations.

Tax Considerations

A word on the taxation of Overhead Expense premiums and benefits: premiums paid for Overhead Expense coverage are deductible as a business expense. Policy benefits are, as a result, taxable. However, the benefits are often used to pay deductible business expenses. As long as Overhead Expense benefits are used to pay deductible business expenses the net tax impact is neutral.

Section III: Business Reducing Term

We turn now to a unique business disability policy—Business Reducing Term (BRT). This policy is designed to protect certain types of fixed-payment business obligations, such as:

- Loan taken out to fund the purchase of a business or practice
- Business loan (e.g. expansion)
- Guaranteed employment contract

You may not realize that Business Reducing Term is unique to Guardian; no other insurer offers it as a standalone policy, besides special risk insurers such as Lloyd's of London. And it efficiently meets a need that is quite relevant for many professionals and business owners.

Note: BRT is available in all states except FL, MT, NC, SC and VA.

A. BRT - Policy Basics

Coverage under a Business Reducing Term policy lasts for a specified policy term. The term selected at application equals the length of the obligation. Benefits are payable until the end of the policy term.

The Business Reducing Term policy is conditionally renewable until the end of policy term. We can refuse to renew only if there is a lack of insurable interest or an economic need for the policy. This means that you have the obligation to conduct an annual review with your client—to assure that the business obligation continues to exist.

The BRT policy pays benefits for total disability only. It has a modified own- occupation definition of disability: unable to perform the material and substantial duties of your occupation and not working at any occupation. The elimination periods available are one, two, three, six, and twelve months.

It's important to understand that monthly benefits are paid directly to the loss payee designated in the policy, e.g. the holder of the loan obligation. This is unlike the overhead expense policy, which reimburses the insured for covered monthly expenses that have been paid.

Other policy basics:

- Issue ages: 18 – 55
- Available to classes 5A, 4A, 3A, 2A
- Elimination periods: 1, 2, 3, 6, 12 months.
- Policy term: 5 – 30 years, not to exceed age 60
- No riders are available
- Premiums are gender-specific.

Issue limits for Business Reducing Term coverage are as follows:

- Minimum: $1,000/mo. ($500 if other Guardian or Berkshire coverage in force)
- Maximum: $6,660-$22,500, depending on the policy term. (e.g. $22,500 for a five-year term, $12,900 for a ten-year term). The maximum issue amount is higher for shorter policy terms. Check the Field Underwriting Guide for full details.

For purchase loans or other business obligations we will insure up to 100% of the monthly payment; for employment contracts, up to 100% of the after-tax cost of contract payments. Note that in all cases the underwriters will require proof of the obligation, such as a copy of the loan agreement.

Tax Considerations

The premiums for Business Reducing Term insurance are not deductible as a business expense. Because the beneficiary of a Business Reducing Term policy is a third party (the loss payee), benefits are not taxable to the policy owner when paid.

Section III: Disability Buy-Out Policy

Smart business partners recognize that they should develop a plan for the disposition of their business interests when it comes time to retire, or if one of them dies or become disabled. So they draw up a buy-sell agreement. This is an agreement whereby an owner's share will be purchased by his or her partners or by the business itself in the event of death, retirement, withdrawal or disability. The agreement creates an obligation for the owner's interest to be purchased and establishes a formula for determining a fair value of the ownership interest.

It is common to fund the "death" provision of the buy-sell agreement with life insurance. However, there is usually no arrangement for funding the disability provision. This gap creates an opportunity for you to point this out to the owners and help them fill a big gap in their planning. The solution is disability buy-out insurance.

Insurance is the most dependable and economical way to fund the disability provision in a buy-sell agreement. It is dependable because the burden of providing funds to accomplish the buy-out has been shifted to the insurance company. The insurance proceeds are available exactly when they are needed. Otherwise assets of the business may have to be used, or funds would have to be borrowed. It is economical because the funding comes as a result of paying premiums rather than depleting savings or investment accounts or drawing from current company revenues.

A. DBO - Buy-Sell Agreements.

The two basic types of disability buy-sell agreements are cross-purchase and entity-purchase. A cross-purchase agreement is made among the owners themselves. To fund the agreement, each owner buys and owns a buy-out policy on each of the other owners. If a buy-out is triggered, the healthy owners are reimbursed for the payments they make to the disabled owner. In return for these payments, the disabled owner's share of the business is redistributed. A cross-purchase agreement is generally used for partnerships with two owners. When there are three or more owners a "trustee" cross- purchase arrangement may be established; under this approach only one policy is issued on each owner. The trust is the owner and beneficiary of the policies and uses the benefits for funding the buy-out obligations.

For corporations or partnerships where there are three or more owners, an entity-purchase agreement may be used. In this case the agreement is made between the owners and the business entity itself. The business owns a policy on each owner. If a buy-out is triggered, the business itself makes the required payment to the disabled owner and is reimbursed by the policy. In return, the disabled owner transfers his or her ownership interest back to the business.

B. DBO - Policy Basics

Under a Disability Buy-Out (DBO) policy benefits are paid to reimburse the corporation or healthy owners for amounts paid to the owner who becomes disabled.

The DBO policy contains unique definitions and conditions for payment, and also offers flexibility in funding methods. It is issued in addition to personal DI or overhead expense coverage.

Disability Buy-Out insurance is not intended to cover short-term disabilities, but those which are essentially permanent (i.e. the owner is not likely ever to return to the business). Given this, the insured is considered totally disabled if unable to perform the substantial and material duties of his or her regular occupation and is not gainfully employed by the business.

First, let's look at the basics:

- Issue ages: 18 – 60
- Available to occupation classes 6 – 3; 6M – 3M
- Elimination periods available: 360, 540, 720 days.
- Benefits can be paid out in one of three ways:
    - Lump sum
    - Monthly payments (24, 36, or 60 months)
    - Combination of initial lump sum and monthly payments (called the "down payment" method)

Renewability

The Disability Buy-Out policy may be renewed until age 65, subject to certain conditions such as ownership interest and employment in the business. See the sample policy for complete details on the conditions or renewability.

Payment of Benefits

The method in which the benefits are paid out, must match the provisions of the owners' buy-sell agreement. Benefits are payable after the elimination period, and are conditioned on evidence that the buy-out is actually occurring.

It is important to understand what is payable in event that a buy-out is triggered. The benefit paid will not exceed the lesser of:

- The purchase amount actually paid for the insured's business interest
- The maximum aggregate benefit shown on the schedule page or
- The business valuation amount less prior buy-out coverage

The policy's maximum aggregate benefit remains level until the policy anniversary on or most nearly after the insured reaches age 61. Beginning at this point the policy indemnity decreases by 20% annually until termination at age 65.

Once monthly installment benefits begin, they continue even if the insured is no longer totally disabled. If the insured dies while monthly payments are still being made a death benefit of the lesser of the remaining installments or two times the monthly benefit will be paid.

The buy-out agreement is not required at time of underwriting, but must be in existence at the end of the first policy year and at the time of disability.

Other Client-Friendly Benefits

- Occupational Rehabilitation Benefit and Modification & Access Benefit helps the insured to return to gainful employment (can be used during the elimination period)
- Conversion to an individual DI policy, should the need for DBO
- Coverage no longer exist
- Transfer of coverage provision, should the insured move to another business
- Waiver of Premium provision similar to that found in ProVider Plus

C. DBO - Optional Benefits

Future Increase Option

Our Disability Buy-Out policy makes available one optional rider, the Future Increase Option. This rider gives the insured the right to increase the maximum policy benefit without evidence of medical insurability.

Berkshire offers annual option dates to age 55. The maximum option amount that is available on each option date is $150,000. The application for additional coverage under the Future Purchase Option is subject to financial underwriting.

D. DBO - Other Important Details

DBO Issue Limits

We will issue up to 100% of the insured's share of the business, as determined by our valuation formulas (see below). We now offer a maximum issue limit of $2,000,000, regardless of the elimination period of funding method chosen.

Eligibility for Disability Buy-Out Coverage

We issue coverage only on owners of the business. There is no minimum ownership requirement in order for a DBO policy to be issued on an individual; however, 90% is the maximum ownership allowed. All owners must apply, unless they are uninsurable or not active in the business. Two of three owners will be accepted if the third owner is uninsurable. See the Field Underwriting Guide for full details on our eligibility rules. We will not consider a business with only two partners having an age spread of more than 15 years, and older partner is at least 51 years old. Check the Field Underwriting Guide for details on eligibility in the case of a family owned business.

Financial Underwriting

One of the more difficult aspects of the Disability Buy-Out sale has been the valuation of the insured's ownership interest at the time of application, and also at the time of claim. Clients have often asked: "How will my business be valued at time of claim? Will the same formula be used that was used when I applied for coverage?"

With our DBO policy we include the business valuation formula by endorsement. Doing so creates consistency, and makes clear to the producer and the client how the business will be valued. We are the only insurer to take this step. Other carriers provide benefits based on the “fair market value” of the business, but do not define how that value will be determined.

Note: The value of the business is one of the factors that determine the amount of benefit payable. See the section of the policy titled Provisions Relating to Benefits for details.

We use different formulas based upon the type of business involved, whether a professional/personal service firm or a commercial firm.

Business Type	Valuation Formula
Professional/ personal service	1 times the business’ average annual gross receipts times the percentage of ownership interest*
All other businesses	2 times the owner’s average total compensation** plus owner’s share of business’ net worth

* As reported for Federal income tax purposes for 3 years prior to the date of total disability.

** As reported for Federal income tax purposes for 2 years prior to the date of total disability.

Complete details on valuation formulas are in the Field Underwriting Guide. As a practical matter, you will want to discuss a particular case with your agency’s DI Specialist to assure that the best outcome for everyone.

Premiums and Discounts

Our Disability Buy-Out premiums are level and gender-distinct. We offer a multi-client discount of 10% when there are three or more policies being issued under the same buy-sell agreement.

Tax Considerations

Premiums paid for a Disability Buy-Out policy are not tax deductible. Benefits should be received income tax-free basis.

Quiz: Guardian's Business Disability Products

1. Which of the following statements about the Overhead Expense policy is true?

    a. The portion of benefits that go unused in low-expense months can be "carried over" for use during months in the same claim when expenses exceed the monthly benefit amount.
    b. The policy reimburses the policy owner for whatever actual expenses are incurred, rather than pay the expenses directly.
    c. Our Overhead Expense policy is non-cancellable and guaranteed renewable to age 65.
    d. All the above are true.

2. The Professional Replacement Endorsement in the Overhead Expense policy will:

    a. Help pay the salary of someone hired to replace the insured while totally disabled
    b. Continue to pay the business owner 75% of his net income (prior to his disability) for as long as he is disabled
    c. Pay the salary of any full-time employees hired before the owner becomes disabled
    d. None of the above

3. A sole proprietor purchases an Overhead Expense policy to pay the fixed ongoing expenses of the business should he become disabled. How are benefits and premiums treated for tax purposes?

    a. The premium is not deductible and the benefit received is tax-free.
    b. The benefit is deductible and the premium is taxed as income.
    c. The premium is deductible and the benefit received is taxable.
    d. The premium is deductible and the benefit is received tax free.

4. Which of the following would not be reimbursable under an Overhead Expense policy?

    a. Cost of any goods, merchandise or inventory
    b. Utilities
    c. Rent
    d. Interest

5. The reason a business owner would purchase a Business Reducing Term disability policy is:

    a. The business was purchased with installment payments over a fixed number of years.
    b. The business has given a five-year salary guarantee to a key salesperson.
    c. The owner takes out a line of credit to finance possible business expansion.
    d. Both (a) and (b).

6. Which of the following is true regarding the Business Reducing Term policy?

    a. BRT is non-cancellable and guaranteed renewable until age 60.
    b. BRT is conditionally renewable (while the obligation continues to exist) until the end of the policy term.
    c. BRT is guaranteed renewable for the policy term, which may be from five to thirty years.

7. Under an entity-purchase arrangement, each business owner purchases a Disability Buy-Out policy on each of the other owners.

    a. True
    b. False

8. Which of the following entities may be designated the beneficiary of a Disability Buy-Out policy?

    a. The corporation
    b. The owner insured under the policy
    c. The trust which was set up to execute a cross-purchase arrangement
    d. The non-disabled partners

9. What is the minimum ownership requirement for a DBO policy to be issued on an individual?

    a. 90%
    b. 50%
    c. 10%
    d. There is no stated minimum ownership requirement.

10. What is the tax treatment of benefits and premiums on a Disability Buy-Out policy?

    a. The premium is non-deductible and benefits are received tax-free.
    b. The premium is deductible and benefits received are taxable.
    c. The premium is deductible and benefits are received tax-free.
    d. The premium is non-deductible and benefits received are taxable.