



Learning about Disability Buy-Out (DBO) insurance from Principal® is easy. This product profile outlines the key features you need to know to help clients.

## How it works

**Disability Buy-Out insurance helps provide the funds needed to purchase a totally disabled business owner's interest** under a buy-sell agreement. With a DBO insurance policy in place, the remaining owners can continue the business without:

- Using business revenue
- Obtaining loans
- Selling shares of the business for capital

## Target market

- Businesses with fewer than 10 owners
- Businesses in existence for more than three years (one year for service businesses) and valued under \$10 million
- Owners:
  - Between the ages 30 to 50
  - Occupations with little or no manual duties, such as corporate executives, accountants/CPAs, attorneys, business owners, dentists and medical professionals

## Policy benefits

- Guaranteed premiums (based on sex distinct rates; unisex in California and Montana)
- Conditionally renewable to age 65 or 67<sup>5</sup>
- A variety of benefit arrangements (lump sum, monthly or combination)

## Product and underwriting guidelines

### Owner

- **Issue ages**<sup>1</sup>: 18-60 (18-57 in California)
- **Number of owners in the business**<sup>1</sup> (by occupation class):
  - 2 to 10: 6A,<sup>2</sup> 5A, 5A-M, 4A and 4A-M
  - 2 to 8: 3A, 3A-M and 2A
  - 2 to 6: A (not available in California)
- **Minimum ownership**<sup>1</sup>: 5%<sup>3</sup> — all eligible owners of the business must apply
- **Minimum years in business:**
  - Service professionals: one year
  - Other: three years
- **Minimum earned income:** \$15,000/year as indicated on federal tax returns
- **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, *continued*

### Maximum issue<sup>1</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.

## Taxation considerations

Your business owner clients will likely be interested in knowing a few tax details:

- The disabled owner is taxed on the gain from the sale of the business.
- A purchase by a non-disabled party from a disabled owner may trigger a capital gain if the buy-out price exceeds the seller's basis in the business. The gain may be taxed under the installment sale rule if at least one payment is received after the close of the tax year (in which the sale was made).
- The payout may be tax-deductible when it's structured as a non-compete or severance pay.
- DBO premiums are not deductible, but benefits are received income tax free.

## Documentation

### Financials are needed for:

- One-Way Buy-Out policies<sup>1,2</sup>
- Any application not using TeleApp
- Applicants over age 50
- Total aggregate benefit amounts applied for that are more than \$360,000

### You'll need to submit:

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

## Available features

### Riders/provisions

- Benefit Update (no cost)
- Benefit Update Valuation (no cost)<sup>2</sup>
- Employment in firm (CA only)
- Full Benefit Continuation<sup>2</sup>

### Built-in benefits

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

### Discounts

- Multi-Life<sup>4</sup>: 20% (not available in OH)
- Preferred Business Owner<sup>2</sup>: 5%
- Select Occupation: 10% (not available for HH794 policy)
- Association<sup>5</sup>: 10%

### Sales programs

- Association<sup>5</sup>
- Multi-Life<sup>4</sup>
- One Way Buy-Out<sup>2</sup>
- Simplified underwriting

## Buy-sell agreement details

Buy-sell agreements should cover a variety of triggering events that could end a business, such as death, disability, divorce, bankruptcy and retirement. In the event of a disability, the buy-sell agreement can protect:

- Disabled business owners — by obligating those listed in the agreement to buy out the disabled owner's interest.
- Remaining nondisabled owner(s) or a 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.

### Two common structures

**Cross-purchase** — Each business owner purchases and owns a DBO policy on each of the other business owners.

- Remaining owners receive an increase in cost 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 generally not available to creditors of the business.

**Entity-purchase** — The business purchases and owns the DBO policies and pays the premiums. 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 an increased cost basis.

## Starting the conversation with clients

- Get in the door by offering, **complimentary business planning services** from Principal that include:
  - **Buy-sell reviews**
  - **Informal business valuations**
- **Ask to confirm the funding vehicles for the buy-sell agreements.** Often they are unfunded for the threat of disability. Help align business owners on a common path by asking if an owner is disabled...
  - What would happen to your business profits?
  - Are you prepared to let a spouse, relative or outsider step into the business?
  - Would you have the means necessary to buy out his/her share or would you be forced to sell the business?
- When cost is a concern, discuss the **20% Multi-Life Discount**<sup>4</sup>. It's a great way to save money, while getting the protection needed.

**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**
- Have a company with a key employee targeted to buy the business? Talk about the **One-Way Buy-Out**. It gives the key employee an opportunity to fund a single owner buy-sell agreement with DBO insurance. It's available in approved states for DBO insurance policies (HH794).

 Let's connect | Contact your local representative.

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

<sup>1</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>2</sup> Available for HH794 policies only; not approved in all states. For details, go to: [www.principal.com/distateapprovals](http://www.principal.com/distateapprovals).

<sup>3</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>4</sup> Available when three or more individuals with a common employer purchase Individual Disability insurance coverage from Principal. In OH, only Individual DI 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>5</sup> Not approved in all states; not available in CA. For details, go to: [principal.com/distateapprovals](http://principal.com/distateapprovals).



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