

Disability Buy-Out insurance

Help business owners protect the future of their business with Disability Buy-Out (DBO) insurance from Principal®. This overview provides key details to help you get started.

How it works

DBO insurance provides funds to help purchase a totally disabled business owner's interest under a buy-sell agreement. With the benefits from a DBO insurance policy, the remaining owner(s) 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, in existence for more than three years (one year for service businesses), and valued at \$10 million or less
- Small family-owned businesses with succession needs
- Businesses with two or three owners with equal ownership and a key employee who could transition into ownership (ideal for one-way buy-out)
- Owners:
 - › Ages 30 to 50
 - › Occupations with little to no manual duties, such as corporate executives, accountants/CPAs, attorneys, dentists, and medical professionals

Policy benefits

- Guaranteed premiums (based on gender-specific rates; gender-neutral in California and Montana)
- Conditionally renewable to age 65 or 67⁽¹⁾
- Multiple benefit payment options: lump sum, monthly, or combination

Product and underwriting guidelines

Owner

- **Issue ages⁽²⁾:**
 - 18-60 (18-57 in California)
- **Eligible occupation classes by ownership group size⁽²⁾**
 - › 2 to 10: 6A,⁽³⁾ 5A, 5A-M, 4A, 4A-M
 - › 2 to 8: 3A, 3A-M, 2A
 - › 2 to 6: A (not available in California)
- **Minimum earned income:**
 - \$15,000/year as indicated on federal tax returns

Business

- **Ownership⁽²⁾:**
 - › Will consider up to 10 owners
 - › 5% is minimum ownership for any one owner⁽⁴⁾
 - › All eligible owners of business must apply
 - › Spousal owners will be considered (with \$1 million cap and Principal approval prior to submission) if a buy-sell agreement funded with life insurance from Principal is also put in place
- **Minimum years in business:**
 - › Service professionals: one year
 - › Other: three years
- **Valuation:**
 - Contact your IDI underwriter for business valued over \$20 million.

Product and underwriting guidelines, continued

Maximum issue² and participation limits

Lump sum					
Elimination Period	Occupation classes 6A, ⁴ 5A, 4A, 3A	Occupation classes 5A-M, 4A-M	Occupation classes 3A-M	Occupation classes 2A	Occupation class A*
365 day	\$2.25 million	\$1.25 million	\$1.25 million	\$750,000	\$250,000
540 day	\$2.75 million	\$1.5 million	\$1.5 million	\$1 million	\$500,000
730 day	\$3 million	\$1.5 million	\$1.5 million	\$1.25 million	\$750,000

Monthly benefit factors 24 and 36					
Elimination Period	Occupation classes 6A, ⁴ 5A, 4A, 3A	Occupation classes 5A-M, 4A-M	Occupation classes 3A-M	Occupation classes 2A	Occupation class A*
365 day	\$2.75 million	\$1.5 million	\$1.5 million	\$1.25 million	\$500,000
540 day	\$3 million	\$1.5 million	\$1.5 million	\$1.5 million	\$750,000
730 day	\$3.75 million	\$1.75 million	\$1.75 million	\$1.75 million	\$1 million

Monthly benefit factor 60					
Elimination Period	Occupation classes 6A, ⁴ 5A, 4A, 3A	Occupation classes 5A-M, 4A-M	Occupation classes 3A-M	Occupation classes 2A	Occupation class A*
365 day	\$3 million	\$1.5 million	\$1.5 million	\$1.5 million	\$500,000
540 day	\$3.75 million	\$1.75 million	\$1.75 million	\$1.75 million	\$750,000
730 day	\$4.5 million	\$2 million	\$2 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⁽²⁾⁽³⁾
- Any application not using TeleApp or Online Part B
- Applicants over age 50
- Total aggregate benefit amounts applied for greater 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)⁽³⁾
- Employment in Firm (CA only)
- Full Benefit Continuation⁽³⁾

Built-in benefits

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

Discounts

- Multi-Life⁽⁵⁾: 20%
- Preferred Business Owner⁽³⁾: 5%
- Select Occupation: 10%⁽⁶⁾
- Association⁽¹⁾: 10%

Sales programs

- Association⁽¹⁾
- Multi-Life⁽⁵⁾
- One Way Buy-Out⁽³⁾

Buy-sell agreement details

Properly structured buy-sell agreements should typically 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 help 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 more than three owners are involved.
- It isn't 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.** Many buy-sell agreements we review aren't funded for the threat of a 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 their share or would you need to sell the business?
- When three or more insureds are involved, discuss the **20% Multi-Life Discount**.⁵ It's an attractive 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).

- 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.

Not all benefits, features, and riders are available in all states or to all occupation classes. DBO is not approved in Massachusetts. For details, go to: principal.com/distateapprovals.

⁽¹⁾ Not approved in all states; not available in CA.

⁽²⁾ 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).

⁽³⁾ Available for HH794 policies only; not approved in all states.

⁽⁴⁾ 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.

⁽⁵⁾ 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.

⁽⁶⁾ Not available for HH794 policy.



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