

Exceptional DI PLANNING

Disability Coverage is Key for High Net-Worth Clients

by Edward A. Tafaro



Think of your largest income-producing clients. With a clear picture in mind, let's brainstorm. What is the profile? Entrepreneur? Privately held business owner with income off the charts? Fabulously wealthy, globe-trotting celebrity?

Let's look at a case with a successful business owner. We'll assume he is 51, owns a 60 percent controlling stake in a business worth \$60 million and draws a pre-tax income of \$4 million annually.

- 1. Have you adequately protected his income? At \$4 million, 60 percent of his income is \$200,000 per month.**
- 2. After you secured \$36 million in life insurance to fund the company cross purchase, did you fund the disability provision?**

Exceptional clients deserve exceptional solutions. Last month, we worked with an advisory firm in NYC that brought this very profile to us. The insured maintained \$15,000 of individual disability income insurance.

His company owned various term insurance policies on his life totaling \$12 million to fund their stock repurchase plan.

The insured's previous advisor told him that he was unable to secure additional disability insurance, as his net worth was too great. After a few months of the requisite "back and forths" with the advisor, owner, CPA and attorney, we helped redesign his disability program with the goal of accomplishing two key objectives:

- 1. Protecting the entrepreneur's lifestyle with more adequate disability income replacement coverage. This was delivered in the form of a monthly disability income product with a monthly benefit of \$185,000, bringing his total disability income protection to \$200,000 per month.**
- 2. Protecting his equity. The advisor updated his life insurance portfolio to more appropriately insure his equity ownership. Simultaneously, we underwrote a \$36 million disability buy-sell policy, two-year elimination period, own-occupation coverage.**

This is all above and beyond what traditional disability underwriters would consider for their best prospects. When working with non-traditional carriers, advisors need to understand fully the strengths and weaknesses of specialized disability products.

Although carriers such as Lloyd's can offer tremendous benefit limits, their products are not without limitations. The largest limiting factor in working in the non-traditional market is that advisors are working with term disability insurance contracts. These contracts maintain duration of less than one year to a maximum term of five years. While not ideal when working with a young client, the protection afforded under these plans is tremendous.

As an example, take a typical corporate acquisition. Hypothetically, let's assume you work with a company that is highly acquisitive, and buys businesses that are considered small- and medium-sized from a corporate acquisition perspective (\$10 million to \$50 million purchase price). Very often, businesses of this size are highly leveraged off of the CEO's relationships, experience, skills and contacts.

A common deal requirement in a transaction such as this is the purchase of key person life insurance on the founder and CEO of the business being acquired. Key person life insurance is commonly available to advisors through dozens of high-quality life insurance companies.

So let's assume your client's company acquires a business with a purchase price in the area of \$30 million. Your instructions are to secure \$5 million of key person life insurance on the founder of the company being acquired. With the need clearly established, you intuitively recognize that the company's greater risk is the disability of the 46-year-old founder, and not the death. Now turn to any traditional disability income insurer, and ask them to underwrite a disability policy that can pay the corporation a \$5 million benefit within one year from the onset of disability, and wait to "hear the crickets."

The exceptional disability markets can easily handle a \$5 million disability exposure. With the insured signing a

five-year employment contract and a portion of the purchase price paid over a five-year "earn out," underwriters in the specialty market can accommodate a five-year policy term. Most companies that grow through acquisition deploy thoughtful transition programs to ensure that over a two- to five-year period, any obvious business succession issues are managed appropriately.

Well, maybe you don't have a Tom Cruise, a Kobe Bryant, a Jack Welch or a Martha Stewart on your client list. But you might have someone exceptional. And you don't bring traditional planning to an exceptional table.

Structurally, the insurance can be designed to deliver the \$5 million in benefit a number of different ways, but the most common form tends to be a combination of monthly payments and lump sum benefits. Keeping with our 46-year-old founder, we might design a plan that offers a 90-day elimination period, paying a disability benefit of \$100,000 per month for a period of 12 months. Following that benefit period, we pay the corporation an additional \$3.8 million in the event the insured were totally disabled, delivering an aggregate benefit of \$5 million to the corporation. All of which can be delivered to the client for about \$25,000 annually, compensating the advisor well over all five years for implementing a plan that more appropriately protects his client than life insurance alone.

Business Overhead Expense (BOE) insurance is another class of coverage where the exceptional DI market can differentiate your practice. An advisor working with a substantial medical group needed \$155,000 per month on a top radiologist to protect the practice adequately in the event of the loss of a

senior physician in the practice. Traditional disability underwriters could not accommodate the entire risk given the required monthly benefit. Complicating matters, the radiologist was a Type 1 diabetic, under good control. With the medical and financial underwriting complete, Lloyd's underwriters issued a policy for the full \$155,000 per month, payable to a maximum of 18 months. On a net cost basis, coverage cost the practice about one percent of the aggregate benefit annually.

How do you transact business in the exceptional DI marketplace? It is up to you. Our industry has a handful of elite advisors who will conduct joint work for a split of the commission, which may be worthy of consideration if you do not foresee replicating these transactions in the future. Many local life brokerage agencies and aggregators offer these products as part of their insurance carrier portfolio, and select advisors with larger cases or books of business may choose to work directly with a U.S.-based correspondent.

Transacting the business is easy, but just be sure that you are working with a qualified distributor that will provide you with the appropriate level of regulatory support to ensure that the transaction is compliant with local state laws.

At the end of the day, these are great products that can enhance your practice, and add considerable value to your best client relationships, while building a nice revenue base for your practice. **INN**

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