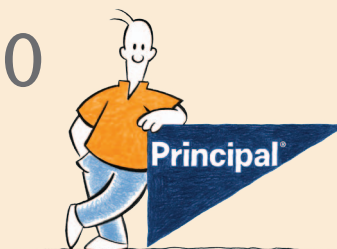


Product Profile – Series 700 DISABILITY BUY-OUT INSURANCE



OVERVIEW

Disability Buy-Out (DBO) insurance reimburses 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 and buy-out objectives should be 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.

Note: A buy-sell agreement is not required to purchase a DBO insurance policy, but one must be in place at the time of a disability claim. (In New York, an agreement is required before purchasing a policy.)

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**.¹
- About 43% of wealthy business owners said they would work to age 70 or later, but **only one-third have written succession plans in place**.²
- The U.S. had **5.8 million small business employers** in 2009, representing more than **99% of the nation's employers**.³

PRODUCT AND UNDERWRITING GUIDELINES

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

- Issue ages: 18-60
- Occupation classes: 5A/5A-M, 4A/4A-M, 3A/3A-M, 2A, A
- Minimum business ownership requirement: 5%; 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 (by occupation class):
 - 5A, 5A-M, 4A and 4A-M: 2 to 10
 - 3A, 3A-M and 2A: 2 to 8
 - A: 2 to 6
- 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.)

The policy

- Elimination Periods: 365, 540 and 730 days
- Benefits: lump sum, monthly installments of 24, 36 or 60 months or a combination of lump sum and monthly installments
- Conditionally renewable to age 65 with guaranteed premiums

FINANCIAL VERIFICATION

Business valuation documentation is required for:

- 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 AND PARTICIPATION LIMITS					
Elimination Period	Occupation Classes				
	5A, 4A, 3A	5A-M, 4A-M	3A-M	2A	A
Lump Sum					
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
Monthly Benefit Factors 24 and 36					
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
Monthly Benefit Factor 60					
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

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.

Ensuring business succession while minimizing disruption to the business.

AVAILABLE FEATURES

Riders

- Benefit Update (no-cost rider)

Discounts

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

- Multi-Life:⁴ 20% (based on sex-distinct rates; unisex rates apply in written state of MT)
- Select Occupation:⁵ 10%
- Association:⁶ 10%

Sales Programs

- Multi-Life⁴
- Association⁶
- Simplified DBO

BUILT-IN POLICY COMPONENTS⁷

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

PREMIUMS

Premium rates depend on a variety of factors, including: age, gender, occupation class, smoking status and any available discounts. This chart shows sample monthly premiums for a business owner whose portion of the business is valued at \$1 million.

	Male	Female
Single-life	\$189.99	\$259.60
20% Multi-Life Discount ⁴	\$151.94	\$207.68

Assumptions: HH703 policy, age 40, nonsmoker, 5A occupation class, 365-day elimination period, monthly benefit of \$16,675 for 60 months.

TYPES OF BUY-SELL AGREEMENTS

Buy-sell agreements come in many forms and 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 co-owners to buy out the disabled owner's interest.
- Remaining nondisabled owners by providing them with the opportunity and funding to purchase the disabled owner's interest.

There are two common structures for disability buy-sell agreements:

Cross Purchase

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.

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.
- Benefits may be subject to the Alternative Minimum Tax.

VALUE-ADDED SERVICES FROM PRINCIPAL LIFE

Take advantage of these no-cost services from Principal Life to open the door to discussing disability solutions with your clients.

Buy-sell review

A team of Principal Life experts reviews clients' buy-sell agreements to ensure they're effective and properly funded.

Business valuation

Conducted by a team of experts, this informal valuation of a client's business helps identify next steps for business continuation planning.

POINTS TO DISCUSS WITH CLIENTS

Business continuation

Unless they've agreed beforehand, owners 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.
- Benefits are received income tax free.
- A transfer from the nondisabled owner 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.

SALES IDEAS

The threat of a disability

Help clients understand the importance of planning for a long-term total disability and the effect it could have on their business.

The chances of a disability occurring may be higher than they think...

Chances of disability lasting three months or longer (before age 65)

AGE	1 OWNER	2 OWNERS	3 OWNERS
27	45.3%	70.0%	83.6%
37	40.4%	64.5%	78.8%
47	22.8%	54.8%	69.6%
57	19.6%	35.4%	48.1%

Commissioner's Individual Disability Table A; equally weighted, all occupation classes, unisex.

Ask them to imagine what it would take to maintain sales if an owner becomes disabled. If the disabled owner wants to be bought out, the firm would have to increase sales to raise the cash.

With DBO insurance, owners can minimize the disruption to the business.

Cross sell DBO to life insurance clients

If your clients currently have buy-sell agreements funded only by life insurance, talk to them about the importance of protecting their business in the event of a disability. An agreement funded with life and DBO insurance helps create a solid foundation for the future of the business.

Coverage at a discount

With the Multi-Life Discount,⁴ 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

FOR MORE INFORMATION

Contact your local representative.

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

¹ 2010 Business Owner Study, conducted by Harris Interactive® for The Principal®.

² *Private Wealth* magazine, April-May 2008; survey by PNC Wealth Management, Philadelphia, PA.

³ Small Business Administration Office of Advocacy, 2010.

⁴ Available when three or more individuals with a common employer purchase Individual Disability Insurance coverage from Principal Life. In Ohio, only Individual Disability Income insurance and DI Retirement Security receive the discount or count toward the three-person minimum.

⁵ Available for the following occupations: actuaries, architects, attorneys, CPAs, engineers, executives (earning more than \$60,000/year), judges and pharmacists.

⁶ Not approved in all states. For more information, visit www.principal.com/distateapprovals.

⁷ May not be available in all states.



WE'LL GIVE YOU AN EDGE®

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