



Edward A. ("Ted")  
Tafaro

## When Your Client's Largest Asset Is Their Business

Are your clients adequately insured? Case studies from the front lines.

Most closely held businesses are highly dependent on the vision, relationships and knowledge held by their equity owners. Entrepreneurs create a foundation of human capital that drives their company's success. Death and disability almost always end in disaster for both the company and the family of any of the chief shareholders when there was reliance on poorly designed and/or poorly funded buy-sell agreements—or worse, when there were no agreements at all. The sad reality is that few business owners are prepared for the death or disability of a partner.

In partnership with Prince Associates and the Inc. Business Owners Council of *Inc.* magazine, our firm surveyed more than 1,400 business owners in order to prepare a white paper we recently published about the death or disability of a partner. Here are some findings that may surprise you:

- Only 40.7 percent of business owners were prepared for the death of a partner.
- Only 14.8 percent were prepared for the disability of a partner.
- Just over 30 percent of business owners indicated "they will work it out" as a solution in the event of death.
- Over 15 percent of business owners cited a lack of time as the reason they have not prepared the business adequately.

### Key Takeaways

- For many entrepreneurs, the largest asset on their personal balance sheet is the equity in their business.
- Proper buy-sell planning with well-constructed documents is essential—as are properly funded and updated insurance plans.
- Most advisors seek out and acquire adequate life insurance protection. But for larger businesses, the greater risk of disability often goes unfunded, as traditional disability carriers lack the ability to deploy the necessary capacity.
- When compared to term life insurance, the cost of an equivalent amount of disability insurance looks high; yet death versus disability statistics explains the pricing differential.

**READER NOTE:** For a complete copy of the white paper, feel free to email the author at [ted.tafaro@exceptionalriskadvisors.com](mailto:ted.tafaro@exceptionalriskadvisors.com) and place "EAF—White Paper—Unprepared for the Unthinkable" in the subject line.

Death is a certainty. We all know that our time on this planet is finite. Life insurance benefits are easy to understand; if an insured person dies, you get paid a benefit. Disability risks are far less tangible. Not all of us will become disabled, and none of us think we will have the misfortune of suffering a substantial disability. The reality is that during our working years, the risk of disability is far greater than the risk of death.

Having underwritten some of the brightest stars in Hollywood, sports and industry, I can say that my experience as a Lloyd's Coverholder gives me a unique perspective when it comes to working with entrepreneurs and their advisors. While the career cycle of an entertainer or professional athlete is quite different from a successful business owner's, many of the same lessons about coverage needs and income protection are applicable.

To bring these concepts to life, I'll share some recent examples from our firm:

### **Case Study #1**

**BACKGROUND:** A highly profitable East Coast firm that designed and distributed back office business process software for community banks and financial institutions was valued at \$22 million. The firm had five equity partners with individual equity stakes ranging from \$2 million to \$12 million.

**SITUATION:** Because most traditional U.S. disability carriers will not issue policies to the limits that were required, our firm was brought in to fashion a unique solution.

**SOLUTION:** We created a stock redemption program that was funded with term life insurance to protect against the risk of death along with a modified disability insurance program that paid a lump sum benefit to the corporation in the event of a permanent disability.

**WHAT HAPPENED NEXT?** Six months later, the CFO went into atrial fibrillation and subsequently suffered a stroke that permanently disabled him. Twelve months later, we delivered a \$2 million check to the company that was used to redeem the CFO's stock. Our solution allowed the company to manage through tragedy, and allowed the CFO's family to manage through their disrupted finances.

### **Case Study #2**

**BACKGROUND:** A California logistics company valued at \$36 million had four equal partners.

**SITUATION:** While the firm had a life insurance policy for all four partners, the partners didn't have disability insurance. All four partners were in their early- to mid-40s and in reasonable health. Operationally, the group felt the company could absorb the loss of any one partner.

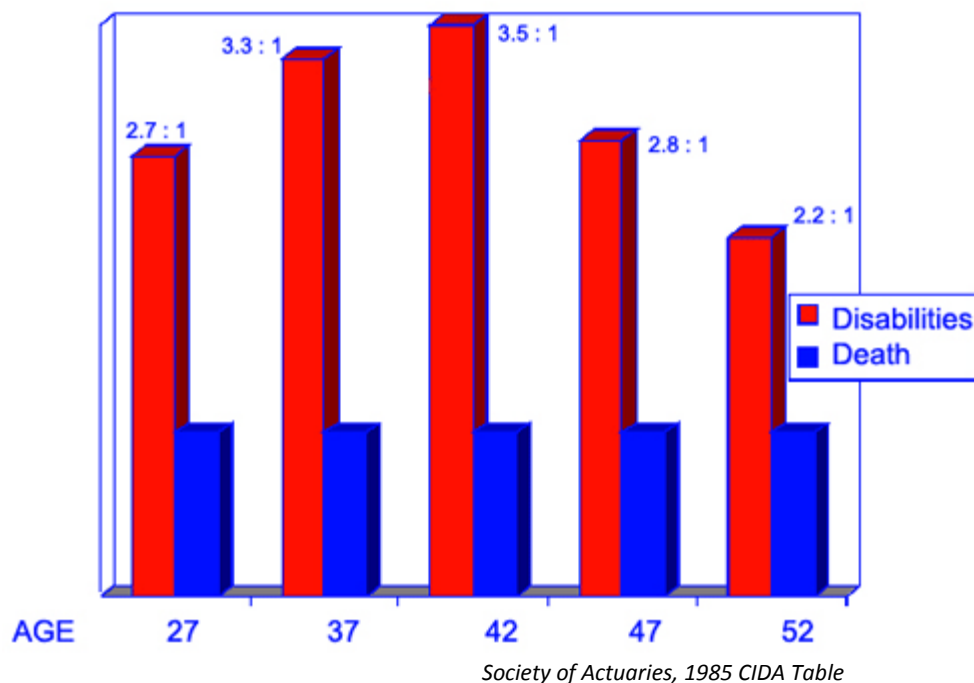
To fund the \$36 million of disability protection fully on all four individuals (\$9 million on each), the cost would have run about \$130,000 annually. While this group had plenty of cash, they wanted to plow every available dollar back into the business to achieve their growth objectives.

**SOLUTION:** Ultimately, the company decided to "self-insure" the first loss. Working with an advisor, we designed a program that insured all four partners, but required the company to self-insure the first loss, unless a second partner became permanently disabled within a five-year period. If a second partner suffered a disability within the policy period, an \$18 million benefit would be paid to the corporation, covering both losses.

**WHAT HAPPENED NEXT?** This strategy saved the company thousands of dollars annually. Coupled with that, an advisor was able to differentiate his practice by delivering an innovative and creative solution to an overlooked need. The net result was a healthy commission on this transaction and two estate planning clients and money management clients.

Don't get me wrong: Life insurance needs to be secured as well to fund the shareholders agreement properly (in whatever format is most appropriate). While I understand and respect the fact that disability insurance is a more complex insurance product to grasp, the cost of transferring the risk to an insurance company generally runs from 0.25 percent of the face amount to around 1 percent of the face amount when you're working with executives nearing retirement age.

As advisors, you have a responsibility to help protect your clients' largest assets. The wealth of many highly successful business owners is often disproportionately tied to their business. Due to this lack of diversification, it's imperative that they protect their equity value and shield themselves from the greater risk of disability during their prime working years. Is the disability insurance protection more expensive than term life insurance? Absolutely. You only need to glance at the chart below to understand why.



#### About the Author

**Edward A. ("Ted") Tafaro**, president and CEO of Mahwah, New Jersey-based **Exceptional Risk Advisors**, is one of the country's foremost experts on high-limit specialty life, accident and disability products for clients with exceptional insurance needs—including celebrity athletes, entertainers, highly compensated executives, entrepreneurs and professionals.

