

FAMILY BUSINESS FORUM

Covering The Business Risks of Disability

By Donald Levitt

The Issue

Individual disability insurance is a pretty simple concept: insurance replaces 45-60% of your gross income on a tax-free basis if illness or injury prevents you from earning an income. Given that the risk of long-term disability is actually rather high (between the ages of 35 and 65, 3 out of 10 working people are disabled 90 days or longer, and nearly one in five people will become disabled for five years or more prior to age 65), making sure that you have individual disability insurance seems like “a no brainer.”

For business owners, and specifically for family-business owners, the potential of a disability poses additional threats to your family and your business. Some insurance professionals do not pay a lot of attention to these often complicated aspects of disability – preferring to focus on the rather straightforward life and individual disability insurance. To learn a little bit about how business owners manage the risks of disability, let’s hear from some disability insurance experts and a business owner who has carefully addressed this risk.

The Experts

Kevin Rood and Dan Peffley are insurance professionals with Seymour and Associates in Maumee, Ohio. They both have special expertise in disability insurance.

“Comprehensive Disability Income Planning is a process of reviewing and quantifying exposures that exist due to the possibility of disability,” says Kevin Rood. “We help the business owner to prioritize their risks, and then start with those areas that could have the greatest impact on their business or their family.”

Their disability review and planning process includes seven distinct areas of focus.

1. Individual Disability Income Insurance. This is the classic “paycheck insurance.” In a family business it can make sense to provide this insurance for each owner, other key positions, and each family member in the business. If any of these people become disabled, and they do not have disability insurance, the business is faced with the dilemma of whether or not to continue to pay a salary to the disabled person. If they continue to pay the person’s salary (out of concern for that person), then there may not be enough money to hire a replacement – and this can have ripple effects throughout the company. Disability insurance frees up the person’s salary, and serves as a “shock absorber” for the business.

2. Business Overhead Expense Insurance. If one of the owner/managers of a family business becomes disabled, the business is likely to suffer a decline in revenue and may not be able to cover overhead expenses such as rent, utilities and salaries. Business overhead expense insurance, often based on each owner's percentage of ownership of the business, increases the likelihood that the business will still be there when the disabled owner recovers and is ready to return to work – or that the business will maintain its value and be ready for sale if the owner cannot return to work.

3. Disability Buy-Out Insurance. Multiple owners usually have buy-sell agreements which cover both death and disability. Life insurance generally funds the buy-out with the death of an owner. Surprisingly, there is often not a funding mechanism in-place for disability – even though disability is a higher risk than death for owner/managers. The lack of this insurance can put the business at risk if the buy-out is funded from profits, and can put the retirement of the disabled person at-risk if it cannot be paid.

4. Key Person Insurance. If a key person, e.g., the head of sales, becomes disabled, there will be a loss of revenue to the company. This insurance replaces the lost revenue for a defined period of time.

5. Group Disability Insurance. This provides a base-level of disability insurance for all employees. While this is a benefit for employees – it is also a “benefit” for the owner of a family business when a disabled employee looks to you for help after they have become disabled.

6. Workers Compensation Insurance. While each state has its own workers compensation laws, insurance professionals can help the family business to get connected with a third-party administrator who can often provide significant savings in workers compensation insurance.

7. Supplemental Disability Income Insurance. Employees can decide to purchase this additional disability insurance coverage – at no cost to the company. By offering this benefit, the company helps employees to purchase additional disability insurance at a discount when compared to purchasing the insurance on their own.

The Business

Rodney Owen, D.D.S. is the most senior partner in Sylvania Pediatric Dental Care in Sylvania, Ohio. This dental practice has three partners, associate dentists, and 30 other employees.

“I have sometimes felt like a ‘deer in the headlights’ when hearing about disability insurance – it’s not something we learn about in dental school. Kevin Rood helped us to see which insurance products were right for us and which were not. We looked at the health of the people in our practice, their anticipated length of practice, and what level of income and overhead replacement would be needed in case of disability. In addition to covering the owners, we have an individual disability policy on our associate who is not

yet an owner, and we offer a cafeteria plan for other employees which allows pre-tax dollars to be used for our disability plan, and which allows employees to purchase this disability coverage at discounted rates,” says Dr. Owen. The owners have also purchased disability buy-out insurance to fund their buy-sell agreements.

“When we are recruiting new dentists, they can see that we are well-organized and that the value of the practice will remain high. This helps us to attract and retain the highest quality professionals,” notes Dr. Owen.

The Tip

Disability insurance is more than just individual disability income replacement. Without a careful and comprehensive disability income planning process, a family business can be taking unnecessary risks for both the business and the family.

Donald Levitt, president of Levitt Consulting, helps family businesses to succeed as both a business and a family. More information about this month’s topic, and other family business issues, can be found at LevittConsulting.com