



Business Continuation Planning

Disability Buy-Out Insurance

A buy-sell policy allows for a timely funded buyout of a disabled owner’s interest in a business should that owner become permanently disabled.

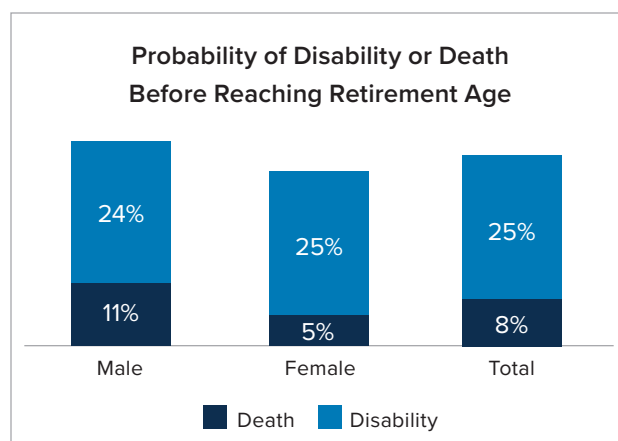
A properly structured buy-sell agreement is important because it allows a co-owned business to continue to operate without interruption if there is a death, disability or departure from the business. It governs the buyout of an owner or partner’s interest in the business by outlining who can buy the interest, the conditions that trigger a buyout, the buyout cost of the owner’s interest, and the requirement that funds are available to complete the transaction.

Disability buy-out insurance can provide partial or full funding of the buyout transaction stipulated in the agreement in the event of a prolonged or permanent disability of an owner, and this protection is especially important given that a long-term disability is statistically three times more likely to occur during working years than a premature death.

Common Buy-Sell Triggering Events

- Death
- Disability
- Retirement
- Divorce
- Bankruptcy
- Voluntary or involuntary termination
- Loss of license if applicable

Risk of Disability vs. Life – 3x Higher



Note: Projections are for workers reaching age 20 in 2023, for whom the full retirement age is 67. Source: Social Security Administration.

Advantages of Funding the Disability Risk with a Disability Buy-Out Policy

- Confirms agreement on a predetermined, fair market value by the owners
- Guarantees a buyer for the disabled owner's interest without excess strain on the business to take loans, draw on company's cash, or reduce profits
- Promotes orderly and timely transfer of ownership, wealth, and management assuring business continuity for customers, creditors, and employees
- "Disability" and "disabled" are defined by the insurance policy, alleviating the burden of determining what constitutes a disability by other owners or family members

Common Buy-Out Structures

- **Cross-purchase** – Each owner purchases a disability buy-out (DBO) policy on each of the other business owners. This arrangement provides funding for the remaining owners to buy out a disabled owner's interest.
- **Entity-purchase** – The business itself purchases the DBO policy to fund the buyout of a disabled owner's interest. Premiums are paid by the business.

Target Markets

- Businesses with up to 10 owners, operating for 3 or more years.
- Businesses with two or three owners and a key employee who plans to become an owner.
- Family-owned businesses.

Policy Plan Design Considerations

- **Benefit Payment Options**
 - **Installment Plan** — Monthly benefits after the elimination period
 - **Lump Sum Plan** — Lump sum payment after the elimination period
 - **Combination Plan/Down Payment** — Lump sum payment after the elimination period, followed by monthly benefits
- **Maximum Issue Age:** Age 60

- **Elimination Period Options:** 12, 18 or 24 months (or expressed as number of days)
- **Benefit Period Options:** 12, 24, 36, 48, or 60 months and/or lump sum
- **Premium Discounts:** Available when three or more policies are issued (even if not all policies are disability buy-out policies).

Note: Domestic market insurance policies are noncancelable until age 65/67, but may be renewed. Policy parameters vary by state and by insurance carrier.

Valuations and Benefits

- Domestic insurance carriers typically offer aggregate benefits ranging from \$1 million to \$4.5 million, with a maximum issue age of 60.
- For businesses with ownership values that exceed domestic market limits, excess disability buy-out coverage may be available through Lloyd's of London.
- The Lloyd's market can also provide greater flexibility in structuring coverage to align with more complex buy-sell agreements and funding arrangements. These policies generally have a five-year contract term, may be issued up to age 62, and can provide up to \$100 million as a lump sum benefit after 6, 12, 18, or 24 months of total disability.

Taxation Considerations

- Policy premiums are not tax-deductible, but benefits are generally received income tax-free.
- The disabled owner is taxed on any capital gain created when the buyout price exceeds their basis, and that gain may be taxed over time under installment-sale rules if payments extend beyond the tax year.
- Because each business and ownership situation is unique, consulting with a financial planner and tax advisor is recommended.

Comprehensive business planning should not only address the risk of premature death, but also the greater risk of disability during working years. With proper coordination and planning, funding a business buy-sell agreement with disability insurance provides the assurance that co-owners will have the means to buy a disabled owner's interest in the business at a fair price if that owner is unable to return to work.



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