



## FINANCIAL UNDERWRITING

### *Financial Formula*

Each carrier has its own formulas and guidelines when determining if the amount of insurance applied for is reasonable and in line with the client's needs. Below is a composite of our carriers' formulas and guidelines when making this determination for both personal and business coverage.

#### DOES IT MAKE SENSE

- The business must suffer a loss at death or death creates a financial need to keep the business whole
- The face amount must reflect that loss or need quantified
- Typically there is an underlying legal agreement in place
- It is more difficult to establish a financial amount for a new business than for an established business
- A cover letter providing background and details is recommended

#### PERSONAL COVERAGE

##### *Income Replacement*

- Based on earned income
- A non-working spouse/partner should not be insured for more than the working spouse
- Amount covered varies by carrier (general formulas and guidelines are shown below)

Age Range	Income Multiple
Age 30 and under	25-30
31-35	22-25
41-45	18-20
46-50	15-20
51-55	12-15
56-60	10-15
61-65	7-10
66-70	5-10
Over 70	*3-5

\*Multiple is subject to individual consideration on a case by case basis.

### *Estate Planning*

- Identify current net worth with documentation
- Apply growth factor (based on mortality and expected interest rate)
- This factor can roughly be based on a growth rate 5-7% and 75% of mortality up to a maximum of 15 - 20 years
- Subtract the \$5,000,000 tax exclusion
- Multiply by 50-55% tax rate to determine face amount

## **BUSINESS COVERAGE**

### *Key Person Coverage*

- Person must be key to the business continuation
- Business is owner and beneficiary
- Carriers will typically approve 5-10 x annual income as an average, sometimes more
- If bonuses and benefits are paid consistently, some carriers will include as income

### *Buy-Sell Funding*

- Provide details of the underlying agreement
- How was the amount determined
- % of insurance coverage of the business worth is based on % of ownership
- All owners should be covered
- Net business income is the starting point for the carrier determining the amount of coverage, supported by the business profit/loss statement going back 2-3 years
- Carrier wants to see the business balance sheet (assets and liabilities and owner equity)
- Most common formula for business value is to divide the average net income (adjusted for any anomalies) by a capitalization rate (defined as return on capital expected).
- Business value =  $\frac{\text{Adjusted net income}}{\text{Capitalization rate}}$ , or multiply adjusted net income x 1/cap rate
- The cap rate for a safe established business is in the 6-8% range and 10-15% for a newer company or one with variable earnings
- A speculative or startup venture may be in the 20-50% range

### *Creditor Insurance*

- Insurance should be sought at the time the loan is made
- A copy of the loan agreement is recommended
- Policy should be collaterally assigned to the creditor or the creditor named as beneficiary
- Typically the full amount of the loan is not covered because there is already some collateralization, or it is well secured by business or personal assets – usually a maximum of 75% of the loan
- Difficult to insure short term loans of less than five years due to persistency concerns
- Insurance should be applied for on the principal(s) of the business