



# Raising the bar in trauma cover

**Integrating trauma cover into a business insurance portfolio is not a walk in the park. But big rewards are in store for both the planner and their clients who take the time to understand this often overlooked segment of the insurance market, explains SUE LAING.**

**P**roviding wealth protection advice to meet the specific risks faced by small business owners and professionals demands certain specialised skills and processes and many advisers shy away from this area altogether. Yet there is tremendous value in positioning advisory practices to handle business succession planning and the insurance packages that go with it.

Those who offer business insurances can at times struggle with both understanding and communicating where trauma benefits can practically fit into the succession plan at claim time, given the less than black-and-white nature of many trauma situations where the sufferer may well recover, but when? What's to be done with the proceeds in the meantime?

Helping the client make the decisions necessary to make trauma cover effective at time of claim is as much of a hurdle – sums insured and ownership being crucial. The inclusion of trauma demands more careful structuring of the buy/sell agreement, too, so this is perceived to add a layer of complexity – therefore more delay – to the task at hand. Add to

this the extra expense of trauma – but after all it's most likely to be claimed on so that's not a valid argument against recommending its inclusion.

There is a path to follow to success in delivery, however, and many advisers get results when fully incorporating trauma into all their advising including business advice. To gain and pass on an insight into this difficult but crucial area of advising, I interviewed Matthew Burgess, a partner of law firm McCullough Robertson Lawyers, which specialises in estate and business succession planning and works closely with many financial advisers; and a specialist practitioner in the area, Brant Dillon, who operates a boutique life risk licensee practice working mostly from referrals from other professionals.

**Sue:** Matt, your practice supports many financial advisers in their dealings with clients. In your experience, are the majority of advisers recognising a need for trauma in business insurance portfolios in addition to the 'traditional' products? And is trauma really important?

**Matthew:** Often lawyers are only involved in this area after a trauma

event has taken place and when the parties involved are facing enormously complex issues under extreme financial pressure. Although my perception may be coloured by these experiences, trauma as part of a business insurance solution is overwhelmingly the single greatest business opportunity for risk advisers. Importantly, it is also the single most important risk-related issue faced by most business owners.

As lawyers we have probably focused more on the issues of business succession, through documents such as shareholder and buy/sell agreements, and not enough on business preservation. A common issue to all business owners is debt and never before have we seen the current levels of personal and business debt. I am constantly dealing with clients who have (or their partners have) suffered a critical illness and having funds available to meet the ongoing needs of the business such as servicing debt would be of great benefit. Therefore we need to focus more on using trauma backed up by simple agreements, to provide funds to enable the business to survive. Given the statistics

of cancer and heart disease, trauma should be one of the first things an adviser raises with business clients.

**Sue:** So recognising the need is the first thing. Maybe advisers just don't think trauma is important. So, using McCullough's own client base as a 'case study' in terms of what you have seen happen to clients, where do the business pitfalls lie?

**Matthew:** There would be three recurring themes that we see in this area.

Firstly, and most obviously, is a scenario where there is no trauma cover and no agreement between the business owners. Rarely in this scenario is there a commercially palatable outcome for all the parties and invariably, no matter how successful the business may have been prior to the trauma of the principal, it disintegrates. Quite aside from the financial ramifications of the fall-out there are always enormous emotional consequences for virtually everyone involved in the business.

Secondly, we often see trauma cover in place with no agreement. Invariably in this scenario the trauma cover will be inadequate as compared to the actual (or

perceived) values of the business interest.

Obviously, the exact consequences of having cover in place with no agreement depend largely on the ownership structure of the trauma policy. Again however, there is rarely a commercially satisfactory outcome achieved without significant financial and emotional cost.

Where the trauma policy is self-owned it is often the case that the exiting partner sees the proceeds solely as compensating them for the injury they have suffered. In other words, they expect to receive full value for their interest in the business (based on a valuation prior to their trauma).

Conversely if the policy is cross-owned or owned via some sort of trust or company structure, quite aside from the detrimental tax consequences, it is often the case that the continuing business owners see the proceeds as compensating them for the loss of the 'traumatised' principal. Furthermore, while generally the continuing owners are accepting of the fact that they must purchase the outgoing principal's interest in the business, rarely is the valuation that they adopt equivalent to the value that the outgoing principal desires.

Finally, there is the situation where cover is in place as well as an agreement, however either the cover or the agreement (or both) are inadequate.

The concept of inadequate funding is self-explanatory.

An inadequate agreement can arise in two situations, namely: where it is drafted by someone that does not specialise in insurance-funded business succession law. This can include a situation where 'pro forma' or 'internet-generated' documents are signed without any specific consideration of a client's circumstances; or where the documentation prepared is based on outdated solutions or strategies.

Somewhat paradoxically the most traumatic (excuse the pun!) situations that we see, and most costly in terms of accounting and legal expenses, are those where although insurance and an agreement are in place, the agreement falls into one of the above two categories.

Sue: If we then assume that these dangers are acknowledged as avoidable

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and advisers accept and engage in the need, what in your view would prevent them from including trauma?

Matthew: Historically the perceived complexity of trauma funding has undoubtedly been an issue. Increased education and specialisation across all facets of industry have helped reduce this perceived complexity, although undoubtedly there is still room for improvement. Clearly premium resistance has also been an issue, although again I believe that education of both advisers in the process and the business community as a whole has helped to address this.

Finally, from a documentation perspective there has been significant uncertainty as to the optimal approach, particularly in terms of articulating at what point following a trauma the exit of the relevant principal is triggered.

Sue: Are these concerns valid and are they surmountable?

Matthew: If business owners (and their immediate advisers) perceive the above issues as concerns then clearly they are valid. With proper planning and advice none of them are insurmountable.

Sue: So if getting the whole package

together – all necessary products plus the right advice from adviser/accountant/lawyer - is such a fundamental of doing business succession planning well, can you give advisers some tips on how to achieve that as an advice 'model' going forward?

Matthew: As with any aspect of the advice process, particularly where there are perceived complexities, a simple methodical approach is always preferred. In my experience, a client-centric approach that sees the risk adviser, accountant and specialist business succession lawyer working together with mutual respect and trust for the skills that they each bring to the process achieves the best results for clients.

Sue: To get down to specifics, it's clear that there is angst over how to time a principal's exit after a trauma – how is this best managed?

Matthew: My experience is that most of the difficulties in this area arise from a perception that there is a 'one size fits all' answer that is somehow right for each and every client. Once those involved in a business succession process acknowledge that this particular issue is one that can only really be answered on a client-by-client basis

much of the problems surrounding this issue dissipate.

There is still obviously a need to facilitate open and constructive communication between the business owners and often this requires the various advisers involved to adopt almost a counselling role that will have little to do with their professional training.

Sue: And then there is the potential for a tax liability when trauma benefits are paid into a company – what means are available to assist with either avoiding this or catering for the cost?

Matthew: As I mentioned before, an inappropriate ownership structure can be enormously detrimental, and not just from a financial perspective in terms of the unnecessary tax consequences.

The hybrid business succession model developed by our firm is, from what we have seen, the only solution in the market place that delivers an effective trauma solution with no adverse tax consequences. We also believe that the most innovative aspect of the model is that it is, in comparison to any other approach, extremely simple for clients and advisers to understand and a cost effective solution to implement. It also allows flexibility in terms of either a standalone solution to cover business debt or packaged into a buy/sell agreement to provide a smooth transfer of equity.

Sue: Can you give us an example of how that works?

Matthew: As an example, assume three shareholders in a company (A, B and C). Each shareholder takes a \$1 million policy of insurance for life, total and permanent disablement and trauma and A suffers an insurable event. The purposes of the insurance protection at the date of implementing the strategy are described in Table 1.

The underlying agreement is the key and ensures the outcomes for all – but the agreement although very straightforward, is nevertheless crucial to be drawn up properly.

Sue: Thanks, Matt.

So there are solutions: to adviser reluctance and lack of engagement; to client education; and to the complexities of ensuring the right outcomes. Like all professional solutions, it cannot and will not be a walk in the park. The rewards for all concerned, though, make it an excellent advice proposition.

The risk store's Living Insurances conference will showcase an enlightening and stark example of how trauma can work in practice in a successful business where the clients would otherwise have suffered devastating outcomes – both the healthy one and the partner who suffered the trauma and is still suffering its effects several years after. ■

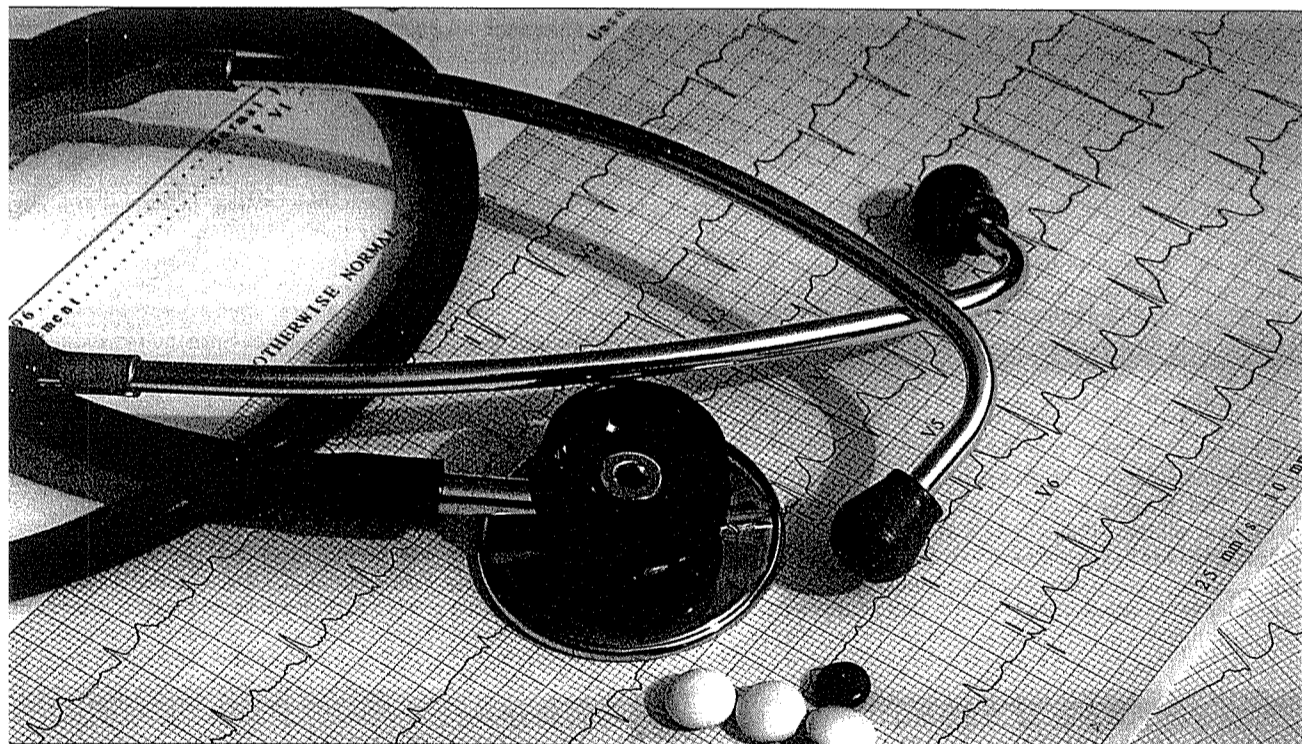
Sue Laing is managing director of the risk store.

Financial Standard is the media partner of the risk store in its upcoming "Living Insurances" conference on 2-3 April in Sydney.

For more details see [www.theriskstore.com.au](http://www.theriskstore.com.au)

Table 1. Illustrative breakdown of a \$1m insurance, policy of three shareholders.

\$400K personal family cover	payment to	A (or the estate)
\$400K equity transfer	payment to	A (or the estate subject to the transfer of the shares to B and C).
\$200K debt reduction	payment to	B and C subject to them arranging for A to be released from all guarantees and security arrangements.



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