In focus: Business protection

With the economic downturn and problems in the mortgage market hitting traditional income streams, advisers are being urged to grab their share of the estimated £500bn business protection gap. Edmund Tirbutt reports

Insurers certainly cannot be criticised for lack of effort in promoting the business protection field during the last year. Any intermediary seeking to offer business clients keyperson cover, loan protection or shareholder or partnership protection (See box on page 27) now has access to a dazzling array of toolkits, websites, road shows and seminars.

In a desperate attempt to compensate for the downturn in the mortgage market, product literature constantly refers to research by Swiss Re which appears to identify a new land of milk and honey. There are around 4.5 million businesses in the UK but only around 10% of these have adequate cover, resulting in an SME protection gap of around £500 billion.

The insurers emphasise that any intermediary able to sell individual life, critical illness (CI) and income protection (IP) cover should be able to diversify into business protection, which uses fundamentally the same products - albeit normally involving shorter time periods, larger sums assured and complex trust documentation and taxation considerations.

Alan Ferguson, marketing and channel development director at Legal & General, says: "Some insurers have probably managed to get across the message that you are wasting customers by looking at them only as individuals. A lot of high net worth clients have wealth from the fact that they own a chunk of a business, and there are clearly enormous opportunities to be taken advantage of.

"The complex issues around tax and trusts are the things that put intermediaries off, so we have decided to demystify the subject and help them to understand what their [clients'] needs are and give them support in actual cases rather than merely offer them training courses. We aim to provide them with enough information to have an initial conversation with a business client and to be aware of what could prove risky to talk about."

IFAs face stiff competition from banks, especially for loan protection cover, and insurers stress the importance of developing professional relationships as the key to developing new business. There is a heavy focus on on explaining how intermediaries can develop a network of leads from accountants and solicitors and - ideally - refer tax and trust work back to them to be completed.

The fact that the smallest businesses can provide some of the most attractive opportunities is another key message that insurers have been keen to impart. Large blue chips typically self-insure for keyperson and shareholder protection cover and, although they often need loan protection, this is likely to be arranged via a bank. Plenty of one man or two man bands may, on the other hand, still need cover involving premiums worth several hundred pounds.

Peter Chadborn, principal at Essex-based IFA CBK Colchester, says: "A lot of advisers think that business protection is an employee benefit or that it involves sitting in front of a board of five directors but this isn't the case. Your essential starting point is your client base. Small limited companies can have good demand and that's where to cut your teeth. Life offices seem to have latched onto this recently and this kind of entry point education is far more important than anything else."

Insurers have also been keen to dispel the perceived myth that business protection cases are far more likely to fall through than individual protection cases as a result of taking much longer to complete. They point out that IFAs can remove much of the pain from the underwriting process by making suitable preparation, managing the expectations of the client, checking that application forms are correctly filled in and keeping regular contact throughout the application process with both the individuals being covered and the insurers.

It is, for example, important to make clients aware that there is a need for financial underwriting and to remind them to bring information like company accounts and details of their income to meetings. They must also be informed of the importance of attending medicals promptly to avoid delays and of providing as much information as possible on application forms to enable quick underwriting decisions to be made.

A plethora of specialist helplines have also sprung up to assist with the underwriting process and it is clear that advisers are taking advantage of them. For example, Norwich Union's "What-if" facility, which allows intermediaries of any description to talk through concerns with the underwriting team, has received over 18,000 calls from IFAs during the past year.

BARRIERS TO PROGRESS

However, despite the commendable volumes of huff and puff expended by providers, there remains a long way to go before the business protection market realises anything like its full potential. Most insurers currently report that, although it is one of the fastest growing areas of the protection sector, it currently accounts for well under 5% of their overall individual protection business. The exceptions are AXA ("5% to 10%"), Skandia ("over 10%") and AEGON

Scottish Equitable (30%).

While there has been no shortage of insurer surveys devoted to understanding the principal barriers that need to be overcome, the fact that these produce some markedly contradictory results does little to help accelerate the rate of progress. For example, a recent survey by Bright Grey shows that 85% of advisers base their business protection decisions on cost but another recent survey by Friends Provident shows that only 17% of advisers regard price as the most important factor when making provider recommendations.

Similar disagreement is evident with regard to how aware businesses are of the importance of having business protection. In a recent survey conducted by Skandia, 78% of advisers said lack of awareness of the impact that death and disability of key employees could have was the biggest barrier to companies taking out adequate business protection insurance. But recent research by Norwich Union seems to tell a very different story. When asked to rate the most important insurance product for their business, nearly five times as many managers of SMEs thought it was more important to protect against the loss of a key employee than insure their own life, and 15 times as many owners believed business protection insurance was more important than health/dental insurance.

Nevertheless, the biggest barrier at the present time is simply that business protection insurance premiums cost money, and this is the one commodity that is in alarmingly short supply in most small businesses during the current economic downturn. The argument that businesses, who never think twice about insuring their plant and machinery, should extend similar wisdom to protecting against the loss of key employees is certainly logical enough. But trying to ensure that there is enough cash available to pay suppliers is likely to seem even more logical to any business owner struggling to survive.

INSURER INITIATIVES

AEGON Scottish Equitable which - along with Scottish Provident - has done more than most to grow the business protection market during recent years, kept up the momentum in March 2008 by making its Online Business Protection Toolkit available to the entire market. The facility, which had been available to existing I FAs since late 2007, is commendably comprehensive.

There was a new launch from Bright Grey in February 2008 and refreshed offerings from Friends Provident in February 2008 and from Legal & General in June 2008. Even insurers which have not launched or officially refreshed product ranges are not short of news.

Business protection toolkits were launched by Norwich Union and Skandia in August and June 2008 respectively. Skandia also invites us to “watch this space” for a project that will be coming to fruition this February. This will involve enhancing its CI proposition and restructuring its rolling term product slightly to make it easier to understand and to make its pricing more transparent.

AXA has focused heavily during the last year on training its sales force, conducting road shows and producing sales aids for IFAs and enhancing its website. It has increased financial underwriting limits to reduce underwriting hassle and has lowered prices gradually since February 2008, meaning that it is frequently amongst the most competitive providers.

Legal & General has also been making its mark on competitive pricing, as has Bright Grey - which offered a 5% premium discount between July 2008 and January 2009. Bright Grey has also been notable for the introduction of its innovative Helping Hand facility, which will help a company find a permanent or temporary replacement once a key person dies or is incapacitated.

Roger Edwards, products director at Bright Grey, says: “We have enough IFAs saying that the service is enough of a differentiator to recommend us as long as our price is not too far out. The success is in part a reflection of our policy of not going for real beginners but identifying IFAs who understand the business protection field and making sure we give them a superior proposition. We realised right from the start that it’s all very well making an exciting presentation to IFAs but that many of them find it a lot harder than they expected when they actually try and sell business protection.”

Zurich Assurance has been another to make a significant impact with its November 2008 launch of its new Business Protection Adviser Tool. Aimed primarily at advisers new to the market, it enables them to provide clients with a tailor-made recommendation, highlighting the appropriate product for specific business needs. For experienced advisers already active in the business protection market, the tool will also provide a useful audit trail.

Advisers complete a fact find for each business owner, giving details of all information relevant to business protection. This helps establish the needs of the business and potential risks in the event of a loss through death or incapacity. The adviser also inputs relevant data on the strategic intentions of the business by completing a series of questions regarding business succession needs and existing business liabilities. The tool then demonstrates how it’s possible to plan against potential losses by using one or more of the planning solutions available.

Alan Lakey, partner at Highclere Financial Services, an IFA based in Hemel Hempstead in Hertfordshire, declares himself a fan of the Business Protection Adviser Tool but is a little scathing about some other players.

He says: "Zurich has recently started to provide very useful material, and its Business Protection Adviser Tool is particularly helpful. One of the problems we come up against is that SME personnel often need help with calculations and this can do it for them and enable them to play with the figures. Scottish Provident still supplies very useful CD-ROMs and brochures, and any IFA who looks at these is unlikely to have any excuse not to be familiar with the intricacies of the field. I also got a very good DVD from Norwich Union.

"But some of the other insurers who pride themselves on helping IFAs don't impress me that much and are not as good at holding beginners' hands as they make out. I've read about a toolkit that Bright Grey has brought out but it has never bothered to send me one and, although Legal & General has actually sent out a toolkit to me, I find it fairly basic and certainly not exceptional."

"This is clearly a growth area, like individual IP," continues Lakey, "but I'm not convinced it's as easy to deal with as individual IP. My own individual IP business is up by 300% during 2008 but business protection business has been flat. It's so much harder to get through to new clients with business protection, the rules about cold calling are much harder and your messages are normally intercepted by PAs. So the best way in is via professional connections."

Unum's Dual Benefit Group Income Protection, launched in February 2008, has also effectively added a further valuable option to those wishing to take out keyperson IP. Although it is primarily a short-term group risk product - offering cover periods of between one and five years and deferred periods of as short as four or eight weeks - it includes significant pay-outs for employers in addition to those for employees. In the event of a claim the employer is able to receive an automatic monthly business benefit to help finance the long-term absence of an incapacitated employee.

There is also a massive opportunity for insurers to come out with a CI product that doubles up as both a group risk benefit and a business protection cover because to date the great weaknesses of group CI has been that, unlike group IP, it is much more of an employee benefit than an employer benefit.

Such a development could potentially give the group CI field just the kick start that it has always so badly needed and, because I FAs need to be doing more group risk business as well as business protection business, an increasing cross-over between the two fields should prove a double win situation by increasing awareness of both.

UNDERSTANDING THE BASICS

Business protection uses essentially the same life, CI and-to a lesser extent - IP products used for individual protection, and premium costs depend on the amount of cover required and the ages, genders, occupations and medical histories of the individuals being covered.

But the fundamental difference is that business protection cover is arranged so that claims pay-outs do not go to the individuals covered or to their estates but to the business. Business protection products also tend to be highly flexible. Insurers will, for example, normally allow life assurance pay-outs to be made in instalments to aid cash flow and avoid corporation tax liabilities. Most will also allow risks to be placed on cover immediately, before the completion of the underwriting process. This can be especially useful in a management buy-out situation if negotiations are kept secret until the very lact minute but cover is then required instantly.

THE TAX IMPLICATIONS

The premiums of a keyperson policy will normally be a tax deductible expense if they meet what have become known as the "Anderson Rules." The policy must be to meet loss of profits resulting from the loss of the key person and should not usually be for a term of more than five years, and the life assured should not have a significant interest in the business. This does not automatically mean that any policy pay-outs made to the business are treated as trading receipts. Each case is determined on its own merits with much depending on whether the receipt is considered to be capital or revenue.

Rod McKie, head of individual protection marketing at AEGON Scottish Equitable, says: "Much depends on the facts of a particular case, and different local tax offices can come up with different interpretations of the rules. Because there are no hard and fast rules the company's tax advisers may choose to clarify the situation with the local inspector of taxes at outset and get them to provide written confirmation of what has been agreed."

Partnership protection premiums are not tax deductible, irrespective of whether premiums are paid for by the partnership or partner. The situation is, however, less straightforward with shareholder Drotection for limited companies. Premiums may be tax deductible by the company although they may be taxable on the shareholder. With partnership and shareholder protection the proceeds arenormallytaxfree, althoughthe tax implications will reflect the method of partnership or shareholder protection chosen.

THE THREE MAIN CATEGORIES OF BUSINESS PROTECTION COVER

LOAN PROTECTION INSURANCE This can be taken out against a business loan or overdraft to cover the business against the death or illness of someone on whom it is dependant for repaying the loan. But this field is heavily dominated by the banks and, even though there are theoretical rebroking opportunities for enterprising intermediaries, there is anecdotal evidence to suggest that banks can review overdraft facilities from businesses that switch insurance cover away from them. Many of the better opportunities for intermediaries to add value are likely to be in keyperson cover or in shareholder or partnership protection cover.

KEYPERSON COVER This can provide a business with a cash injection in the event of a key employee dying or becoming too ill to make a contribution. The cover, which is typically written for up to a five year term and can be increased or decreased at any time, is written on the life of the key person but the premiums are paid by the employer and any money that becomes due in the event of a claim becomes payable to the business.

The costs to a business of losing a key person could be devastating and even threaten its very survival, so keyperson cover is intended to pay for any resulting loss of profits and the costs of finding and training a suitable replacement. It should ideally include CI as well as life assurance and in some cases it may also include IP. This can provide added security, as IP will pay out for conditions such as stress and bad backs that are not covered by CI, but will greatly bump up the costs.

SHAREHOLDER AND PARTNERSHIP PROTECTION When a key individual is a director or a partner there are also additional succession planning issues to be considered. There is the possibility that a sick or deceased person's share of the business could pass to an unsuitable dependent, which could cause considerable disruption. It is therefore important to ensure that the remaining directors or partners can maintain control of the company by buying out a sick colleague's share or buying out a share left to a deceased colleague's dependents.

This can be achieved by each director or partner taking out life cover and - if affordable - also CI. A written legal agreement is put in place to ensure that the remaining partners or directors have the right to buy the interest in the business and that the inheriting spouses have the right to sell their interest to them. Policies can be set up in a way that suits a company's ownshare purchase agreement.