DATE: **June 27, 2011**

TO: **IIPRC Management Committee**
FROM: **Industry Advisory Committee**

SUBJECT: **DBOE Standards Dated June 27, 2011**

Re: Comments on DBOE Policy Standards

Missing Definition of Maximum Covered Monthly Expense Benefits

While we were in the process of reviewing the PSC proposed DBOE changes, we noted that the ***Accumulation "Carryover" Benefit*** on page 20 refers to a *Maximum Covered Monthly Expense Benefit*. Inadvertently, we have lost the definition for this term in Section 3 of the DBOE standards. We suggest that the following definition be included:

"Maximum Covered Monthly Expense Benefit means the maximum monthly benefit payable under the policy for *Covered Disability Business Overhead Expenses*, except where a greater benefit may be payable as described in the Accumulation "Carryover" Benefit if such benefit is included in the policy."

Page 20, §3.F., Item (1)(b)

This item would require a mandated refund in situations of overinsurance.

We continue to have serious concerns with the mandated refund approach which today is not required by any state other than Maryland.

The statutes cited in defense of the mandated refund were enacted in the 1950's, and it is safe to say that at that time no one contemplated a DBOE, Buy-Sell or Key-Person products. When companies began filing the DBOE product in the late 1970s/1980s, states were willing to approve these even though the disability statutes did not specifically accommodate them, probably because the extension of the "income replacement need" to reimbursement of business expense need appeared logical. When these products were first filed without the mandated refund language, no state objected. Companies rarely needed to update the DBOE chassis because of the limited market need, so states rarely see DBOE filings.

The purpose of the DBOE product is to reimburse business expenses that are incurred during a time that the business owner is disabled. Pages 19-20 of the DI/DBOE application standards details the business information that is requested to conduct the financial underwriting of a business. Typically, as stated in the standards, information is requested for the average over the past 12 months. This is because business expenses tend to fluctuate from month to month, and at best the owner provides an average estimate at the time of application. The company will do its financial underwriting to assess the estimates, but for the most part it relies on the information provided. ***Whereas the purpose of a DI product is to replace a fixed monthly income, the purpose of a DBOE product is to reimburse specified business expenses that were incurred during a particular month of disability.*** Due to fluctuations in business expenses, companies offer an optional ***Accumulation "Carryover" Benefit*** (see page 21 of the DBOE standards) which allows unused benefits in one month to be carried over to the next month.

The DBOE product is limited to the small business owner with a benefit period not exceeding 2 years, and only a few companies market this product. If a small business owner is out on disability for a year, it is unlikely that the business will survive, and typically companies see temporary disabilities rather than permanent ones.

In most cases, the DBOE product was sold as an adjunct to a DI product sale so that both income and business expenses would be covered.

We continue to believe that the DI and DBOE products need to be distinguishable in some ways and yet the PSC believes that a mandatory refund is what state laws would require, but fail to acknowledge that, for good reasons, the states have been approving DBOE products without the mandate.

We have asked companies how they handle the Maryland requirement today and have learned that companies do not have experience with this requirement since most of their products are decades old and since they have not filed in some years were not made aware of the Maryland requirements. One company reports that it last made a nationwide DBOE filing in 2002 at which time Maryland advised of its mandated refund requirement. The product was never launched in any state, so the company does not have any experience regarding the administration of the refund.

The proposed language poses the following practical concerns with its intent:

For examples:

1. It is not clear how often or when the refund would have to be made.

2. It is not clear how the refunds would interact with the Accumulation "Carryover" Benefit ,

3. In a situation where in a subsequent month *Covered Disability Business Overhead Expenses* exceed coverage from all sources and a full benefit is paid by all the companies involved, is it expected that the benefit will be administered at the adjusted benefit amount on which the benefit was initially paid and for which 2 years of premiums have been refunded?

4. Since the DBOE ***is Guaranteed Renewable and non-Cancellable,*** companies do not have the right to force a permanent reduction in benefits if it turns out that the business owner is overinsured. The language makes the companies vulnerable to recurring "refunds" because it rewards the business owner who ends up in a recurring overinsurance mode, thereby eliminating any incentive to correct the overinsurance.

As we stated on June 7, while we agree that it is the insurer's responsibility to issue the appropriate amount of DBOE, we disagree that it is the insurer's responsibility to monitor the business needs on a going forward basis – not possible without input from insured. The nature of business expenses is that they do not remain fixed – they fluctuate. Accordingly, a mandated refund is counterproductive to this type of product.

We fully appreciate that DBOE products are not common and serve a small business market, and as a consequence not many regulators may not have seen a lot of filings and had the opportunity to develop a better understanding of how these products differ from DI products. Accordingly, we encourage the Management Committee to schedule at least one call for the purpose of further discussing the purpose of the DBOE product and why we need some differentiation of it from DI products. The IAC and the PSC had one call to do this but we ran out of time and never completed the agenda. We strongly recommend that additional calls be scheduled so that industry representatives and regulators take the opportunity to address the mandated refund issues/concerns, as well as other issues/concerns that may remain.

As always, we welcome the opportunity to further discuss this issue.

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