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Let's Get Technical: Business expense cover

Although business expense cover is often an important component of small business insurance advice, it seems to be overlooked by many advisers, partly because it is not well understood and, being an indemnity product, it is subject to changing circumstances. It is also generally not well promoted by insurers.

Small businesses are dynamic entities, subject to change and evolution. Annual business expense reviews are therefore recommended for those that have business expense cover, to check whether the business has undergone a restructure and changes in expenses. These reviews could also uncover other business insurance opportunities such as succession (buy/sell) and key person insurance needs.

ClearView's Business Expense Cover is specifically designed for self-employed individuals or small business owners who need to cover their eligible regular fixed business operating expenses if they cannot work due to sickness or injury. Having Business Expense Cover in addition to Income Protection can assist so that the insured person does not erode their personal income protection benefit (up to 70 per cent of income) by the ongoing requirement to also meet their fixed business expenses.

To be eligible for this benefit, insured persons need to demonstrate (among other things) that they have fixed overheads in the running of their business and that they are employed in an eligible occupation.

Business Expense Cover can be vital for sole proprietors and one-person incorporated businesses as they are usually totally responsible for both the generation of income and the fixed operating expenses of the business. This cover is also available to small business owners with no more than five staff, including the owners.

The insured person must generate income for the business and cannot fulfil a purely administrative role. If there is more than one person directly responsible for the generation of income in the business, ClearView apportions the eligible business expenses in the same proportion as the insured's share of business income prior to the claim, between the insured and the other person(s), to determine the former's share. ClearView will act reasonably when considering requests to divide the eligible business expenses on a different basis. It will also act reasonably when requiring financial evidence for determining an insured's share of eligible business expenses at the time of claim, as well as their share of pre-disability business income.

The minimum entry age for Business Expense Cover is 18 and the maximum entry age is 60 for variable age-stepped premiums and 55 for variable premiums. The minimum insured monthly benefit amount is $1,500 and the maximum is $60,000 per month and the cover can be up to 100 per cent of eligible business expenses. Waiting period options for the cover are 30, 60 or 90 days.

The benefit period of the cover is one year but may be extended until 12 times the monthly benefit has been paid in total if the insured person continues to satisfy claim requirements beyond one year. A policy owner can only claim one full benefit period for any one sickness or injury (including any related sickness or injury) but otherwise can make subsequent claims for unrelated sicknesses or injuries.

Built-in benefits of the policy at no extra cost are:

- Indexation Benefit;
- Relapse Benefit;
- Future Increase Benefit;
- Death Benefit;
- Waiver of Premium while on a Claim Benefit;
- Suspending Cover Benefit; and
- Extended Cover Benefit.

The Specified Events Option, which pays a pro-rated daily benefit during the waiting period if the insured is totally disabled due to a specified event, is available at an extra cost.

Eligible business expenses include the insured's share of the normal day-to-day fixed expenses actually incurred in the running of the business. Fixed expenses are expenses that continue even if the insured's business is not operating, and include (among other things):

- the salaries or remuneration of employees who are not directly involved in generating sales, income or billings (including related costs such as superannuation contributions and payroll tax);
- the net cost of a locum (a person sourced external to the business and who is a direct replacement for the insured person and whose gross sales, income or billings are less than the fees incurred for that locum);
- rent and – something that not all insurers provide – regular principal and interest instalment repayments on business loans or mortgages (unless the business premises is also the insured's principal residence).

Note that the only occupations excluded from having a locum (and Business Expense Cover) are those in the Special Risk category as per the **ClearView Adviser Guide**. The latest **ClearView ClearChoice Product Disclosure Statement** provides more examples of eligible business expenses and more detail on policy benefits and exclusions. The list of eligible business expenses is not exhaustive, and our friendly underwriters would be more than happy to assist where there is uncertainty.

Case study

This case study is based on an actual ClearView claim. However, factual details have been changed for privacy reasons.

The application

- Original application for Business Expense Cover lodged in February 2023.
- Insured is a self-employed periodontist (specialist dentist) with two full-time and two part-time employees.
- Net income for the past 3 years was as follows:
  - $320,000
  - $260,000
  - $300,000
- Business Expense Cover was accepted on standard terms in February 2023.
- Sum insured as at date of disability in March 2024 was $21,566.

The claim

- The forty-one-year-old female insured claimed for a right Achilles tendon injury whilst exercising at the gym.
- Claimant hospitalised between 12 March 2024 to 26 June 2024 to undergo tendon lengthening and free anterolateral thigh flap surgery.
- Treating specialist initially certified claimant as unfit to work from 12 March 2024 to 15 May 2024 due to pain, limited mobility and current inability to walk. She was expected to return to part-time work from 15 May 2024 for 4 hours per day.
- Claimant returned to work part time from 15 May 2024 for 10 to 20 hours per week and returned to work at 90 per cent of pre-disability capacity from June 2024
- Business expense claim benefit assessed and paid for April as follows:

Pre-disability business income and eligible business expenses 12 months immediately prior to date of disability

1/12th of gross pre-disability business income	$59,779.25
1/12th of eligible business expenses	$19,192.50
Business Expense Cover monthly benefit	$21,566.00

Business expenses for April 2024

Total cost of sales	$0.00
Gross profit	$0.00
Operating expenses	
Computer expenses	$90.91
General expenses	$217.94
Light, power, heating	$809.15
Printing and stationery	$71.11
Superannuation for Practice Manager and Dental Assistant	$347.11
Wages and salaries for practice manager and dental assistant	$6,100.00
Professional indemnity insurance	$225.58
Equipment lease	$2,155.13
Clinic fit-out loan	$9,793.99
Rent	$3,230.00
Total Operating Expenses	**$23,040.92**

Under the policy, the Business Expense Cover benefit payable is the lesser of the monthly benefit (sum insured), $1/12^{th}$ of pre-disability earnings and actual business expenses for the month while the insured is totally disabled. As such, the full monthly benefit of $21,566 was payable for April 2024.

In May 2024, the business generated $64,900 of gross business income, which exceeded the gross monthly pre-disability business income of $59,779.25 and which under the partial disability calculation below meant there was no business expenses benefit payable that month.

$$\frac{(A-B)}{A} \times \text{Monthly benefit amount - Other disability payments}$$

A = the insured's share of the **pre-disability business income**

B = the insured's **share of the business income for the month** in which they are disabled and claiming a Disability Benefit before any benefit is payable under the cover

- **Monthly benefit amount: lesser of $1/12^{th}$** part of the eligible business expense; share of the actual eligible business expense incurred and insured monthly benefit amount
- **Pre-disability business income:** The average monthly business income in the 12-month period* immediately preceding the date of disability. If the insured become disabled while on parental leave or sabbatical leave, then pre-disability business income will be based on their average monthly business income during the 12 months before the period of leave commenced.

  * The most recent Australian tax year (1 July to 30 June) may be used in place of the relevant 12-month period.
- **Business Income:** the insured's share of the gross income generated by the business before expenses and tax. For the purpose of this definition, business income will always have a minimum value of zero.

The insured also had a concurrent ClearView Income Protection policy and was paid the monthly benefit of $26,250 for the month of April. Given the above claim, you can see that Business Expense Cover can assist an insured in situations where a business will cease to trade – temporarily or permanently – or suffer a significant reduction in turnover and profit if the insured person is disabled, while still incurring business expenses claimable under the policy. It also illustrates that having both Business Expense and Income Protection Cover can be appropriate depending on the insured's circumstances.

Summary

Business Expense Cover is a product that should be considered for appropriate small business structures – particularly for sole proprietors and one-person incorporated businesses – where it could provide a complement to Income Protection Cover.

A business' expenses should be reviewed at least annually to ensure that the level of cover is appropriate.

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