Protect your business from the loss of a key employee

Advanced Markets

Key person coverage

EQUITABLE

What if your business lost a key employee?

You've worked hard to make your vision a reality. Your business is successful, thanks in part to at least one key person. It could be someone you depend on for leadership, support or important relationships. While you've made sure that your business is protected in case of theft or fire, have you thought about what would happen if you lost your key employee? Now is the time to protect your business and make sure you're successful in the future, even if you lose that key person. Equitable can help.

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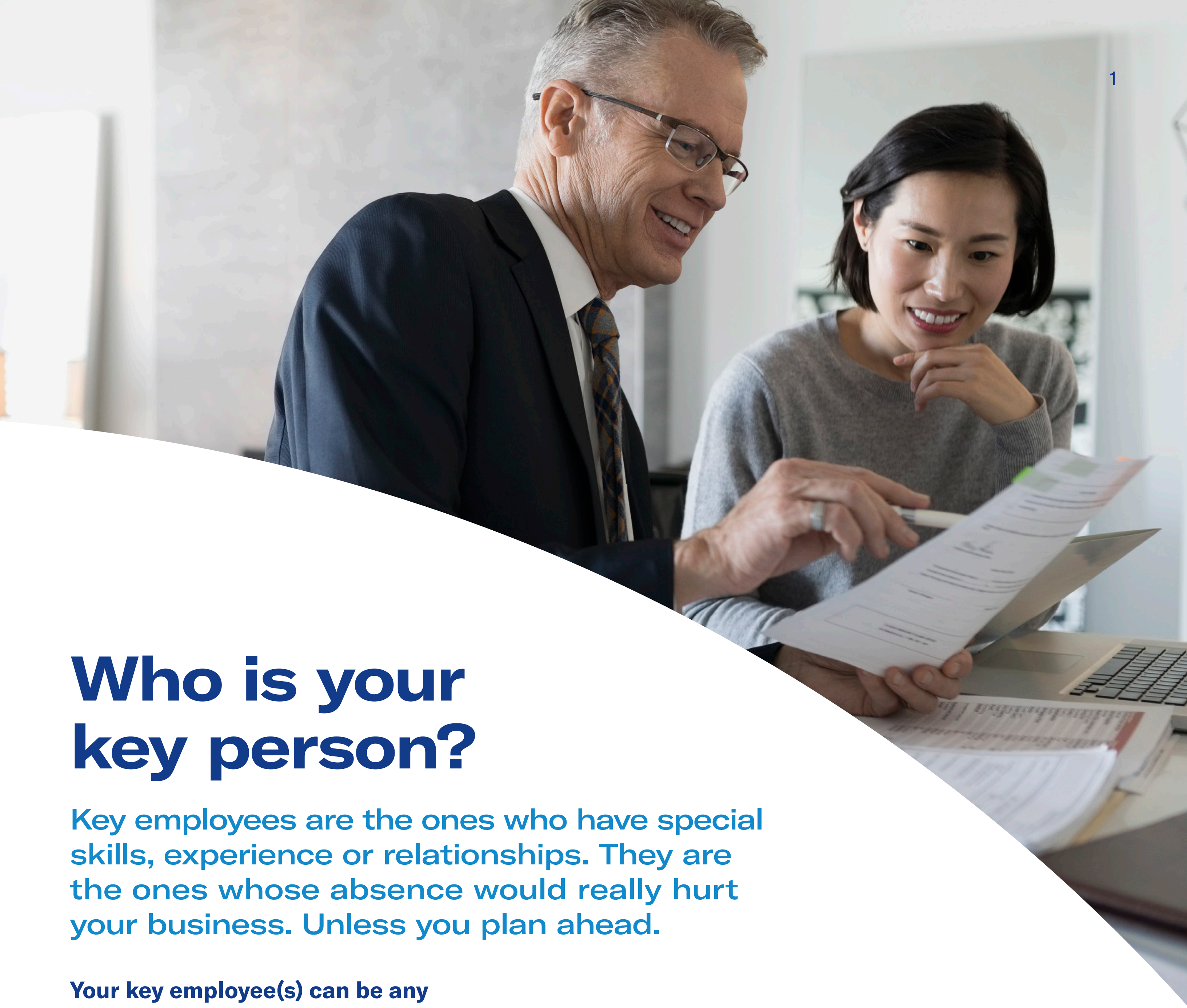


Who is your key person?

Key employees are the ones who have special skills, experience or relationships. They are the ones whose absence would really hurt your business. Unless you plan ahead.

Your key employee(s) can be any of these people:

- You, your partners or co-owners.
- Your most valuable senior executives.
- Highly skilled technicians who make the business operate efficiently.
- Productive sales people who keep business coming in the door.
- Someone whose special skill set is imperative to the success of your business.
- The ones who maintain the best customer service relationships.
- An employee who drives one of your key business lines.

Designing key person coverage to meet your needs — and theirs

A key person protection program can help both you and your key employees, if designed properly.

For you, it can:

- Protect against the unexpected death of a key person by providing the funds needed to help sustain your business following the loss of a key person. Funds can be used to cover debts and operating expenses in the face of lost sales, or to recruit and hire a qualified replacement.
- Protect against the unexpected departure of a key person by acting as "golden handcuffs" to help keep key employees with your company.

For your key person(s), it can:

- Show them you value their contribution to your business.
- Provide financial incentives for them to stay with your business as long as possible, instead of going elsewhere for a better offer.

What are "golden handcuffs"?

These arrangements offer a strategic benefit to the employee, as well as your business; the longer the key employee stays, the larger the financial reward.

Executive bonus plans	Pay a bonus to the key employee, which is used to fund high cash value life insurance protection for the employee's family.
Split-dollar life insurance	The business and the key employee share the cost of a permanent life insurance policy, to benefit the employee's family.
Nonqualified deferred compensation	As a supplement to a standard qualified retirement plan, these types of plans can provide additional retirement income for key employees if they stay with the company until retirement.

A comprehensive and properly funded key person program using cash value life insurance can allow you to protect yourself against the death of a key person, and have the cash values available to fund a living, "golden handcuff" executive benefits program. Equitable has a number of ways to help you select and present the most appropriate "golden handcuff" executive benefit plan, but let's focus on protecting your business from the unexpected death of a key person.

Tying a dollar amount to your key person protection

One of the first things you'll need to do to put key person coverage in place is determine the costs associated with losing your key person. This includes funds needed to cover debts, expenses and replacing that position.

Things to consider:

1 **Salary**
Typically allow for 10x the key person's salary

2 **Bonus**
Include bonus or equity participation in the business

3 **Training**
The cost of hiring, training and relocating a replacement

Equitable's life insurance illustration software will help you estimate the cost to replace a key person. Your financial professional can work with an Equitable office to help determine your need. Your CPA can also help determine a realistic valuation.

The role of life insurance in key person protection

An Equitable key person protection program is funded by life insurance. Your business purchases a permanent, cash value life insurance policy insuring the key employee's life. That policy is held as an asset of the business, and when you need it most, the policy can provide the funds you need.

If the key person unexpectedly dies:

The life insurance policy provides a death benefit in the form of cash — free of taxes.[1] Those funds can be used to sustain the business, cover debt and operating expenses, and recruit and train a qualified replacement.

If the key person retires:

The life insurance policy could be used as a funding mechanism for a selective nonqualified benefit. The policy cash value can then be used to provide retirement income for the key employee. As an added value, the death benefit can also be used to provide cash for the family if the key employee dies.

Important life insurance benefits

Tax advantages. The cash value in the policy generally accumulates without triggering current taxes, potentially grows tax-deferred and the life insurance benefit is generally federal income tax-free.

Guarantees. The policy is backed by the claims-paying ability of the insurance company. All U.S. life insurance companies are state-regulated to make sure they maintain enough reserves to meet claims.

Life insurance protection. Permanent life insurance protects your business or your employees' family for as long as the employee lives, and provides a cash benefit right after death.

Cash value accumulation. The cash value in a permanent life policy can grow over time. When the policy is company-owned, the cash value is considered an asset on the balance sheet, and can be used to fund "golden handcuff" arrangements.

Other considerations. Please remember cash value life insurance does have many other considerations clients should review carefully before selecting a key person life insurance policy.

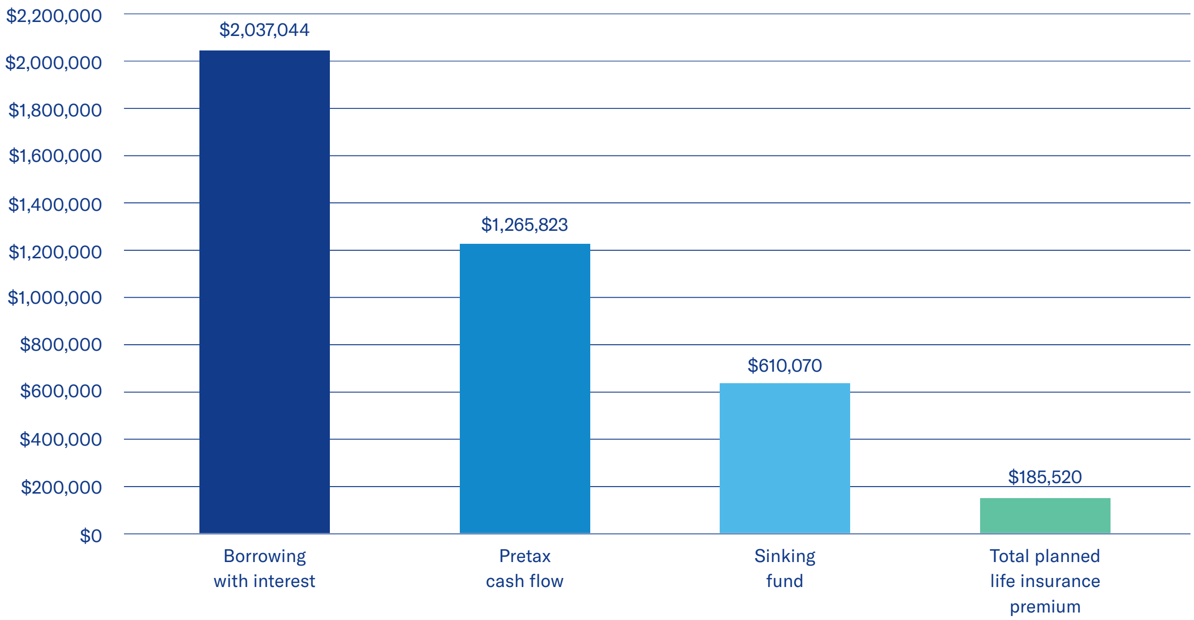
Please keep these important points in mind

- Clients must keep paying the required premiums; missing or skipping premiums will negatively impact the amount of loans and withdrawals available. A life insurance policy generally takes years to build up a substantial cash value. To be effective, the policy should be held until death.
- Clients must qualify both medically and financially for the life insurance.
- How much life insurance can be purchased, and the premiums paid will depend on the medical and financial underwriting.
- Generally, there are many additional charges associated with a life insurance policy, including, but not limited to, a front-end load, monthly administrative charge, monthly Segment charge, cost of insurance charge, additional benefit rider costs and a 15-20-year surrender charge.
- Tax-free distributions will reduce the cash value and face amount of the policy. Clients may need to pay higher premiums in later years to keep the policy from lapsing.

Life insurance can be the most cost-effective way to fund key person coverage

As you can see below, there are other ways to fund a key person need, but life insurance is by far the most cost-effective. See the example below for a healthy 45-year-old male.

Ways to fund a $1,000,000 key person need



The policy premium and death benefit amounts used for this case are intended only to help demonstrate the planning concept discussed and not to promote any specific product. The rates are broadly representative of rates that would apply for a policy of this type, and size for the insured's good health and ages noted in the example. To determine how this approach might work for your client, individual illustrations based on their own individual age and underwriting class, containing both guaranteed charges and guaranteed interest rates, as well as other important information, should be prepared or requested for their review.

Borrowing with interest	$2,037,044 — A business expecting to borrow to meet its key person needs risks being denied the financing, as the loan would occur at a time when the business and its management team are under stress. The value presented here is what a business would pay in interest and principal if it could receive a 20-year loan at an 8% rate.[2]
Pretax cash flow	$1,265,823 — This is what a business, in a 21% tax bracket,[3] will need to net (after expenses) to meet its key person need.[1]
Sinking fund	$610,070 — This is what a business would need to set aside each year, between an employee's age 45–65 to amass the same amount a $1,000,000 policy will provide. This assumes an annual contribution of $30,504 and an after-tax growth rate of 4.5%.
Permanent life insurance	$185,520 — This offers cash values that can be used as a business asset — as collateral for a loan, an informal line of credit or to help fund a benefit program for a retired key employee.[4]

See a key person program in action

The owner of Cogswell Cogs recognized Paul as a key person in the business. Paul recently signed one of their largest accounts and worked with two other accounts that brought in 15% of the company's total revenue. So a $1,000,000 key person life insurance policy was established on Paul's life, in case something should happen to him.

When Paul passed away unexpectedly, Cogswell Cogs was saddened by the loss of a valued employee and friend, but the company was not devastated financially because it had the key person policy. The business received the $1,000,000 cash tax-free, and was able to use it to help the business adjust to Paul's loss:

$125,000
was used to recruit, offer a sign-on bonus and relocate a replacement for Paul.

$50,000
was allocated to special training and marketing to help the replacement get up to speed more quickly.

$200,000
was posted as collateral to help keep one of the business's creditors from raising the rate on a credit line.

$250,000
was paid to Paul's widow as a special bonus for his years of service.

The balance was held as a cushion against any possible dips in revenue in the future. Three years after this unexpected loss, Cogswell Cogs is as strong as ever.

Why Equitable?

You may want to consider Equitable as a resource for key person coverage. Here's what we offer:

- A strong life insurance portfolio with the death benefit coverage you need, and a line of high potential cash value product options and term products with flexible conversion privileges.
- Illustration support to show how your specific key person plan might work.
- A wide selection of riders,[5] including:
  - An enhanced cash value rider allowing the life insurance cash value on your business's books to offset the premium expense.
  - The Long-Term Care Services℠ Rider that can accelerate the death benefit to help your business in case the key person cannot work because of a qualifying long-term care event.
  - The Charitable Legacy Rider® offering an additional death benefit to the charity(ies) of your choice at no added cost.
- For over 160 years, we've been working with clients across generations, building on what's proven and pursuing what's possible.

Taking the next steps

Are you ready to find out how the loss of a key person would impact your business? Contact your financial professional today. During a fact-finding session, they can help you define your business and personal goals, and can act as a planning resource for your business — to help protect against the loss of a key person and provide you with a valuable asset in a life insurance policy.

Trust comes with experience. You can count on ours.

Over **160** years and counting

More than **$220b** assets under management[2]

Over **2.8** million clients[2]

1 Effective August 17, 2006, the Internal Revenue Code Section enacted 101(j), otherwise known as Employer-Owned Life Insurance (EOLI) Notice and Consent. Among other things, EOLI requires that the employer must give the following notice and consent before the insurance policy is issued:

- The employee must be informed in writing that the employer intends to insure his or her life, and the maximum amount for which he or she could be insured.
- The employee must provide written consent to being insured and that such coverage may continue after he or she terminates employment.
- The employee must be informed in writing that the employer will be the beneficiary of the death proceeds. Key person coverage should also be coordinated with your business continuation plans. If this notice and consent is met, as well as certain additional requirements related to reporting, and insurance coverage is maintained once an employee separates from service, the death proceeds should generally remain income tax-free.

2 This percentage is based on a hypothetical loan rate.

3 The tax bracket is based on an overall average.

4 Policy withdrawals are not subject to taxation up to the amount paid in the policy. Policy loans and/or withdrawals will be taxable to the extent of gain if the policy is a Modified Endowment Contract. Policy loans and/or withdrawals also reduce the cash surrender value and policy death benefit. Taking a policy loan could have adverse tax consequences if the policy terminates before the insured's death. Clients may have to pay additional premiums in later years to keep the policy from lapsing.

5 Some riders have an additional cost, and all have restrictions and limitations. Be sure to review with your financial professional for further details.

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The 160-year history reference applies exclusively to Equitable Financial Life Insurance Company.

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