



# Setting your plan in motion

## Key person life insurance

**Just as every family has a breadwinner, businesses have key individuals whose management roles, special talents or revenue-generating abilities are critical to a business's success. The loss of such employees can be detrimental to your business if you are not prepared. With the unpredictability tied to the timing of a key person loss, it's important to have a unique type of reserve fund to prepare for such an event. A key person life insurance policy is a strategy to financially provide the protection against the loss of your company's best talent at the moment it is needed.**

### Highlights of a key person life insurance policy

- Only with a life insurance policy can a business be assured it will have the funds necessary to sustain a business through a rough period following the loss of a key person. Alternative methods (such as a sinking fund or borrowing) are less predictable due to whether or not sufficient funds will be available.
- Ownership of key person life insurance can help assure banks and other creditors that the firm's debts will be paid in the event of the key person's premature death.
- Annual increases of the policy's cash values are not currently taxable to the business.
- The life insurance policy is owned by, and an asset of, your business. The cash surrender value can have a positive effect on your balance sheet and is generally available without publicity, irrespective of business conditions, the money market or credit restrictions.
- Policy cash surrender values can be used as collateral for bank loans, making cash available in the event of default.
- Death benefit proceeds are generally received by your business income tax-free.

### Your key person

The employee whose special skill set is imperative to the success of your business. The key person generates the highest sales, maintains the best customer service relationships and drives one of your key business lines.

# How it works

Our key person life insurance policy can potentially provide your business with the cash it would need, untouched by taxes, at the point in time when it is needed most. Here's how it works.

## During key person's employment:

We receive premium payments and apply the funds to the life insurance policy offering death benefit protection. With a key person life insurance plan in good standing and as owner of the policy, your business has access to secure loans and/or cash surrender value withdrawals during your key person's working years. Additionally, your life insurance policy can also become the funding mechanism for a selective benefit program for your best employees to entice them to stay on with your business (i.e., executive benefit retirement plan).

## At loss of key person:

A key person protection program can help provide your business with the funds needed to help you withstand the financial shock and sustain your business following an unexpected death. It can help you with a source of funds to cover debts and operating expenses in the face of lost sales, as well as recruit, hire, train and retain a qualified replacement.

## Common key person valuation methods<sup>1</sup>

It is a necessity for your business to have the cash in reserve to protect against the loss of your company's best talent. The ability to purchase an appropriate amount of life insurance to protect a key person is largely dependent upon selecting an appropriate valuation method. Effective options include:

### Valuation method

#### Multiple-of-salary

Key person's salary multiplied by a selected factor (e.g., x 10)

#### Key person's contribution

Present value of contributions to gross sales (less salary paid) compared to the contribution of a replacement

#### Cost to replace a key person's lost profits

The difference between the anticipated profits produced by the key person and the profits expected from a new "replacement"

#### Capitalization of excess earnings

The earnings attributed to the key person that are more than what the owner expects to earn with "ordinary" investments

#### Cost to replace key person's experience

Experience measured by the compensation "premium" paid to the key person in excess of other employees in similar positions

#### Loss of value to business

Reduced revenue directly related to loss of "good will" associated with loss of key person

#### Known key person value

Based on business owner's own instinct

<sup>1</sup> Business- and employer-owned policies — Any employer-owned life insurance arrangement on an employee or director, as well as any corporate, trade or business use of a policy, should be carefully reviewed by the policyowner's tax advisor. Federal tax legislation enacted in 2005 imposes requirements for income tax-free death benefits on business-owned policies. These include detailed notice and consent requirements as to the insured, limits on those employees (including directors) who can be insured and certain tax-reporting requirements.

Loans and withdrawals reduce the policy's cash value and death benefit, may cause certain policy benefits or riders to become unavailable, and increase the chance the policy may lapse. If the policy lapses, is surrendered or becomes a Modified Endowment Contract (MEC), the loan balance at such time would generally be viewed as distributed and taxable under the general rules for distribution of policy cash values. If the policy is a MEC, all distributions (withdrawals or loans) are taxed as ordinary income to the extent of gain in the policy, and may also be subject to an additional 10% premature distribution penalty prior to age 59½, unless certain exceptions are applicable.

To see how this may be an advantage, let's consider the Cogswell Cogs business: Cogswell Cogs needs \$1,000,000 of key person life insurance. They are focused on value and buy a BrightLife® Grow indexed universal life policy with the CV Plus High Early Cash Value Rider.<sup>2</sup> This offers Cogswell competitive cash value potential.

Let's look at the financial impact from their product selection on the company's balance sheet:

Year	Age	Premium	Cash value	Cumulative balance sheet impact
1	46	\$14,000	\$11,200	-\$2,800
5	50	\$14,000	\$53,900	-\$16,110
10	55	\$14,000	\$124,200	-\$15,800
15	60	\$14,000	\$254,700	\$44,700
20	65	\$14,000	\$424,400	\$145,400

This is a supplemental illustration and must be read in conjunction with the basic illustration. The basic illustration contains values using the same underwriting assumptions as this supplemental at both guaranteed charges and guaranteed interest rates, and contains other important information. The values represented here are for a \$1,000,000 BrightLife® Grow policy on a 45-year-old male preferred non-tobacco user. The values reflect the cost of 20 years of premiums. The values represented here are non-guaranteed and assume current charges and a current interest rate of 6.12%. If guaranteed rates and charges are used, the policy would fail in year 31.

The access to policy cash surrender values can be extremely helpful for funding executive benefits or to help ease/loosen unexpected financial constraints to finance inventory, equipment or even payroll. It's important to remember permanent life insurance cash surrender values may be withdrawn or borrowed even when the banks say “no” to extending credit to your business:<sup>3</sup>

In addition, the cash surrender value accumulation:

1

Is a capital asset of the business, not just a “squandered” cost.

2

May be available for loans or withdrawals, regardless of the business's financial condition.

3

Is a potential source of collateral for other loans.

4

May help secure favorable financing for business by improving the balance sheet.

2 The CV Plus Rider enhances policy cash values in the first 8 policy years. The rider comes with an added charge of \$.48 per thousand of initial face amount for that 8-year period.

3 Loans taken will be free of current income tax as long as the policy remains in force until the insured's death and is not a MEC. This assumes any loan balance will eventually be repaid with income tax-free death benefits. Loans and partial withdrawals will reduce the policy's death benefit and increase the chance it may lapse. Clients may need to pay higher premiums in later years to keep the policy from lapsing.

# Why Equitable?

Our dedicated, expert team of Advanced Markets specialists meets the changing needs of your clients by offering custom-designed advice and actionable strategies that can proactively help them achieve their desired results — including:

- A wide range of permanent and term products that can help tailor the key person contract to the business's exact needs and budget.
- The ability to illustrate your key person needs, including the ability to help value the loss of a key person.
- A wide range of riders that can be added to our life insurance policies and help further tailor your contract, including a charitable rider and a rider that can offer flexibility in addressing long-term care needs by allowing you to accelerate the payment of policy benefits if a key person has a long-term care event.
- Strong portfolio of life insurance products and services designed to help our clients protect their families, plan their retirement and meet other important financial goals.
- A resilient and stable business model based on the diversification of businesses, products, geographies, distribution channels and assets.

**For more information about how you can safeguard your business with key person planning, contact your financial professional.**

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