

# Corporate Policy Review

## PROGRAM INTRODUCTION

### Purpose

The purpose of our Corporate Policy Review (CPR) Program is to arm business owners and their financial, legal, and accounting advisors with reviews and recommendations that can allow them to make informed decisions with regard to their company's life insurance and the plans to which those policies relate, i.e., buy/sell agreements, split dollar, key person, deferred compensation plans, estate plans, etc.

### Issues

Prolonged low interest rates and increasing reserve requirements have negatively impacted many policies. This has caused an immediate need for business owners to revisit their corporate policies and goals from both a personal and holistic business perspective.

Economic conditions, including an ever-changing array of regulations, have made it prudent to review these arrangements both for policy performance, as well as for compliance considerations.

### There are several areas of concern that business owners should consider:

1. **Existing company-owned insurance policies** should be reviewed to ensure they are still performing as expected and will provide the liquidity, protection and desired cash proceeds.
2. **Executive Benefit Plans** – those plans that were put in place to recruit, reward and retain top talent – should be reviewed at least every two years.
3. **Business Succession and Continuation Planning** is another area business owners should review. Having pre-funded, up-to-date plans in place can allow owners to transition out of the business in the time frame they have in mind and at the value that meets their needs.
4. **Business Valuation** is an integral part of business continuation planning. Many times a formal valuation isn't necessary until the sale or transfer of the business is imminent. ESG can provide informal business valuation services – based on three (3) years of company tax returns or financials – may be useful in the business continuation planning process.
5. **Beneficiary Designations** of all policies should be reviewed annually.

This situation opens the door for your contact with existing business owner clients to offer to review their documents and their policies to see if they are performing as they should.

# CPR Program Fact Finder

Advisor Name \_\_\_\_\_ Phone Number \_\_\_\_\_ Date \_\_\_\_\_

## Business Background Information

<b>Business Name:</b>	<b>Owner's Name:</b>	<b>Location:</b>	
<b>Type of Business Entity:</b> <input type="checkbox"/> C Corporation <input type="checkbox"/> S Corporation <input type="checkbox"/> Sole Proprietorship <input type="checkbox"/> Partnership <input type="checkbox"/> Professional Corporation C Corp <input type="checkbox"/> Professional Corporation S Corp		<b>Phone:</b>	<b>Email:</b>
		<b>Website:</b>	
<b>Number of Owners:</b> __ 1 __ 2 __ 3 __ 4 __ 5+			
<b>Shareholders:</b>			
Name:	Percentage of Ownership:	Income:	Age/Date of Birth:
Name:	Percentage of Ownership:	Income:	Age/Date of Birth:
Name:	Percentage of Ownership:	Income:	Age/Date of Birth:
Name:	Percentage of Ownership:	Income:	Age/Date of Birth:
<b>Employees Critical to Business:</b>			
Name of Key Employee:	Duties:	Income:	Age/Date of Birth:
Name of Key Employee:	Duties:	Income:	Age/Date of Birth:
Name of Key Employee:	Duties:	Income:	Age/Date of Birth:
<b>Outstanding Corporate Loans/Lines of Credit</b> Type:  Outstanding Balance:  Monthly Payment:  Duration (months/years remaining):			
<b>How many years has the business been operating?</b> <input type="checkbox"/> Fewer than 3 <input type="checkbox"/> 3-5 <input type="checkbox"/> 6-9 <input type="checkbox"/> 10-20 <input type="checkbox"/> 21+		Approximate Business Value? _____  Source of Valuation? _____	
<b>Business Tax Rate</b> (Enter the business owner's tax rate if business is taxed as a pass-through organization) _____ %			

# CPR Program Fact Finder (cont'd)

## Areas for Review

<p><b>1. Business Continuation Plans</b></p> <p>a. Do you have a buy/sell agreement?</p> <p>b. On what basis does it value the business?</p> <p>c. Does it transfer your business to a specific party at an established price?</p>	<p>_____ Yes _____ No</p> <p>_____</p> <p>_____ Yes _____ No _____ Need Review</p>
<p><b>2. Business and Key Person Valuations</b></p> <p>a. If you had a change in management, would your business be as successful as it is today without one of the owners or a key employee(s)?</p> <p>b. Have you conducted a business valuation?</p> <p>c. Have you conducted a key person valuation?</p>	<p>_____ Yes _____ No</p> <p>_____ Yes _____ No _____ Year</p> <p>_____ Yes _____ No _____ Year</p>
<p><b>3. Executive Benefit Plans</b></p> <p>a. Are you or your key employees able to set aside enough money for retirement considering the limited amount of contributions that can be made to an employer-sponsored 401(k) plan?</p> <p>b. Do you have a plan in place to help you recruit, reward and retain key employees?</p> <p>c. Do these plans contain any form of restrictions, vesting, or "handcuffs"?</p>	<p>_____ Yes _____ No _____ Need Review</p> <p>_____ Yes _____ No</p> <p>_____ If Yes, Type of Plan _____</p> <p>_____ Yes _____ No _____ Need Review</p>
<p><b>4. Company-Owned Life Insurance and Related Plans</b></p> <p>a. Do you have company-owned policies in place to address Key Person/company needs, loan indemnification, or other needs?</p> <p>b. Was any life insurance with respect to any of the above placed in effect after August 17, 2006?</p> <p style="padding-left: 20px;">i. Was notice and consent obtained from the insured employee at that time?</p> <p style="padding-left: 20px;">ii. Have the death benefit amounts been reported as required?</p> <p>c. Do you have a Deferred Compensation Plan and/or a Supplemental Executive Retirement Plan?</p> <p style="padding-left: 20px;">i. Have all of the above plans been reviewed for the impact of regulatory changes since January 1, 2009?*</p> <p>d. Do you have a Qualified Plan with life insurance providing part of the funding?</p> <p>e. Have there ever been any ownership changes to any company-owned policies?</p>	<p>_____ Yes _____ No _____ Need Review</p> <p>_____ Yes _____ No _____ Need Review</p> <p>_____ Yes _____ No _____ Need Review</p> <p>_____ Yes _____ No _____ Need Review</p> <p>_____ Yes _____ No _____ Need Review</p> <p>_____ Yes _____ No _____ Need Review</p> <p>_____ Yes _____ No _____ Need Review</p> <p>_____ Yes _____ No _____ Need Review</p>
<p><b>5. Exit Planning</b></p> <p>a. How much longer do you plan to work in your business?</p> <p>b. What is your exit strategy? To whom will you transfer/sell your business to?</p> <p>c. Do you know how much money you will need to net from the sale of your business to provide you with financial independence?</p> <p>d. Does your business need additional capital or refinancing?</p>	<p>Number of Years _____</p> <p><input type="checkbox"/> Family members</p> <p><input type="checkbox"/> Co-Shareholders</p> <p><input type="checkbox"/> Management Team</p> <p><input type="checkbox"/> All Employees</p> <p><input type="checkbox"/> Outside Buyer</p> <p>_____ Yes _____ No</p> <p>\$ _____ Amount</p> <p>_____ Yes _____ No</p> <p>\$ _____ Amount</p>

## CPR Program Fact Finder (cont'd)

### Your Financial Priorities (Please rank 1-6, with 1 being the highest)

<b>Income Protection</b> Upon an accident or severe illness, would you be able to meet present financial obligations based on your expected income during that stressful time?	<input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Rank
<b>Survivor Income</b> Will your spouse and beneficiaries be able to maintain their desired standard of living after your death?	<input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Rank
<b>Business Protection</b> In the event of a death, resignation of a key employee or a future change in management, would your business be as successful as it is today?	<input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Rank
<b>Retirement Income</b> Do you have fringe benefits in place to help you recruit, retain and reward key employees with supplemental retirement income?	<input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Rank
<b>Exit Planning</b> Have you established a definite time period to transfer or sell your business to a specific party at an established price?	<input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Rank
<b>Wealth Transfer</b> Is your will/trust current and does it accurately reflect how you want your assets distributed? Have you utilized advanced planning strategies to minimize estate taxes?	<input type="checkbox"/> Yes <input type="checkbox"/> No <input type="checkbox"/> Rank

### Your Professional Advisors

<b>Accountant/CPA:</b>			
Name:	Phone:	Email Address:	Mailing Address:
<b>Attorney:</b>			
Name:	Phone:	Email Address:	Mailing Address:
<b>Banker:</b>			
Name:	Phone:	Email Address:	Mailing Address:
<b>Insurance Advisor:</b>			
Name:	Phone:	Email Address:	Mailing Address:
<b>Investment Advisor:</b>			
Name:	Phone:	Email Address:	Mailing Address:
<b>Employee Benefits Advisor:</b>			
Name:	Phone:	Email Address:	Mailing Address:

*CPR Program Fact Finder (cont'd)*

**Business Owner Background**

Why did you start the business? \_\_\_\_\_

\_\_\_\_\_

What is your business's greatest accomplishment? \_\_\_\_\_

\_\_\_\_\_

Why are you considering a succession plan? \_\_\_\_\_

\_\_\_\_\_

What is the future of the business after you leave? \_\_\_\_\_

\_\_\_\_\_

What are you looking forward to in retirement? \_\_\_\_\_

\_\_\_\_\_

How will the sale of the business affect your family? \_\_\_\_\_

\_\_\_\_\_

What role will you have in the business after your retirement? \_\_\_\_\_

\_\_\_\_\_

What relationship will you have with the new owner(s)? \_\_\_\_\_

\_\_\_\_\_

What plans do you have for the sale proceeds from the business? \_\_\_\_\_

\_\_\_\_\_

**Notes:**

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

## FAQ - Frequently Asked Questions

### What is the CPR (Corporate Policy Review) Program?

It is a program designed to provide pertinent information for, and a systematic analysis of, business related in-force life insurance policies, as well as various types of plans and legal documents that may be related to those policies. Precipitated by dramatic changes over the past decade, the CPR program is designed to give business life insurance consumers an understanding of their policy performance and plan design effectiveness with an eye toward maximizing value.

### Is there any cost for this service?

No, the CPR is a complimentary service offered through Business Intelligence Institute.

### What are the components of the Program?

A report is generated on each policy that consists of the following:

- An analysis that succinctly discusses the changes that have occurred in the life insurance marketplace.
- Depending on plan designs encountered, a report that addresses changes and regulatory issues that may be applicable.
- “In-force ledgers” of the existing policy with different funding options or goals.
- A one-page analysis of the in-force ledgers showing the death benefit and assumed cash values at various intervals, the number of years that the policy will stay in-force under current assumptions, alternative assumptions, and the number of years the policy is guaranteed to stay in-force.

If appropriate, the report may include optional policy alternatives, but only if there is a distinct client advantage.

### What is an “in-force ledger?”

It is different from the original illustration or projection at the time of purchase or an annual statement, which is a snap-shot of a policy’s status, an in-force ledger is a “re-projection” of the value of a permanent life insurance policy that is already in-force. An in-force ledger uses a policy’s cash value as of the date that the ledger is created and then projects values into the future based on premium levels, dividend rates, and other variables that can be chosen. It is a way to compare the actual performance of the policy versus the original projections. The effect on the policy of changing premium levels, death benefits, etc., can be analyzed.

## FAQ - Frequently Asked Questions (cont'd)

### What factors may affect the performance of existing permanent life insurance policies?

There are three major factors that can affect the performance of a life insurance policy:

- 1) The interest rate return on the underlying investment that provides the cash value in the policy. In Universal Life (UL) and Whole Life (WL) policies this investment account is in insurance company-directed investments. It consists mostly of bonds, with some real estate assets. In Variable and Variable Universal Life (VUL) policies the cash value is invested in separate accounts with the asset classes chosen by the policyowner.
- 2) The expenses in the policy, including the acquisition costs (commissions, underwriting expenses, etc.).
- 3) The actual mortality charges within the policy.

Of the three factors noted, the one that most affects the actual performance of the policy versus what was projected in the sales illustration is the interest rate credited. In all illustrations there is an assumed projection and a guaranteed projection. The assumed projection is a “best guess” of what will occur in the policy going forward using the then current assumptions for expense, mortality and policy values. The guaranteed projection uses only those factors that are guaranteed when it projects the outcome. If the actual current interest rate that is obtained in the policy is less than the projected rate, the policy will not perform as well as expected.

### Key Person

#### What is Key Person Insurance?

Key Person Insurance is a life insurance policy purchased by an employer on the life of a critical employee to help protect the business from the financial loss resulting from that employee's death. Policy proceeds can be used to recruit, hire, and train a replacement. They can be utilized for loan repayment to satisfy a completion bond on a project, or generally to maintain credit. Basically, Key Person Insurance is coverage that can provide a business a cash cushion in the event of an untimely death of a key employee and can help creditors, employees, and shareholders remain comfortable about the business' long-term stability and viability.

#### How is the amount of Key Person coverage determined?

It depends on what the business stands to lose at the death of the key person. There are a number of valuation methods utilized in assessing this loss. They include:

- Loss of Business Value
- Loss of Excess Earnings
- Cost to Replace Experience
- Cost to Replace Contributions
- Cost to Replace Lost Sales Profits
- Multiple of Salary

## **FAQ - Frequently Asked Questions (cont'd)**

It may be best to focus on the Multiple of Salary method to substantiate the amount of coverage being applied for. In the absence of a cover letter explaining one of the other methods and financial documentation to justify it, underwriters regularly default to the Multiple of Salary method.

### **How is the policy structured?**

The business is the owner, pays the premiums, and is the beneficiary.

### **Executive Bonus Arrangement**

#### **What is an Executive Bonus Arrangement?**

An Executive Bonus Arrangement, sometimes called a Section 162 Arrangement, is employer-financed personal life insurance that is intended to benefit select executives. It is not a group plan. Properly structured plans allow an employer to provide valuable life insurance protection for select executive(s) through a bonus of the premium by the employer to help retain, attract and reward key executives. It is an informal plan and therefore does not need IRS approval and, in most cases, is not subject to ERISA. Certain bonus plan designs may include restrictions on the employee's ability to access policy values. An Executive Bonus Arrangement is by far the most popular form of an executive benefit plan for companies of all sizes and structures.

### **Split Dollar**

#### **What is a Split Dollar plan?**

A Split Dollar arrangement is a plan in which a life insurance policy's premium payments, cash values, and death benefit are split between two parties. It is a method of buying life insurance, not a reason for buying it.

These types of plans in various forms are used to help individuals minimize the income and gift taxes connected with the funding of large premiums and/or reduce the cash flow required to fund a much needed life insurance policy. They can be used by businesses as an executive benefit to encourage employees to remain with a company.

Although the 2003 Final Split Dollar Regulations (the "Final Regulations") changed the Split Dollar landscape in some important ways, a properly structured Split Dollar arrangement is a viable and important planning approach to consider. Plans implemented prior to 2003 must be carefully reviewed to ensure that there are no inadvertent tax consequences.

#### **Who can benefit from a Corporate Split Dollar arrangement?**

Any employee of a "C" corporation can benefit from a Split Dollar arrangement. Any non-owner employee of a pass-through entity can benefit from a split dollar arrangement. Split Dollar agreements are less effective for tax purposes for owners in a pass-through entity. However, Split Dollar arrangements are often implemented by owners for gift tax leverage when, for estate purposes, the policy will be owned by an irrevocable life insurance trust (ILIT) or other third party.



## **FAQ - Frequently Asked Questions (cont'd)**

### **What is the Economic Benefit Regime?**

Under the Economic Benefit Regime, the company owns the policy and endorses over a portion of the death benefit to the employee or his or her trust. The premium is split between the economic benefit portion of the premium and the balance of the premium. The economic benefit for income and gift tax purposes can be significantly lower at younger ages because it is based on the annual “term” cost of the death benefit and not the policy’s full premium.

### **What is Loan Regime?**

Under the Loan Regime, the employer makes a series of loans to the employee in order to pay premiums. Each loan will bear interest at the prevailing Applicable Federal Rate (AFR) or higher.

The employee is the owner of the policy with a collateral assignment made back to the employer to secure and repay the loan. The employee repays the loan either during lifetime using a portion of the policy’s net cash value and other available funds, or at death using the life insurance proceeds. The loan balance is equal to cumulative premiums paid in addition to capitalized loan interest, if any.

If the loan interest is forgiven each year by the employer, the employee includes the forgiven amount in his or her gross income. The employee is not taxed annually if the loan interest is paid or accrued.

Unlike a Split Dollar plan under the Economic Benefit Regime, a loan regime includes a loan interest component that is applied to the cumulative premiums paid instead of an economic benefit cost related to the death benefit.

### **Does a Split Dollar arrangement require an exit strategy?**

Yes, Split Dollar arrangements are a form of premium finance and, as such, require careful consideration of a lifetime exit plan. Eventually the economic benefit costs of an endorsement or non-equity arrangement may become prohibitive. Further, interest charges under the Loan Regime can become onerous. Also, if a policy is expected to generate significant equity the parties may wish to exit the plan before such equity arises in order to insure that such equity inures to the benefit of the employee or trust with minimal adverse tax consequences. Third-party premium financing and self-financing (e.g., as with switch dollar) may also be considered. In addition, zeroed-out grantor retained annuity trusts (zeroed-out GRATs), charitable lead trusts (CLTs), and FLP/LLC planning should all be considered as part of the overall insurance and estate plan.

### **When does a Split Dollar Rollout occur?**

A Split Dollar rollout occurs when the arrangement is terminated and the employer is repaid for its aggregate premium advances under the arrangement. A rollout often occurs at the employee’s retirement.

Unless the employee or other insured dies while the Split Dollar arrangement is in effect, the arrangement will eventually terminate as specified in the agreement between the parties, such as at the employee’s retirement. A lifetime exit strategy from a Split Dollar arrangement has traditionally been known as a “rollout”. The policy is transferred to the employee. The employer is repaid out of policy values or other employee assets. After the rollout, the employee may use dividends (when applicable) and paid-up additions to offset any further premium payments

## FAQ - Frequently Asked Questions (cont'd)

### Buy/Sell Agreements

#### **What is a Buy/Sell Agreement?**

A Buy/Sell Agreement is the centerpiece of any Buy/Sell Planning. It is a legally binding document that spells out what will happen to a business when a specific triggering event occurs, such as the death or disability of a business owner or shareholder. Other events typically covered include the resignation, retirement or termination of a shareholder or owner.

#### **What are the benefits of a Buy/Sell Agreement?**

The major benefit of a Buy/Sell Agreement is that it allows for the continuation of the business by providing for an agreed upon transition of the business. In addition to providing a ready market for the business, it can ensure that the price for both buyer and seller is a fair one. The agreed upon price can, in many instances, set the value of the business for estate planning purposes.

#### **Is the valuation of the company an important component of Buy/Sell Planning?**

Absolutely. One of the most important aspects of Buy/Sell Planning is determining a fair price for the business. Everyone should agree with that purchase price and the agreement should come before the triggering event. It allows the sales process to occur during a crisis without a conflict and also allows all parties to plan ahead with confidence.

#### **Can the business owner set the price of the business for Estate Tax purposes with a valuation?**

The IRS will value the business interest at its “fair market value.” According to Treasury Reg. Sec. 20.2031-3, that amount is defined as “the price at which property would change hands between a willing buyer and a willing seller – with both parties having reasonable knowledge of the relevant facts.” Although the IRS will not be bound by any agreement, in order for the business value to be “pegged” for tax purposes:

- The price must be either fixed or easily determinable by a formula
- The agreement must not be a device to simply pass business interests for less than fair value; it must be a true business agreement
- The obligation to sell must be binding during lifetime

#### **What is meant by a “Funded” Buy/Sell Agreement?**

While the Buy/Sell Agreement can provide the legal framework for the sale and transition of a business, it does not provide the cash needed to fund it. One of the most popular methods of funding a Buy/Sell Agreement is permanent life insurance. The majority of Buy/Sell Agreements funded with life insurance are either Entity or Cross Purchase Agreements. Other methods include Trusteed Cross Purchase and Wait and See Agreements.

## Authorization for Release of In-Force Policy Information

The information shall include, but not to be limited to:

- In-force illustration at current premium schedule
- In-force illustration showing minimum premium to endow
- Run 1. And 2. Above at a one point (100bps) reduction in current dividend scale
- Policy Summary reflecting policy values including issue date, face amount, issuing status (smoker/non-smoker), any loan information, etc.
- Policy cost basis

Policy Owner: \_\_\_\_\_,  
\_\_\_\_\_, Trustee  
SSN#/Tax ID#: \_\_\_\_\_

I hereby authorize \_\_\_\_\_ to obtain and/or verbally request information regarding my life insurance policy(s) listed below. The policy data collected may be reviewed and assessed by qualified personal consisting of medical, underwriting, and actuarial resources.

Insurance Carrier	Policy Number	Issue Date	Insured(s)/Date of Birth

This authorization shall be valid for six (6) months from the date below. I also understand that I may revoke this authorization at any time and that the revocation will take effect when my Representative receives my written request.

Please e-mail, if possible to: \_\_\_\_\_. If it can't be emailed then fax or mail to:

**Fax to:** \_\_\_\_\_ (fax)  
\_\_\_\_\_

**Mail to:** \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Owner (sign): \_\_\_\_\_ Owner (sign): \_\_\_\_\_

Owner (print): \_\_\_\_\_ Owner (print): \_\_\_\_\_

Signed on the \_\_\_\_ day of \_\_\_\_\_, \_\_\_\_\_ (year), at \_\_\_\_\_ (city/state)