



KEY PERSON LIFE INSURANCE

Overview

The most valuable asset to many companies is their key employees that really make the business profitable. Business owners normally insure many aspects of their business, and they should insure their key people as well.

How it Works?

- Company determines the value that each key person brings to the business (we have calculation tools to assist business owners)
- Company applies for life insurance and is the owner and beneficiary of the life insurance
- There is no tax deduction for key person life insurance premium payments, but the cash values are assets to the company
- The company may also use the life insurance as a vehicle to provide for a salary continuation or non-qualified deferred compensation arrangement
- Provides financial confidence to the business owner, fellow employees, customers, vendors and creditors

Planning Details

- Any type of life insurance may be used for key person protection
- Death proceeds are generally received by the company on a tax-free basis as long as the company complies with IRC Section 101(j) which requires notice and consent prior to policy procurement
- If the company is a C-Corporation, the death benefits may be subject to 20% tax as a preference item under the AMT calculation. This can often be provided for by just increasing the coverage.



KEY PERSON LIFE INSURANCE

Funding Permanent Versus Term

Male Age 69 Best Class

	Current Term	Individual Life
Option Type	15 Year Level Term (Current term has 14 Yrs. Remaining)	Universal Life at 4.75% Current Interest Rate
Company	John Hancock	TIAA-CREF (M Proprietary)
Initial Death Benefit	\$3,000,000	
Annual Premium	\$31,480	\$57,831
Premiums for 14 Yrs.	\$440,720	\$809,634
Less the cost of keeping current coverage in force for 14 years	-\$440,720	-\$440,720
Additional cost of permanent insurance	\$0	\$368,914
Cash Value Year 14	\$0	\$397,262
Less the additional cost of permanent insurance	\$0	-\$368,914
NET GAIN YEAR 14		\$28,348

The cost of obtaining individual life coverage when the John Hancock term period ends (14 years) is \$161,950 annually. Term insurance is not an option. This is a hypothetical number based upon actual insurance rates today. This is not a guarantee of future premiums.



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Determining Value

Keyperson Valuation Prepared for Sample Business	
METHOD 1: MULTIPLE OF COMPENSATION	
a. Total Compensation	\$600,000
b. Multiple of Compensation	4x
TOTAL KEY PERSON VALUE	\$2,400,000
METHOD 2: CONTRIBUTION TO PROFITS	
a. Average Gross Business Profit	\$5,000,000
b. Percentage Attributable to Key Person	25%
c. Months to Replace the Key Person	18
d. Months to Train	6
TOTAL KEY PERSON VALUE	\$2,500,000
METHOD 3: COST OF REPLACEMENT	
a. Recruiting Expenses	\$10,000
b. Training Expenses	\$5,000
c. Other Expenses	\$0
d. Months to Replace the Key Person	18
e. Months to Train	6
f. Compensation & Benefits for New Hire	\$650,000
g. Compensation Differential	\$50,000
h. Years for Compensation Differential	2
i. "Loss of Opportunity" Costs	\$2,500,000
TOTAL KEY PERSON VALUE	\$2,615,000



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Determining Value

Method 1 – Multiple of Compensation

Assumes that an employee's value is accurately reflected in his or her total compensation package. The "multiple" that is used (for example, 2x annual compensation) will depend on the type of business and the estimated difficulty in finding a qualified replacement.

Method 2 – Contribution to Profit

Estimates the impact a key employee has on the company's net profit. The firm first calculates the expected profit from a "normal" return on capital. Profit in excess of this normal return is assumed to result from the efforts of the key employees. An estimate is made of the percentage of profit attributable to each key employee and the percentage is multiplied by total excess profit, to determine the dollar amount of excess profit from each employee. This sum is then multiplied by the number of years needed to find and train a competent replacement.

Method 3 – Cost of Replacement

Totals the direct, out-of-pocket costs involved in finding, hiring and training a replacement, as well as the estimated "loss of opportunity" costs.

These calculations provide a rough estimate of a keyperson's value and are meant as a starting point for discussions with your client. Other factors should be considered, including geographic location, competition, and unique skills of the keyperson. This spreadsheet does not constitute tax or legal advice and full disclosure as to its hypothetical nature should be made to your client.



Disclosures

This is a hypothetical example for informational purposes only. The example provided is not representative of all clients' experiences and are not indicative of any future performance or results.

Illustrated pricing assumes indicated gender, smoking status, underwriting classes, issues ages, state of issue, interest rate assumptions, and in-force durations as specified in the presentation. To continue coverage beyond stated durations may require substantially higher premiums. Illustrated products and options shown based on product availability and pricing as of this date. Any product guarantees, including the death benefit, are subject to the claims paying ability of the issuing insurance company. This presentation is not complete without the accompanying illustrations. This information has been taken from sources, which we believe to be reliable, but there is no guarantee as to its accuracy. This material is intended for informational purposes only and should not be construed as legal or tax advice and is not intended to replace the advice of a qualified attorney, tax advisor or plan provider.

The policy values reflect current policy charges, current cost of insurance rates, current mortality and expense risk charges, average fund expenses and the stated hypothetical gross rate of return. The policy values are hypothetical for illustration purposes only. Loans and partial withdrawals will decrease the death benefit and cash value and may be subject to policy limitations and income tax.

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