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The Business Transfer Newsletter

Insuring Your Future Exit

Business owners are risk-takers by nature. Interestingly, however, is the fact that these same owners are often-times not risk averse. What this means is that owners will assume risks in one area of their lives, but not necessarily work to mitigate risks in other areas. The primary issue in not mitigating risks lies in the fact that there are a lot of people in your world who rely on you and the decisions that you make. This newsletter challenges the use of insurance in the singular manner of addressing a loss of life. In fact, insurance products are useful tools throughout the spectrum of advanced planning for a future exit. This newsletter is written with the intention of discussing risk mitigation and broadening owner's views on how and where insurance can ground and solidify your plans for a future exit, i.e. while you are still alive.

An Aleatory Business Contract

Let's begin by taking a look at insurance by starting with the concept of an 'aleatory contract'. Insurance policies are known as aleatory contracts. An aleatory contract is defined as "an agreement concerned with an uncertain event that provides for unequal transfer of value between the parties. Insurance policies are aleatory contracts because an insured can pay premiums for many years without sustaining a covered loss. Conversely, insureds sometimes pay relatively small premiums for a short period and then receive coverage for a substantial loss."

So the financial industry provides a marketplace to understand your business risks and allow you an opportunity to share those risks with another institution. In a limited sense it is a forecast of the future – in the case of insuring the loss of life, if the event / death that you are insuring occurs, you "win" and the insurance company pays. If the event does not occur, you don't necessarily lose because you have some peace of mind.

Insurance as an Asset Class

Insuring for the loss of life is only a small part of utilizing insurance in an exit plan. However many business owners fail to see the benefits of certain other forms of insurance. Insurance can serve as an asset class and a tool to harvest savings, share benefits and leave assets on your company balance sheet, as well as sharing an asset with key people to more easily retain them at your company. Most business owners, when thinking about planning for their exit, fail to see insurance as a tool for many facets of a transition plan.

Insurance as an Accumulation Asset for a Future Exit

Some typical goals of business owners who are thinking about a future exit, include:

- Having enough retirement income to sustain your lifestyle.
- Retaining key people and aligning incentives to grow the business

- Having a tax efficient transfer of wealth as the business changes hands.
- Avoiding complex tax code provisions inside of your key person incentive plan
- Providing a path for key people to potentially purchase the business interests from you, the owner.
- Having access to cash that is needed to run and grow the business.

Insurance contracts can serve as a 'funding solution' for the issues listed above. The primary goal of this newsletter is not to provide complex details of how this can work, but rather to help to re-conceptualize the role that insurance can play in your future plans.

Remember that insurance is a unique asset in many respects, not the least of which is the ability to harvest tax benefits, provide disciplined savings with your planning, and to customize an agreement that retains your key people.

Solving or Not Solving for Death

As mentioned, business owners too often view the purchase of insurance only as a vehicle to deliver needed cash in the event of a death. The use of funds is often to replace business income or to fund family needs and / or estate taxes. Many business owners hold contracts that are set to address these contingencies.

However, there is another way to look at insurance: as a tax-efficient, forced savings plan for you, your company, and your key people. In this case, the purpose of insurance is not necessarily to anticipate a death and for cash to be provided at the time of death. Rather, this form of insurance is for cash accumulation, either within the company or held outside of the business.

Overcoming Immortality

One of the reasons that insurance is looked down upon as an effective tool for exit planning is because many owners have survived against insurmountable odds to grow their business. Also, there is the uncomfortable issue of dealing with death. However, when insurance is viewed in more broad terms as a tool to accomplish many goals while you continue to grow your business and make plans for a future exit, the options and alternative uses begin to grow.

Concluding Thoughts

For better or for worse, it is often said that insurance is something that is sold, not purchased. In other words, the use of insurance in an exit plan has historically required a sales process in which a purchaser of insurance needs to see a vision of what could happen to their lives without insurance. This newsletter is written with the intention of moving business owners in a direction where a desire to learn about and utilize certain forms of insurance is something that is 'purchased' for the benefit of you and your company, and not something that needs to be 'sold'.

Cathey Paine is a registered representative of Lincoln Financial Advisors Corp.

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