

BUSINESS SUCCESSION PLANNING

Case Study Series



Client profile:

- Large commercial construction contractor
- Growing company with positive cash flow
- Existing client of property casualty agency

Ownership:

Four key employees, ages 47, 58, 64 and 72, have just paid \$8 million to a non-working owner to purchase the company. Each now holds an equal share in the company and expects to pay off the purchase price within three to four years.

The situation:

While conducting an annual review, the commercial insurance producer asked the owners about succession planning. The owners felt a \$1 million term policy for each owner would satisfy their buy-sell coverage needs because of the company's already strong cash flow. To assist, the producer brought in the Cincinnati Life Advanced Markets team.

The problem:

While analyzing the company's stock redemption situation, the Advanced Markets team found that no formal buy-sell arrangement was in place. According to the operating agreement:

- Company shares must be redeemed or purchased at the death or retirement of any owner.
- Any debt resulting from ownership transfer must be repaid within seven years.
- The total value of unpaid obligations would fluctuate annually with the current year's valuation.
- Cash flow could be impacted negatively if more than one death or retirement occurred within a short period of time.
- Living owners could structure distribution of profits in such a way to reduce the value of outstanding shares, creating uncertainty and potential volatility for both existing owners and the retiree or heirs.

The solutions presented:

After the owners understood the potential effect an underfunded agreement could have on the business, all agreed to a fully funded arrangement. The producer presented two options:

1. The three older owners purchase 10-year term policies for \$2 million each; the youngest, a 20-year term policy for \$2 million. The total annual premium would be \$67,220.
2. Each owner purchases both a \$1 million term policy and a \$1 million 10-pay whole life policy with a Chronic Illness Rider on each owner. The total annual premium would be \$33,760 for the term policies and \$227,830 for the whole life policies.

The decision:

The clients chose the second option because the:

- guaranteed cash value of the whole life policies at the end of the 10-pay premium payment period would exceed the amount of premium paid by \$79,168.
- cash value also could be used to pay obligations resulting from triggers to the agreement, such as disability, termination or retirement.
- Chronic Illness Rider allows the remaining owners access to most of the death benefit if the insured is diagnosed as being chronically ill as defined in the rider.
- paid-up policies can be transferred to the insureds for individual planning needs if they are no longer needed by the company.

The takeaways:

- The producer discovered what the owners needed by asking questions about the current business succession plans, then immediately contacted the Cincinnati Life Advanced Markets team.
- The producer and Cincinnati Life team were able to craft a solution for an issue the clients did not realize existed within their current operating agreement.
- The producer helped manage both life and commercial risks for the owners, hopefully ensuring they remain long-term clients.



Everything Insurance Should Be®

This is not a policy. This example is for educational purposes only. For a complete statement of the coverages and exclusions, please see the policy contract. All applicants are subject to underwriting approval. Products and riders available in most states.

Do not reproduce, post online or otherwise reuse this work, in whole or in part, without written permission. © 2019 The Cincinnati Life Insurance Company. 6200 S. Gilmore Road, Fairfield, OH 45014-5141. Mailing address: P.O. Box 145496, Cincinnati, OH 45250-5496.