

An Introduction to Business Protection



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Objectives

- Why write Business Protection?
- What is Business Protection?
- Understanding keyperson protection
- Understanding loan protection
- Understanding partnership/shareholder protection
- Marketing and distribution opportunities

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Protection: the opportunity

- There are 148,000 SMEs in Singapore*
- SMEs account for around 99% of all Singapore enterprises**
- 6 out of 10 employees in Singapore are employed by SMEs**
- Multiple sales by understanding how to promote – keyperson, loan and shareholder protection

*Source SME development survey 2007

** Source SPRING

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SMEs in Singapore

- Defined as:
 - Having 30% local equity
 - Fixed productive assets of \$15 million
 - Less than 200 employees
- Multiple government schemes to promote start up and growth:

Microloan, SPRING SEEDS, Enterprise Investment Incentive, Business Angel Scheme, Loan Insurance Scheme, Growth Financing Programme, Local Enterprise Finance Scheme, Internationalisation Finance Scheme, Trade Credit Insurance Programme, The Enterprise Fund

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SMEs in General

- SMEs are highly aware of the need to secure their financial future but do not have any plans on how to achieve this*
- 44% of business owners said their businesses would fold within 12 months of the death or critical illness of a key person and 50% of the business had corporate debts with only 46% of them having death or critical illness cover in place**
- Key challenges include insufficient cash flow, financing and manpower issues which include hiring, developing and retaining key staff

*Swiss Re Survey of Risk Appetite – Asia Pacific 2009

** L&G 2009

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The need for protection – the facts

The question is.....?

Why worry?	Impact	Covered?
Office equipment	Med	Yes
Office building	Med	Yes
Loan recalled	High	No
Loss of key employee	High	No
Loss of partners	High	No
Loss of lap top	Med	Yes

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Did you know....?

→ You are 5 times more likely to suffer a critical illness than to die before retirement

→ 1 in 4 men and 1 in 5 women will contract one of the illnesses covered by a standard critical illness product before they reach age 65

→ Many critical illness victims make a full recovery after a lengthy and expensive treatment period

Sources: telegraph.co.uk 2009;
life-assurance-bureau.co.uk 2010;
bhfinancialservices.com 2010

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What is business protection?

- Keyperson – protecting a business for the loss of a key employee
- Loan Protection – enables the business to repay any loans/debts
- Partnership/shareholder protection – protecting the surviving partners/shareholders

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Keyperson protection

‘An individual whose knowledge, creativity, inspiration, reputation and/or skills are critical to the viability or growth of an organisation and whose loss may cripple it’

Business Dictionary.com

- Top sales person
- Technical expert
- Project leader
- Precision engineer, fashion designer etc

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Business risk (1)

Impact of loss of keyperson through death or critical illness:

- Loss of profits:
 - Loss of confidence in the business
 - Loss of competitive edge
 - Major projects delayed or not completed
 - Withdrawal of credit facilities
 - Monies to recruit or train a replacement

Worst case scenario – insolvency and liability for outstanding debts

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A keyperson example

Scenario

Helen is head of sales for a graphic design firm, Design for Success. She has a wealth of sales experience, a good reputation with all the company's customers and unrivalled negotiating skills. She is key to the business and receives a generous salary and package in recognition of this. Unfortunately Helen suffers a stroke which leaves her severely paralysed and unable to return to work.

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A keyperson example

Without keyperson protection in place..

- Sales revenue decreases significantly
- Cash flow severely disrupted
- Strain on company finances
- Difficulty finding money to recruit
- Business deteriorates and could be forced into liquidation

With keyperson protection in place..

- Design for Success took out a life or earlier critical illness plan equivalent to 5 x Helen's annual salary
- Helen's condition was one of those covered by the policy's definition of critical illness
- Company claims the payment
- Money available to recruit and smooth the cash flow pressures whilst other initiatives are designed to minimise any fall in profits resulting from her disability

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Keyperson – product solution

- Life and critical illness assurance can provide the business with financial compensation
- Term Assurance most common product used
- Term is determined by how long the individual will remain key to the profitability of the business

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Calculating cover - keyperson

- **Must reflect financial loss of keyperson**
- **Business must be able to justify the amount of cover and how calculated**
- Loss of profits:
 - Net profit – 5 x the average net profit over the last 3 years
 - Gross profit – 2 x average gross profit over last 3 years
 - Consideration given to companies in expansion phase
- Contribution to profit:
 - Keypersons remuneration/ total salary bill x gross profit x expected total recovery period in years
- Multiple of remuneration:
 - Total of remuneration x to a maximum of 10
 - Lower multiple if easier to replace eg accountant 5 x as opposed to fashion designer 10 x

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Calculating cover – keyperson - example

- **Gross profit \$10 million**
- **Net profit \$200,000**
- **Key person salary \$100,000 – top sales person**
- **Total salary bill \$4 million**
- **Recovery of company would take 3 years**
- **Loss of profits:**
 - $\$200,000 \times 5 = \1 million
- **Contribution to profit:**
 - $\$100,000 / \$4 \text{ million} \times \$10 \text{ million} \times 3 \text{ years} = \$750,000$
- **Multiple of remuneration:**
 - $\$100,000 \times 10 = \1 million

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Calculating cover – keyperson - example

- Keyperson age 40 (Helen)
- \$750,000
- Estimated premium = \$127 per month
- Total cost to the company over 20 years = \$30,480 OR 4% of the life cover

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Setting up the keyperson plan

- Cover should be set up on 'Life of Another' basis
 - Keyperson is life assured, business owns the plan
- Sum assured paid to company
- No trust documentation required

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Taxation summary - keyperson cover

- Tax relief available in respect of premiums paid if the following conditions are met:
 - The insured must be a key person associated with the business
 - Policy must insure against loss of profit, not against the capital structure of the company
 - Sum assured must be directly related to the profits attributable to the key person
 - The insured does not own a substantial shareholding in the company
 - The insured must not be a sole trader or majority partner in a partnership
 - Policy must have no surrender value = term assurance

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Loan protection

A company may need to obtain finance for various reasons (expansion, product development, recruitment)

- Commercial Loans:
 - Loss of keyperson may effect loan repayments
 - Bank may recall the loan at inopportune time
- Solution:
 - Keyperson term assurance for value of loan and for term of loan = security
 - Policy owned by the company

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Loan protection

A company may need to obtain finance for various reasons
(expansion, product development, recruitment)

- Directors loan
 - Director loans personal money to the business on unsecured basis
 - Loss or critical illness of director – family would want the loan repaid to them = strain on finances
- Solution:
 - Term assurance for value of loan
 - Policy owned by the company

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Loan protection

A company may need to obtain finance for various reasons (expansion, product development, recruitment)

- Personal Guarantees
 - Director gives a guarantee that in event of insufficient funds being available in the company – they will cover the remainder
 - Loss or critical illness of director – family would have to find funds if loan recalled from their own finances
- Solution:
 - Term assurance for value of loan
 - Policy in name of director with trust documentation to company

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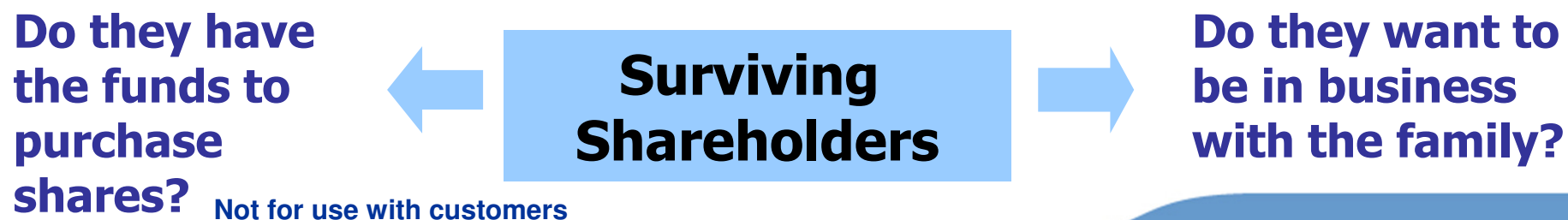
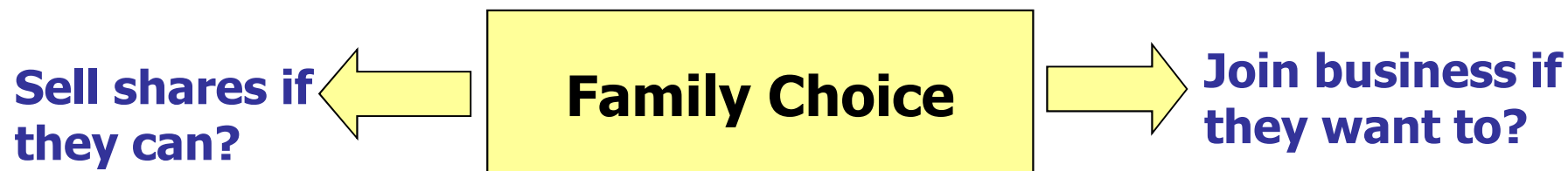
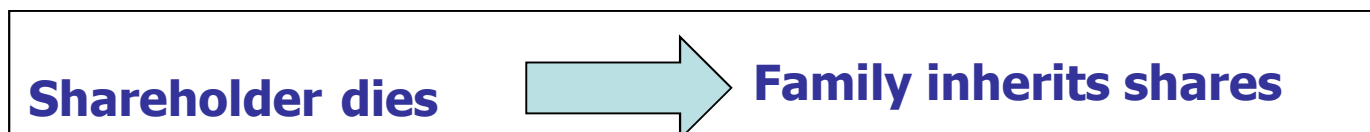
Partnership & Shareholder protection

‘The right money in the right hands at the right time’

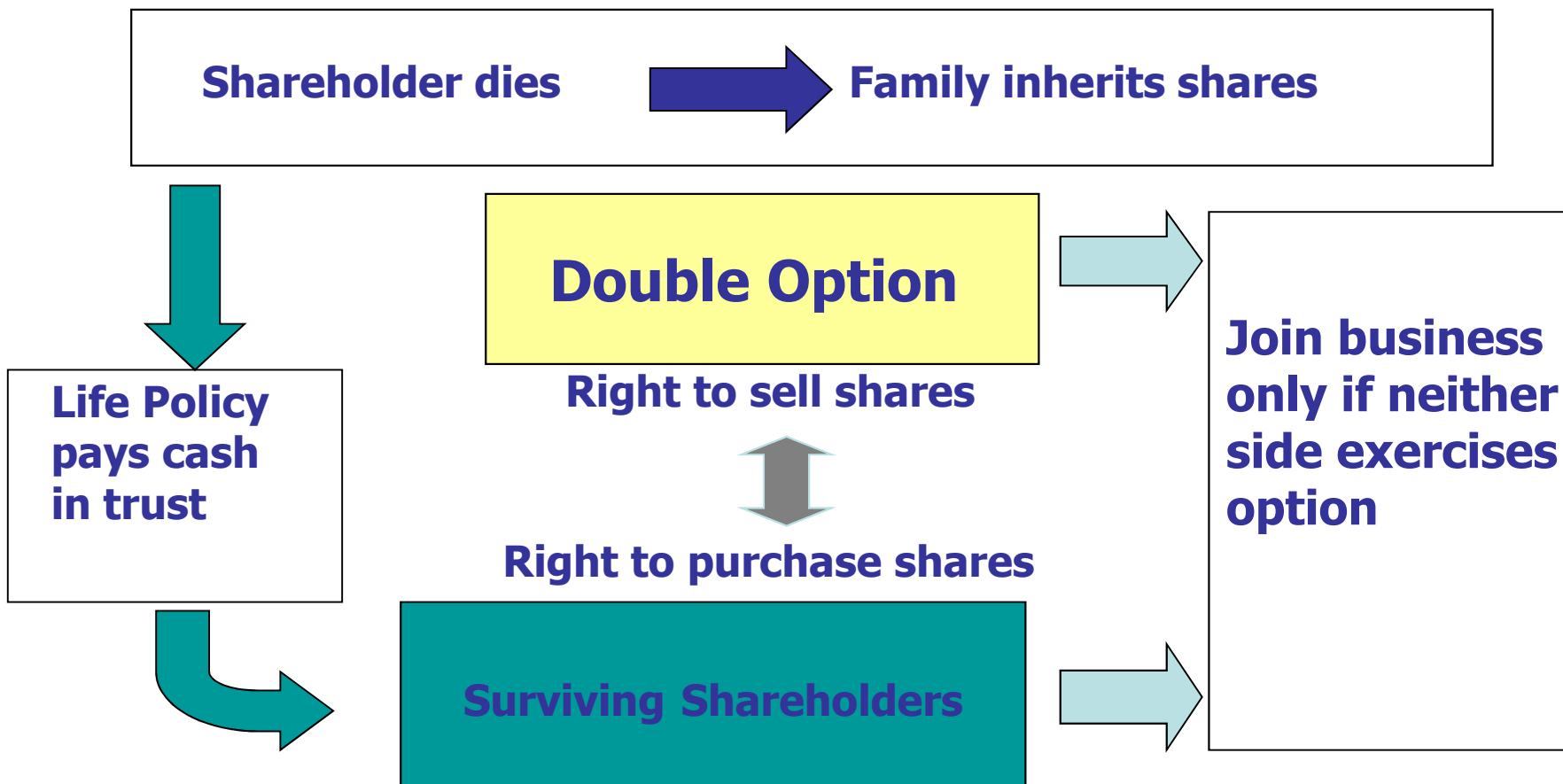
- Ensure, when partner leaves through any cause, the remaining partners are able to continue the business, whilst maintaining control, and without undue financial strain
- Ensure when a partner leaves the business their family is adequately provided for

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Without Business Protection



With Business Protection



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Amount of Cover

Partnership

- Value of Shares & other business assets
- Goodwill (if in the Accounts)
- Undistributed profits

Ltd Co

- Value of Shareholding
- Report & Accounts
- View of Accountant/Solicitor

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Life Policy

Own life under trust

- Term Assurance written to expected retirement age
- Whole of Life
- Critical Illness
- Business Trust
 - Allows for change/new partners
 - Or assignment of policy to partner on leaving/retirement
- Flexible Trust
 - Flexibility to distribute surplus to family members

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Share Purchase: Buy & Sell Agreement

Consists of the life insurance plan and an underlying legal agreement:

- Executors will sell business share to surviving shareholders
- Partners will buy the deceased's share
- Life policy provides proceeds to pay family

- Own life plan
- Under trust for benefit of remaining partners
- Care needed with tax implications

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Share Purchase: Automatic Accrual Agreement

- Only applies to partnerships
- On death shares pass to surviving partners without payment
- Partners each take out life cover for family protection to 'compensate' for the lack of payment for the shares

- Own life plan
- Bare trust or discretionary trust for benefit of immediate family
- On death if plan proceeds are less than value of partnership, the surviving partners will make payment to deceased estate for any excess
- Generally free of IHT, income tax and capital gains tax

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Share Purchase: Double Option Agreement

Incorporated into partnership agreement:

- Partners have **option** to buy within specified time period
- Estate has **duty** not to sell to another party and an **option to insist** on purchase by surviving partners
- One party exercises then other must comply
- Neither party exercises option – shares remain with family

- Own life
- Business trust for remaining partners

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Premium Payment

Partnership:

- Usually paid by each individual
- Partnership could pay

Ltd Company:

- Often Company pays
- Director could pay from net pay
- May need to 'balance' for uneven premiums
- Consider salaries tax implications

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Equalising Premiums - Example

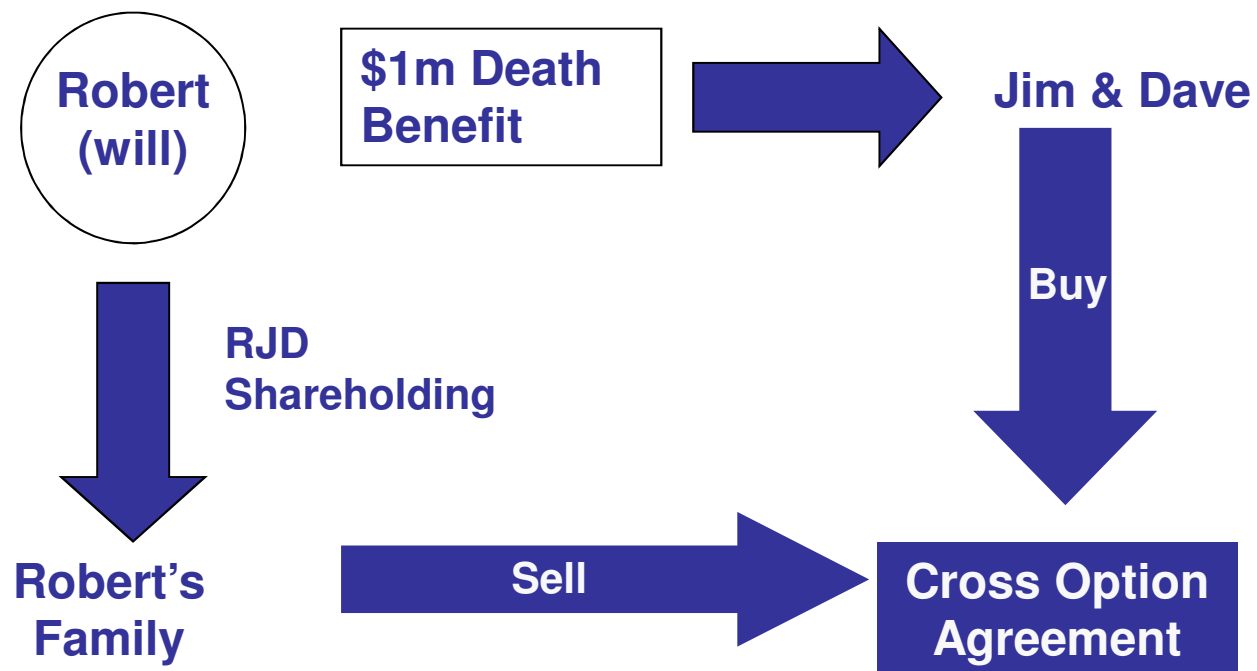
- RJD Ltd – worth \$3m
- 3 director shareholders
- Each effects a term assurance plan for \$1m
- Term is to age 60
- They write the plans under trust

Robert – 46:	\$275.78 per month
Jim – 40:	\$212.52 per month
<u>Dave – 38:</u>	<u>\$197.20 per month</u>
Average premium:	\$228.50 per month

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Example

- 5 years later Robert dies after an accident:



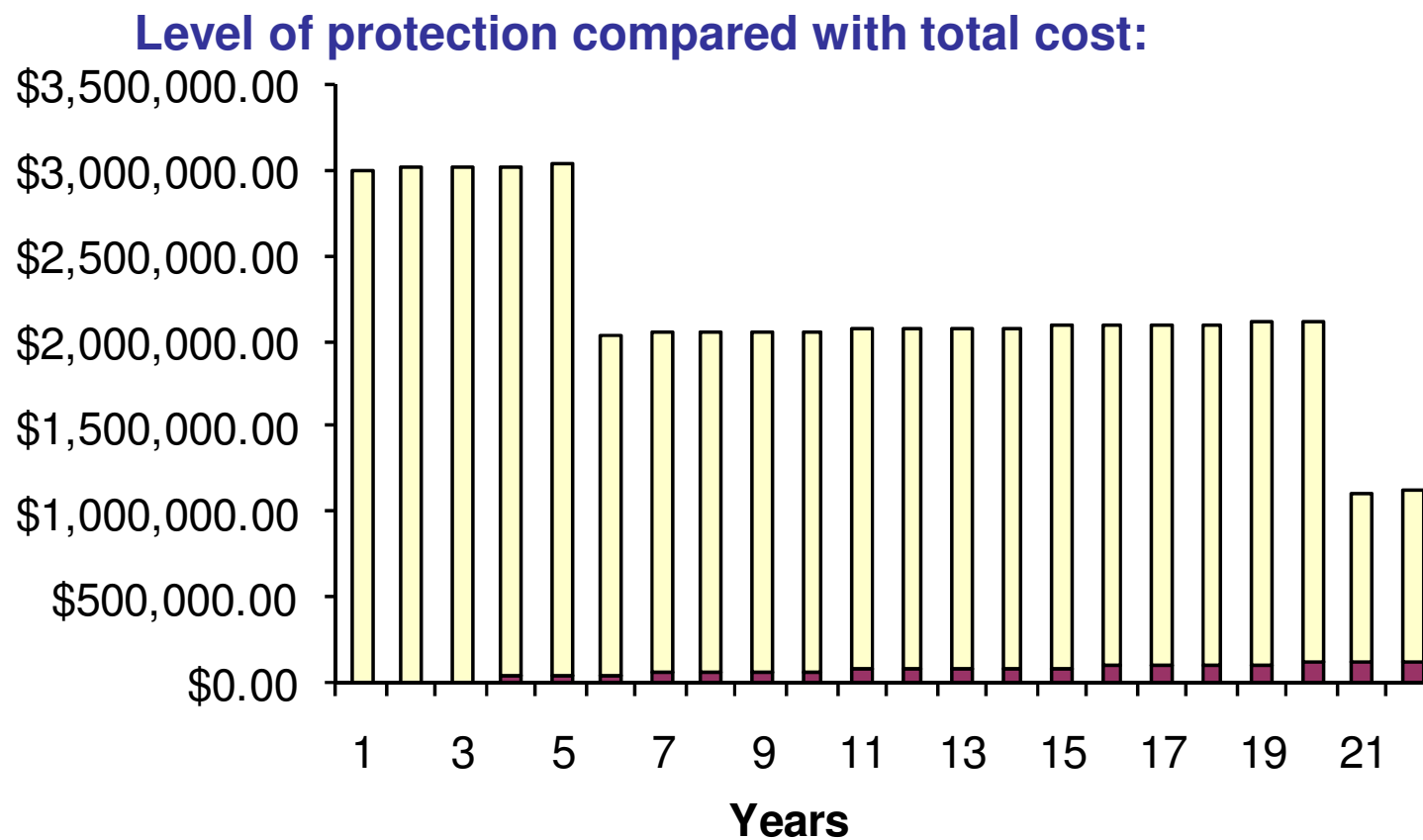
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Example

- Remaining directors can continue with the business without interference
- Robert's family gains financial independence
- At time of claim total outlay would have been 4.1% of the death benefit paid
- Premiums now fall to \$409.72 per month
- When Jim retires, premiums drop to \$197.20 per month

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Example



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Combining with Regular Savings

- Partners could also effect savings plan each
- Build up a fund to buy others out if they retire
- Make subject to beneficiary nomination in favour of family

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Target clients, key questions

- Could the company survive the loss of it's 'driving force'?
- Who contributes most of the profit to the company?
- How long would the business survive without this person?
- What strategies do you have for succession planning/ recruitment/retirement?
- Are there any outstanding loans or finance?
- Would you want your family left with the responsibility of running your company?



Choose the package that best suits your clients' needs

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Recommending protection - Key considerations

- Does the product provide cover whilst at work or travelling?
- Is it affected by changes in residency or personal circumstance?
- Does it cover a wide range of illnesses?
- What is the company's claims rate?
- Are the premiums fixed, guaranteed, renewable or escalating?



Choose the package that best suits your clients' needs

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Business Protection – reaching the market

- SME group memberships – presentations at conferences, AGMs etc
- Bank distribution
- Direct marketing – website advertising
- Utilising existing client banks
- Concentrate on specific trades – specialise
- Cross sell with general insurance products

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In Summary – business protection

- Massively under insured market
- Excellent way to gain other business
 - retirement planning
 - savings
 - management of directors' personal wealth

Important Notes

Any personal tax liability will depend on your clients' country of residence and their personal circumstances.

The information given in this presentation is based on current Singapore and UK law and taxation practice, which may change in the future. No liability can be accepted for any personal tax consequences or for the effect of future tax or legislative changes.

Tax legislation may change.

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Protection: The opportunity

