Sales Insights

Information and Ideas You Can Use

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RopTerm and Key Employees

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One big problem with selling Key Employee coverage in small to mid-size business is getting the owner to admit they have key employees. Ask the owner and they will tell you the only key employee is ME. Those people working for me are more trouble than they are worth or something to that effect. So how do you identify who's key in the business?

Some times you have to ask a different way. Give the owner a pen and paper and ask him to write down the names of employees that if they left to join his nearest competitor the company income would decline by at least 10 percent. Or your expenses would go up by at least 10 percent. These are your key employees. Now look at the list, then hand it back to the owner and ask: "What if they get hit by a bus tomorrow?"

"I have a program to help you with both the bus, and the competitor. It's called key employee insurance." The bus is easier to handle than the competitor, but we may be able to help with both in one deal.

The bus can be handled by term insurance that is owned by the business so if something happens to a key employee it will provide MONEY to the company that can be used to hire and train a replacement. It's also extra cash to fall back on until that new employee is really into the job.

But you can also use the insurance to provide a long-term incentive for that key employee to stay with the company. In the past this was done using cash value life insurance. But the cost of the plan was such that it could only be used for high-end key employees. Plus the guarantees were not so good, and there was still an element of "trust me" in a plan using current cash values. But now there is an alternative that is lower in cost but higher in guarantees, so all key employees may be covered.

It's called Return of Premium term. The company gets death benefit coverage for a key employee for a period of 15, 20, or 30 years. The employer may design a plan that at the end of that period the employee is paid a lump sum bonus equal to the return of premium, if they stay with the company. The company can't take a deduction for the premium paid along the way, since the company gets the death benefit - tax free - if the key employee dies, but they can get a deduction for the bonus they pay at the end. Plus the insurance company provides the money by way of the return of premium to pay the bonus. The down side is the employee pays taxes on the bonus when they get it. But the employer could take some of the savings of their deduction and double bonus the employee, and pay the tax for them. Remember we are talking 15, 20 or 30 years from now, so who knows what the tax rates will be? So the company gets years of insurance protection, gives the employee a bonus for staying all those years, takes a deduction for the bonus, the money to pay the bonus is paid by the insurance company - tax free - to the employer, and unless the employee dies before the end of the period the money is guaranteed to be there when needed, no matter what. A corporate resolution awarding the bonus is recommended to help ensure this favorable tax treatment. What's not to like? Plus, we're not done. Checkout the example on the next page.

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ROP*TERM* AND KEY EMPLOYEES (CONTINUED)

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An example. The company has a 50-year-old executive who is a preferred plus non-smoker. The company buys $250,000 of 15-year term (taking him to 65). They also promise to pay a bonus equal to all the premium paid if the employee stays to 65. Note the key employee gets nothing if he leaves early. The premium is $1,767.50 (secure a board resolution). That means the return of premium (and the bonus) at age 65 will be $26,512.50.

In 15 years the insurance company will pay the business, as the policy owner, $26,512.50 as the return of premium - which is NOT taxable income to the company. The company in turn pays the $26,512.50 to the employee as a bonus and takes a deduction for it (assuming it is reasonable compensation). The employee will have to pay taxes on the bonus, but the company could use some of their tax savings and increase the bonus by the amount of the taxes covering the taxes for the employee (called a double bonus). This works best when the corporate taxes are higher than the individual tax rate. This is the simple version of the program.

However, we're not done. There are more options to this deal.

Instead of paying the bonus in cash the company could actually "bonus" the ROP policy itself to the employee by changing the ownership of the policy. From a tax standpoint the results are the same. The company still gets the same deductions and the employee still pays taxes on the ROP value. But the employee now has options to keep the insurance in force on their life after retirement and name their own beneficiaries.

Once the employee is the owner of the policy the following options are available:

1. Take the ROP money and let the policy lapse.

2. Take the money but keep the policy at the A.R.T. rates - this is if they are in really poor health and have limited life expectancy.

3. An AIG American General exclusive - take a reduced paid up life policy. Though technically a non forfeiture option, that negative can be a positive in the right circumstance. Amount is guaranteed.

4. Convert all or part of the term coverage to a cash value plan, maybe even on a single premium basis. Can use the ROP money to pay future COIs in the new policy - use same money twice!

The rate class locks in at preferred plus under the current conversion rules, even if the insured's health changes. Yes, we understand that our 15-year ROP term plan is higher priced than some others in the market. But part of the idea of an ROP business case is to move money from today to some point in the future on a guaranteed basis and also from the business to the individual. Remember, you get what you pay for and with AIG you get the highest rated company selling ROP*Term* in the market today. Finally all of these options at the end of the level period - when the ROP is paid - are available to both business and individual cases.

Ask us about using ROP*Term* in an endorsement split dollar case…..

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