A GUIDE TO INSURANCE-BASED

KEY PERSON SOLUTIONS

Protect a business owner's most valuable asset: people.

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THE POWER OF PEOPLE

"Take away my people, but leave my factories, and soon grass will grow on the factory floors. Take away my factories, but leave my people, and soon we will have a new and better factory."
– Andrew Carnegie

Ask any business owner, "What's your most valuable asset?" The answer will almost always be "my employees."

With unemployment at an all-time low, today's employers are facing an extremely competitive job market. Top talent is in high demand, and competitors aren't afraid of poaching good people from their competition.

And, since people are the driving factor behind success in any industry, any good business owner will want to keep and protect their best. Especially those who are an integral part of their business's success.

It comes as no surprise then, that the most in-demand advanced planning request is key person retention solutions.* Business owners are ready to take the next step and take control of the employment market. To quote one business owner, "I'm tired of losing my best employees to competitors."

*Based on 2½ years of phone call data from Ash Brokerage

IN THIS GUIDE

YOU HOLD THE KEYS

Key person plans don't have to be complicated. The best plans are simple. In fact, business owners are most likely to implement a solution when it is:

- Easy to understand
- Easy to implement
- Easy to explain to the employee

Your job is to keep it easy. You don't need to be a business planning expert to help business owners reach their goals. The solutions outlined in this guide are within reach for any financial professional. You simply have to be willing to ask the right questions of your business owner clients.

- Would your business be impacted if any particular employees left? Who are those key people?
- Would you be willing to create a plan to retain those employees and keep them from working for your competitors?
- What's more important to you in planning: Tax advantages or control of your assets?
- Would you be willing to take on a small amount of plan administration to protect your business?

These solutions can help you develop new relationships or deepen existing ones. Key person plans are especially important if you've already helped an owner with business valuation or succession planning – this is the natural next step to protect their business.

THE POWER OF LIFE INSURANCE

All four of the plans in this guide are designed around life insurance because it creates significant advantages for both the business and the employee.

POTENTIAL ADVANTAGES FOR BUSINESSES

- Leverage of a predictable, repeatable rate of return
- Tax-deferred growth of cash value
- Tax-free death benefit*

POTENTIAL ADVANTAGES FOR EMPLOYEES

- More valuable than cash bonuses – protection for loved ones or supplemental retirement savings
- Tax-deferred growth of cash value
- Tax-free death benefit for beneficiaries

More importantly, life insurance helps meet the business owner's three biggest requirements: Easy to understand, easy to implement and easy to explain.

TURN THE KEY

This guide will walk you through four key person solutions with considerations for each – control, taxation and implementation. They're listed in order of complexity and retention power – essentially, as administrative requirements increase, so does the incentive for the employee to stay with the business.

Your business owner clients will need to decide which factors are most important to them and their company. That's where you come in. As you'll see, you don't need to be a tax planner or lawyer to offer any of these concepts – you simply need to be willing to ask the right questions.

1 2 3 4

*If the business meets all requirements of §101(j)

1 KEY PERSON PLUS

HOW IT WORKS

The focus of this plan is to protect the business in the event of a key employee's unexpected death. The business purchases a cash value life insurance policy on the life of a non-owner key employee – the business is the owner, premium payer and beneficiary of the policy. Should the employee die before retirement, the business receives a lump-sum of capital to cover resulting costs, i.e., the costs of locating, hiring or training a replacement.

This plan is called Key Person *Plus* because the owner has the option to expand upon the concept by:

- Paying some of the death benefit to the employee's family in the event of pre-retirement death
- Transferring the policy to the employee as a bonus upon retirement (when the business will no longer need the key person death benefit)

This plan is ideal for tight-knit businesses where the employee feels like they're truly a part of the owner's family – their relationship runs deeper than employment. Both the owner and employee must feel comfortable having no formal agreement in place. While the employer has the option, they are not obligated to share any of the death benefit or transfer the policy at retirement.

KEY CONSIDERATIONS

CONTROL

The owner maintains complete control of this plan. The employee and their family have no legal rights to the policy or its death benefit unless the employer chooses to transfer the policy as a bonus upon retirement. So this plan is better for rewarding loyalty than creating retention.

TAXATION

Business

- Premium payments are not tax deductible
- The death benefit is received tax-free so long as the business meets the Notice and Consent requirements of IRC §101(j)
- Any pre-retirement death benefit paid to the amily would be deductible to the business as a compensation expense

Employee

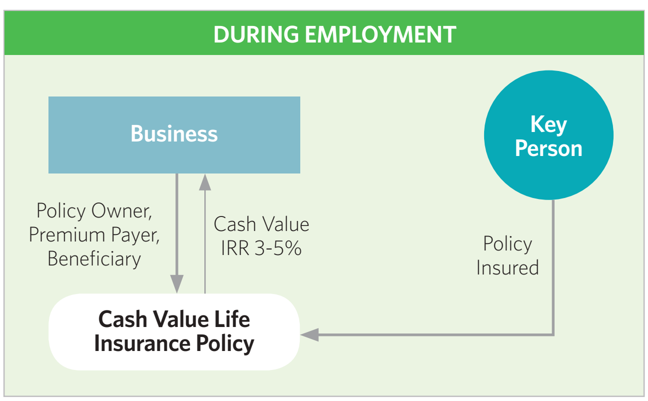
- Premium payments are not considered taxable compensation
- Any pre-retirement death benefit paid to the family by the business would be subject to income tax

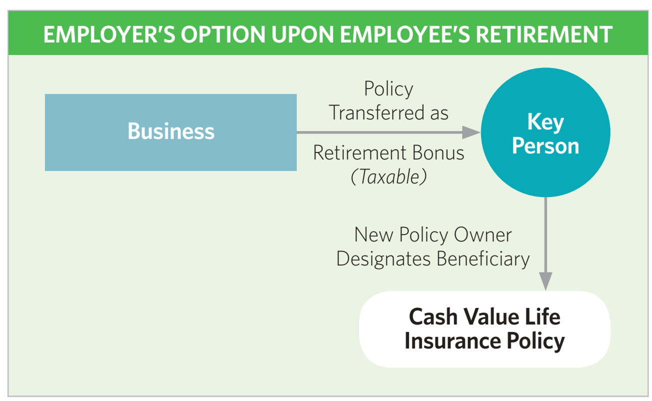
IMPLEMENTATION

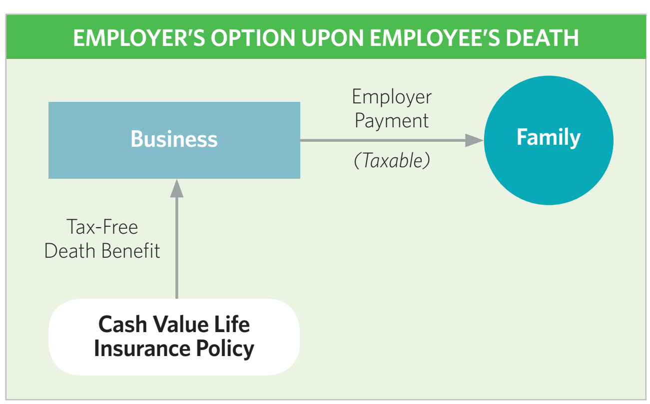
Extremely simple to implement – business must follow the Notice and Consent requirements of IRC §101(j).

About IRC §101(j)

- Requires businesses to notify and obtain consent from individuals to purchase a life insurance policy on their life, and to properly report the policies on tax returns
- See "A Guide to IRC §101(j) Compliance: Avoiding Potential Taxation of Employer-Owned Life Insurance" for more details







2 RESTRICTED BONUS

HOW IT WORKS

The business agrees to make annual contributions to a cash value life insurance policy owned by the employee, who agrees to stay with the business for a set number of years. When that time comes, the employee gains full access to the policy and its cash value. Should the employee not fulfill the agreement, the business can recover its contributions.

To make this plan work, you need three planning tools:

01	A Section 162 bonus agreement
02	A life insurance policy with a restrictive endorsement
03	An employment contract

Bonus Agreement

This is often referred to as a Section 162 bonus agreement because IRC §162 allows the business to deduct the bonus amount paid to the employee as an "ordinary and necessary business expense," i.e., reasonable compensation.

Restrictive Endorsement

The life insurance policy will include a restrictive endorsement contract, which is provided by the carrier. This limits the employee's rights to the insurance policy during the contract period, creating an incentive for the employee to stay with the company and fulfill the agreement. Typically, the endorsement will restrict the employee's rights to surrender the policy, take loans, withdraw cash value, etc. However, the employee retains the right to change their beneficiary.

Employment Contract

This contract allows the business to recover the value of contributions should the employee quit or be terminated prior to their agreed-upon length of employment. A vesting schedule can be created to determine the amount and timeline.

KEY CONSIDERATIONS

CONTROL

Under this plan, control shifts to the employee. However, the business creates a stronger incentive for the employee to stay, and measures are in place to protect the business.

TAXATION

Business

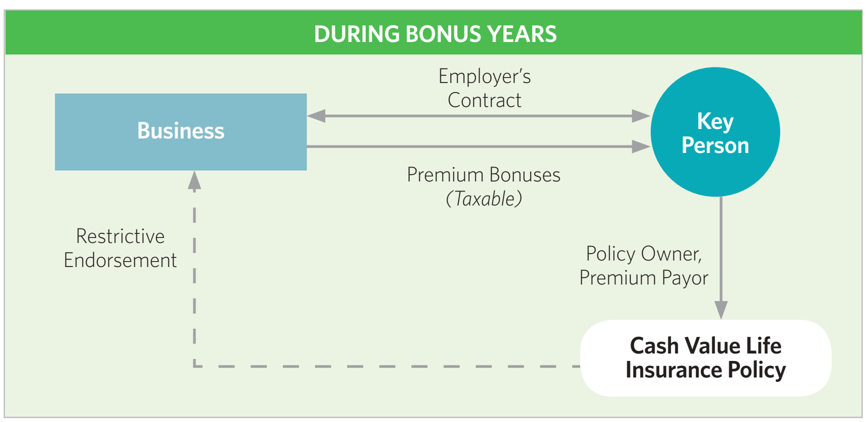
- Premiums are a tax-deductible expense considered compensation for the employee
- This is an attractive benefit to business owners – many are willing to give up policy ownership for a tax advantage

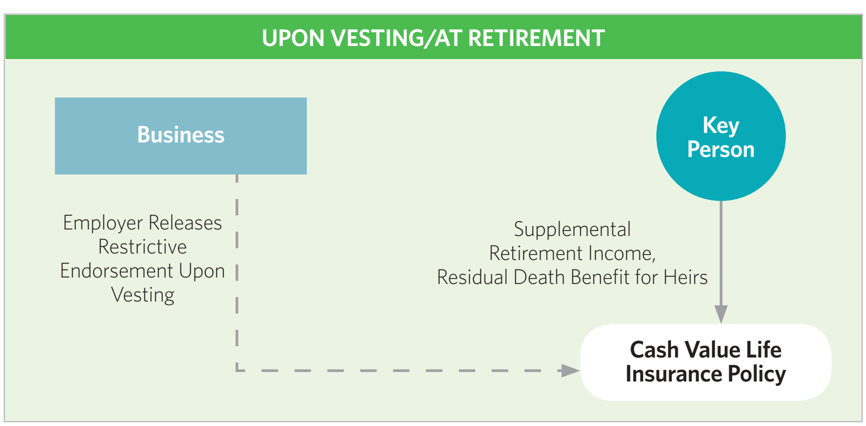
Employee

- The premium is considered taxable compensation, and the employee could incur an out-of-pocket expense if the business does not "gross up" the bonus to cover the taxes due
- Should the employee pass away, their beneficiaries receive a tax-free death benefit

IMPLEMENTATION

This plan is simple to create and execute – life insurance carriers help with necessary administration. There are no Employee Retirement Income Security Act (ERISA) requirements, and the owner can pick and choose which employees receive the bonus.





3 LUMP-SUM DEFERRED BONUS

HOW IT WORKS

The business owner selects a non-owner key employee to receive a lump-sum bonus after remaining employed for a certain number of years. During that time, the business pays premiums on a cash value life insurance policy, which can then be used as a fund to pay some or all of the promised bonus. The policy is owned by the business but insures the life of the employee, and can be designed to create leverage for the bonus amount.

The death benefit also comes into consideration. During the agreement period, the business can endorse a portion of the death benefit to the employee's family for income protection, should the employee pass away unexpectedly. The business can use the remaining death benefit to help find, hire or train a replacement.

The business and employee enter into two separate agreements:

01	A bonus agreement that specifies the employment period and deferred bonus amount
02	An endorsement split-dollar agreement that designates a portion of the death benefit to the employee's beneficiaries

KEY CONSIDERATIONS

CONTROL

The business retains control of the policy and creates a strong retention incentive. At the end of the agreement, the business may choose to surrender the contract or transfer ownership to the employee as part of the promised bonus payment.

TAXATION

Business

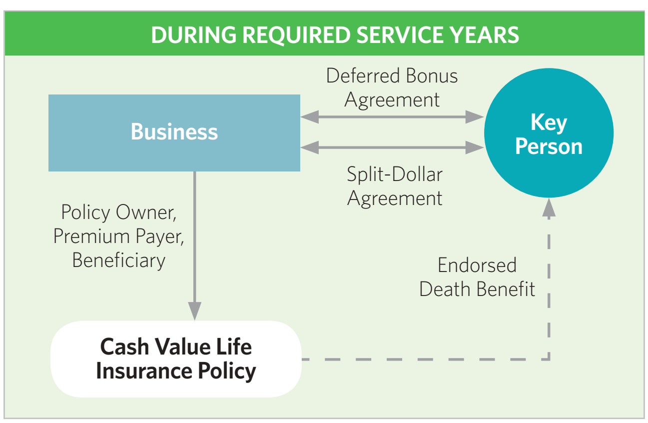
- Premiums are not tax deductible, but the business gets a full deduction for the bonus paid to the employee at the end of the agreement period
- The death benefit is received tax-free so long as the business meets the Notice and Consent requirements of IRC §101(j)

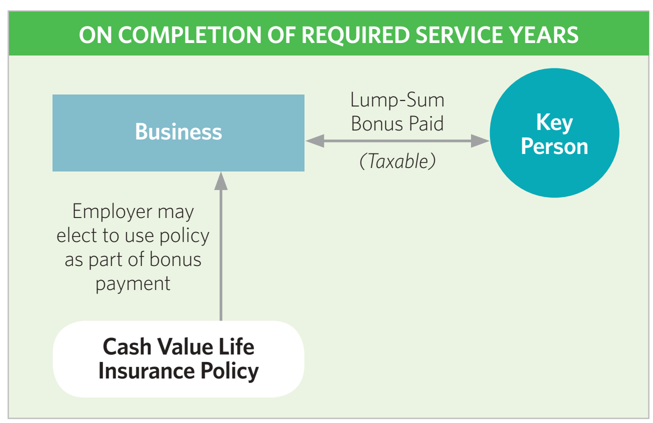
Employee

- During the agreement period, the employee pays income tax on the "economic benefit" of the endorsed death benefit – this tax is typically small and significantly less than a personally owned life insurance policy
- If the employee passes away, their beneficiary receives a tax-free death benefit
- Upon completion of the employment term, the employee's lump-sum bonus is taxable income – it may be possible to use the insurance policy's cash value to pay the income tax.

IMPLEMENTATION

Easy to implement – avoids the complex deferred compensation requirements of IRC §409A if the bonus payment is made within 2½ months of the agreed-upon completion date. A small amount of plan administration is required if the business chooses to endorse part of the death benefit to the employee's beneficiaries. Several carries will handle this at no cost.





4 NONQUALIFIED DEFINED BENEFIT

HOW IT WORKS

The business promises to make future bonus payments to a key employee over a period of time. To fund the payments, the business purchases a cash value life insurance policy. Sound familiar? It should. This option is very similar to the lump-sum deferred bonus, with a few key differences:

01	The bonus is paid over a period of time instead of in a lump sum
02	If an employee is uninsurable or highly rated, the business may "borrow a healthy life" by insuring a young, healthier key employee and using that policy as a fund to pay the bonus for other employees
03	Because the payments are spread out over time, this plan is governed by IRC §409A and typically requires an out-of-pocket expense for administration

About IRC §409A

- Allows select, highly compensated employees to defer a greater percentage of their compensation (and current income taxes) than is allowed by the IRS in a qualified retirement plan
- Lays out the rules for when nonqualified deferral elections can be made, and when distributions can be taken
- All nonqualified plans must comply with §409A rules or risk losing tax-deferred status

KEY CONSIDERATIONS

CONTROL

Out of all four solutions in this guide, the business retains the most control with this option. It retains the insurance policy as an asset on the books, and after the bonus payments are made, any unused amount remains with the company. Any residual death benefit may also allow for eventual cost recovery.

TAXATION

Business

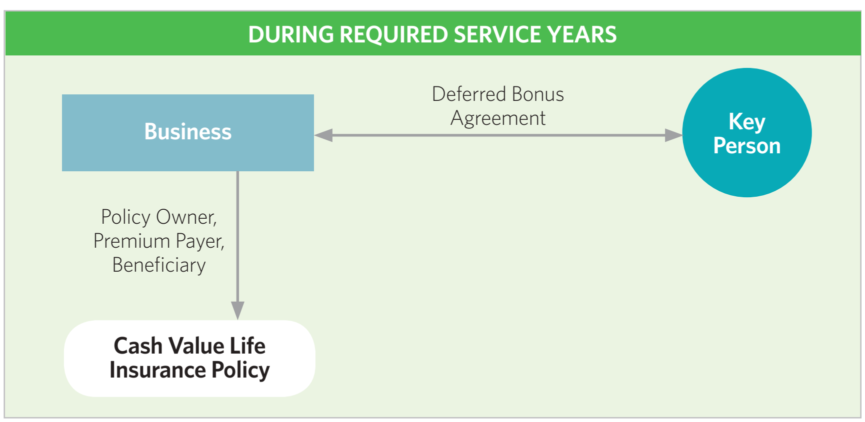
- Premiums are not tax deductible, but the business gets a deduction when bonus payments are made to the employee
- The death benefit is received tax-free so long as the business meets the Notice and Consent requirements of IRC §101(j)

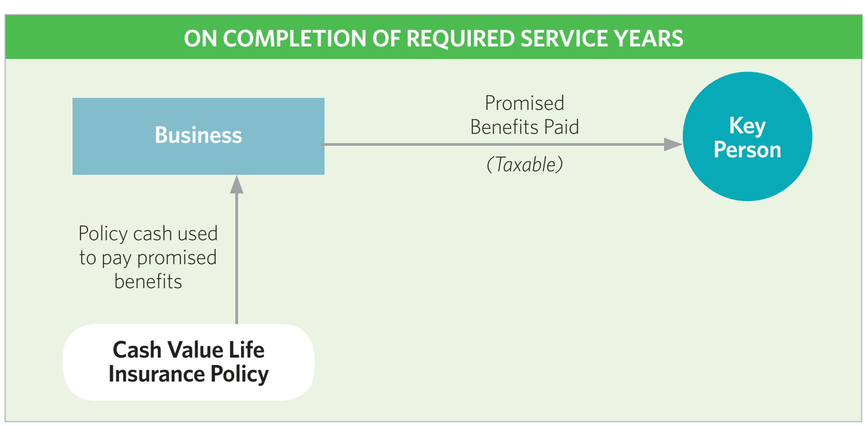
Employee

- No taxes are due during the agreement period
- Bonuses are considered taxable income when they are paid

IMPLEMENTATION

This plan must comply with IRC §409A. Of all plans outlined in this guide, it requires the most administration and possible out-of-pocket expense. However, this option also creates the strongest retention incentive, as it offers some of the most attractive benefits to the employee.





THE RIGHT PLAN IS PERSONAL

These plans may be for business, but the choices are very personal. Ask your business owner clients which factors are most important to them to help them find the right solution.

Employer Priority	Less	+	++	More
Control	Restricted Bonus	Lump-Sum Deferred Bonus	Nonqualified Defined Benefit	Key Person Plus
Administration	Key Person Plus	Restricted Bonus	Lump-Sum Deferred Bonus	Nonqualified Defined Benefit
Retention Power	Key Person Plus	Restricted Bonus	Lump-Sum Deferred Bonus	Nonqualified Defined Benefit

Note: The policy insuring the key person is owned by the business under all plans except Restricted Bonus. A policy is required on the life of each key person under all plans except Nonqualified Defined Benefit, for which "aggregate funding" may be feasible.

GET STARTED

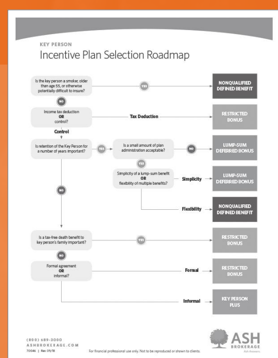
Any business owner could be a good fit for key person incentive planning. However, we've found the most success with owners of small to mid-size businesses who either have a close relationship with their key employees or have non-owner key employees who are largely responsible for the success of their business. Some examples:

- Sales team members with exclusive ties to clients or vendors
- Highly skilled employees with unique training or certifications
- Leaders with irreplaceable business knowledge

Remember, key person incentive planning is a natural next step for business owners who have completed succession or retirement planning. Those are the clients you want to approach first.

NEXT STEPS

If you haven't already, download the Key Person Plan Roadmap and Census. The Roadmap is a decision tree to help you and your clients decide which solutions may be right for their business. And the census helps you gather information to submit to your Ash Brokerage Advanced Markets team for a quote. We'll take it from there.



KEY PERSON

Incentive Plan Selection Roadmap

Key Person Plan Roadmap

Form #70046 | Rev.09/18

Key Person Incentive Compensation Census

Key Person Census

Form #70047 | Rev. 09/18

NOTE: Forms are updated frequently; please visit the Ash Producer Portal for the most current versions.

ASH ANSWERS.

Advanced Markets don't have to be difficult. Advanced means extraordinary. It means you need more – more ideas, more resources and more answers. You don't stop at good enough. Neither do we. Whatever the question, whatever the need. Ask your Advanced Markets team.

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Life comes with questions. We bring answers. Life insurance, retirement income, longevity planning, disability insurance – no matter the need, we provide the tools and, more importantly, the people financial professionals need to get the job done. And done right.

Most brokerages show up with a product and a payout. We show up with solutions, turning obstacles into opportunities. Any partner can process quotes and applications – we help you anticipate challenges, discover new opportunities, innovate and grow.

Trust is your business, and trust is our business. It's what we do. We do it because we care – deeply – about your business, your clients, your future.

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