Select Chapter

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Assess
Quiz
Study Chapter

Business Insurance Considerations

Businesses use life insurance for the same reason individuals use life insurance: It creates an immediate payment upon the death of the insured.

The most common use of life insurance by businesses is as an employee benefit, which serves as a protection for employees and their beneficiaries. There are also other forms of life insurance that can serve business owners and their survivors, and even protect the business. These include funding business continuation agreements, compensating executives, and protecting the business against financial loss resulting from the death or disability of key employees.

A. Six Business Concerns

Owners and presidents of companies have definite business concerns. We will start by identifying these needs before we talk about how life insurance can meet them.

1. Expansion

How concerned are you that your cash flow, credit lines, and business surplus will be available to meet plans for expanding your business? Business thrives on a positive cash flow. Establishing the most effective strategy for making sure money is available when needed is essential for a growing business.

2. Tax Advantage

How concerned are you about getting all of the tax relief to which you are legally entitled, and that is suitable and logical for a business? Increasing taxation in the business world is a real, serious problem for a business attempting to fund its growth with cash flow. The bite of taxation can inhibit or even kill the growth efforts of a company.

3. Safety

How concerned should you be about your ability to recover all or most of the investment made into the business? Some businesses take a very conservative approach to operations and expansion, while others show a higher level of risk taking.

4. Recruitment

To what extent should you be concerned that the cash flow of the business helps to recruit and retain key executives and employees? The market for middle and upper management or people with specialized skills is extremely competitive. Being able to meet the competition and attract and hold key people will be even more important in the future.

5. Transfer

How concerned should you be that your plans contribute to an orderly transfer of the company (at a top price) upon retirement, the sale of the company, or in the event of a

Select Chapter

6. Personal N Practice Question

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owner's compa... *...interested is one in using business dollars to fulfill personal needs wherever possible?* Increasing business taxes may dictate that those items that afford tax deductions must be paid for by the business, and those that do not must be apportioned between the business and the personal pocketbook.

B. Business Overhead Expense

A **business overhead expense plan** helps to protect a company or owner-operator from the financial difficulties associated with a disability. Fixed overhead expenses can constitute a major portion of a company's operating budget. If a certain individual's on-the-job performance is critical to the operation of a business, that person's disability can be devastating. Fortunately, the IRS recognizes the significant difficulties that a disability can impose on a company and provides for a tax-advantaged plan to minimize financial repercussions.

An **overhead expense disability policy** reimburses a company or individual for overhead expenses incurred, with a set maximum during a covered disability. If this type of contract is used, the premiums paid are deductible as a business expense. When proceeds are paid out during a disability, they are taxable as income. Then, when the business overhead expenses are paid, they are typically tax deductible.

If a standard disability contract is used instead of an overhead expense disability policy, the premiums are not tax deductible. However, the proceeds that are received during a period of disability are not taxed as income. Even if the proceeds are used to pay business overhead expenses, the premiums are not tax deductible, and the proceeds are tax exempt if a standard disability contract is used. The set amount of the benefits is not dependent on the amount of business overhead expenses.

When developing a business overhead expense plan, a company or owner-operator should carefully consider the tax ramifications of the different types of insurance policies. He or she must decide whether current tax deductions for premiums paid or tax-exempt proceeds are most important.

C. Business Life Insurance Needs Analysis

A study conducted by Dun & Bradstreet indicated that 47% of business failures are attributable to a lack of management and finances. The death of a key employee can cause serious problems for the business. Life insurance is used in business applications to insure key employees, fund buy-sell agreements, and serve as an important part of various compensation arrangements, such as death-benefit only plans, split-dollar arrangements, qualified pension plans, and nonqualified deferred compensation plans.

The primary function of life insurance is to offset the economic loss that comes with the death of an individual to compensate for the human value that disappears with death. People tend to insure their physical assets against loss from fire, tornadoes, and other hazards. Yet, protection against the loss of human life values, which is provided by life insurance on key people, may be far more vital. The probability of loss

Select Chapter

D. Evaluatin

Practice Question

Quiz

Financial state

business life insurance needs. Let's look at some of the indicators from the financial statements:

- **Funding Buy-Sell Agreements** — A balance sheet will often disclose how a company's present buy-sell agreement is funded or how a proposed insurance plan could be funded. The presence or absence of insurance cash values on a balance sheet calls for further investigation into the prospect's business continuation plans.
- **Absence of Cash Values** — The absence of cash values on the balance sheet might indicate that the company has a business continuation plan that either is not funded by life insurance, is funded by term insurance, or is funded by a permanent policy that has yet to show cash values. It is possible that the company has neither a business continuation plan nor enough present insurance to fund one.
- **Presence of Cash Value** — The presence of life insurance cash amount on the balance sheet indicates that the company has either an entity-purchase business continuation plan, or the company has purchased insurance for some purpose other than to fund a buy/sell.

Whether or not a balance sheet contains insurance cash values, an agent should investigate the prospect's business continuation plans in order to determine the correct need with the company.

The presence of a buy-sell agreement should not discourage an insurance agent from investigating to determine if the needs are completely covered. An insurance agent can take the most current balance sheet and compare it to the one for the year in which the agreement was last considered.

E. Determining the Amount of Key Employee Insurance

The key executive's employer often has a difficult time arriving at the amount of insurance it should purchase on the employee's life. The employer deals with human life values, not property values, so no set formula or rule can be used. *For example*, the determination of insurance amounts in a buy/sell insurance case is much more precise because the assessment of the insurance amounts is determined largely by the property values. In many key-executive insurance cases, however, the amount of insurance will be established in a more or less arbitrary fashion.

There are a few points that might be considered in reaching a reasonable figure. Let's look at these questions and possible answers.

- **How much would it cost to replace the person in question?** A new person would have to be hired to take the key employee's place at death. Would the new individual demand more salary? Would the new individual do the job as well? How long would it take to train the new person to reach the proficiency level of this key employee? How much could the company be expected to spend in finding and training a capable successor?
- **What proportion of the company's actual loss is it willing to insure?** What proportion of the company's desire to insure completely against the loss of the key individual may be limited by working-capital considerations?
- **How much is this person worth to the firm in net profits?** The executive is making a definite contribution to the firm's success and is accountable for some

Select Chapter

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Practice Question

F. What Life

Quiz

Life insurance

death strikes, but it can indemnify the business for the cash value of the services that will be lost, to the extent that human life values can be measured. Life insurance can provide the business with cash to do any of the following:

- Cover the expenses of finding, securing, and training a new person to take the deceased's place;
- Assure creditors that their loans are safe;
- Assure customers that the business will continue operations;
- Keep the business running;
- Cover the mistakes that the replacement employee makes until he or she learns the things that the deceased knew; and
- Be made available for many uses that cannot be predetermined because they depend upon the particular circumstances of that business at that time.

The key executive is vitally important to the continued welfare of the firm. Without insurance to offset the loss of a key person's death, there may be a very serious interruption of the flow of business profits.

G. Consumer Application

Scenario #1: Buy-sell Agreement

Two partners, each married to a nonworking spouse, opened a retail hardware store and want to protect each other in case one should die. They have their attorney draw up a buy/sell agreement, whereupon, if either of them should die, the other agrees to buy out the deceased partner's share. The business is capital intensive, which means that the inventory and store expenses do not allow the owners to have a great deal of money sitting in the bank. They agree that the value of their business is $1 million, so if either of them should die, the other would have to give the surviving spouse $500,000. They determine that the only practical way to fund the agreement is for each of them to buy a $500,000 insurance policy on the other.

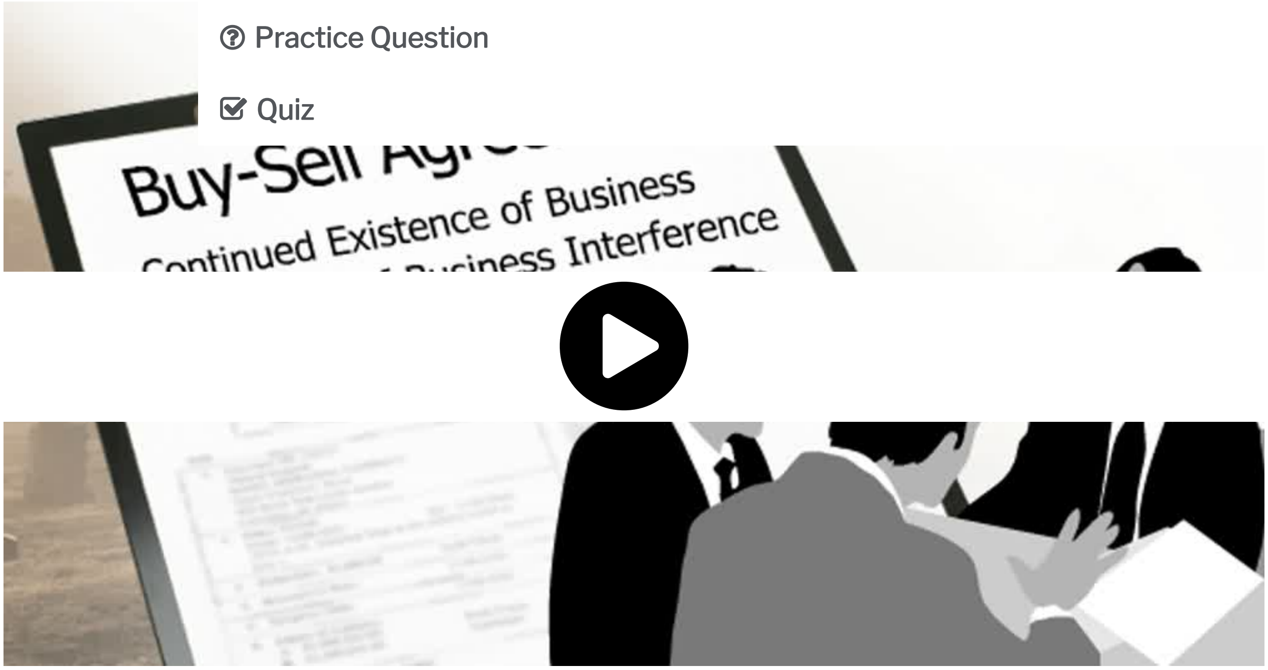
Choices for the buy/sell:

- Term insurance is the least expensive option and affords maximum coverage for the premium dollar. The cost can rise dramatically in later years.
- Whole life provides a level premium and tax-deferred cash accumulation with the ability to take loans against the cash values. The cost may be prohibitive for higher face amounts.
- Adjustable, universal, and variable adjustable life are all possible choices, with the same provisions as whole life. Additionally, these plans offer flexible premiums and potentially greater cash accumulations through the use of the underlying investment funds.

Select Chapter

Practice Question

Quiz



Scenario #2: Key Person

An owner operates five fast food establishments and hires a general manager to oversee all the operations. If the manager were to die, the owner would have to search for, hire, and train a new manager. Because the manager works approximately 50 hours per week, the owner estimates it would cost the business $50,000 in expense and lost profits to replace him.

Scenario #3: Key Executive

A publicly traded company in the computer industry has 16 executive vice presidents (EVPs) who oversee national and international manufacturing operations. If any of those EVPs were to die, company operations and profits would suffer. These executives hold advanced degrees and have experience that is difficult to replace. Being publicly traded, the EVPs have newsworthy visibility; if any were to die, the company's stock price might be affected. The company estimates that if any of the EVPs were to die, the company would lose in excess of $5 million. In this case, the key executive life insurance policy could protect the company against this kind of loss.

H. For Florida Producers Only

Unauthorized Entities:

An entity that is required to be licensed or registered with the Florida Office of Insurance Regulation, but that is operating without the proper authorization, is identified as an unauthorized insurer. All persons have the responsibility of conducting reasonable research to ensure they are not writing policies or placing business with an unauthorized insurer. Any person who, directly or indirectly, aids or represents an unauthorized insurer can lose his or her licenses, or face other disciplinary sanctions. Lack of careful screening can result in significant financial loss to Florida consumers due to unpaid claims and/or theft of premiums. Under Florida law, a person can be

Select Chapter

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I. Course Re

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1. Exam Breakdown

The Exam Breakdown should be used to see where to focus your valuable study time. Each test is weighted per chapter, so concentrating your efforts will benefit you when taking the actual exam.

Life Insurance Policy Types & Suitability - Final Examination
50 Questions - 2-hour time limit

Chapter	Percentage of Exam
The Basics of Life Insurance	2%
Understanding Needs Analysis	4%
Determining the Amount of Life Insurance	2%
The Elements of Life Insurance	4%
Understanding the Life Insurance Contract	4%
Understanding the Features & Benefits of Life Insurance	6%
Life Policy Features and Benefits - Policy Loans	2%
Term Life Insurance	6%
Whole Life Insurance	6%
Types of Whole Life Insurance	6%
Understanding Flexible Premium Products: Adjustable Life	4%
Workings of Adjustable Life Insurance	6%
Universal Life Insurance - Overview	6%
Universal Life Insurance - Features and Benefits	6%
Universal Life Insurance and Taxes	4%
Variable Life Insurance	6%
Types of Variable Life Insurance and Other Related Concepts	4%
Variable Universal Life Insurance	6%
Group Life Insurance	6%
Features and Benefits of Group Life Insurance	6%
Business Insurance Considerations	4%

Select Chapter

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Practice Question

Quiz

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http://www.retirementplans.irs.gov/plan-comparison-table/, Internal Revenue Service, *IRS Retirement Plans Navigator*

http://www.dol.gov/compliance/laws/comp-erisa.htmERISA, *U.S. Department of Labor, The Employee Retirement Income Security Act (ERISA)*

www.finra.complinet.com, *FINRA Manual*

http://www.ssa.gov/policy/docs/quickfacts/stat_snapshot, Social Security Online, *Monthly Statistical Snapshot, February 2012*

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Chapter Complete