The Cincinnati Life Insurance Company

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.

Agent Information Only

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.

THE CINCINNATI LIFE INSURANCE COMPANY
Everything Insurance Should Be®

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