THE "ONE PAGE, ONE POLICY SUCCESSION PLAN"

A Sample Client Presentation

(This Presentation refers to the Coloured Risk Analysis Worksheet.)

One Page Succession Plan

Our aim is to establish a one page succession plan for each proprietor in the Business.

The one page identifies three needs:

- ***Asset*** needs;
- ***Liability*** needs; and
- ***Personal*** needs.

Selling Your Asset

Most business people understand the need to insure their equity in the Business.

This is often called "buy/sell insurance".

The purpose of the insurance is to ensure that:

- the life insured or their estate obtains full value for their equity; and
- the Continuing Proprietors are able to fund 100% of the purchase price without borrowing or using their own funds.

Lawyers are usually required to prepare a Buy/Sell Agreement.

The role of the Agreement is to:

1. Determine the purchase price;
2. Ensure that the Vendors sell their equity in the Business;
3. Ensure that the Purchasers acquire the equity; and
4. Ensure that there is no capital gains tax payable with respect to the insurance proceeds (apart from any CGT that would otherwise be payable with respect to the sale of the equity).

A traditional Buy/Sell Agreement should not be a very complicated agreement.

It normally deals only with the purchase price and no other requirements of a succession plan.

It normally has no impact on the level of premium payable for the insurance.

However, a succession plan needs to address issues other than the sale of the equity.

Extinguishing Your Liabilities

Our succession plan needs to make sure that when we sell our assets, we also extinguish our liabilities.

The business might have:

- Overdrafts;
- Loan facilities;
- Lease facilities;
- Hire purchase agreements; or
- Supply agreements.

The proprietors might have given personal guarantees or second mortgages over personal assets (such as their homes) as security for these facilities.

Many clients think these securities die when they die or when they sell their equity.

Unfortunately, they don't. Instead, they trigger a re-consideration of the facility by the bank or creditor. At the same time, the executor of your estate wants to obtain a release of the security, so that it can distribute the estate to the beneficiaries.

The bank can effectively turn around to the Continuing Proprietors and say, "We are being asked to release a security, we want replacement security from you".

If the Continuing Proprietors can't provide adequate security, the estate might continue to be responsible for liabilities of the Business.

This means that the purchase price of the equity and any other assets might be available to the bank. If there was a default, the bank would prefer to access the cash sale proceeds sitting in a bank account (rather than have to sell a house or other personal asset).

This problem can be avoided by insuring part or all of the debt.

If there are three directors and we reduce the company debt by one-third, the Continuing Proprietors can justifiably say, "three people used to be responsible for 100% of the debt, now two are responsible for two-thirds of the debt". This should help obtain a release of the security.

In summary, a succession plan should help a proprietor to leave both the asset and the liability sides of the ledger.

Meeting Your Personal Needs

Most business people have residual personal needs over and above their asset need.

For example, if their goal was to fund a living expenses budget of $50,000 per annum for their family, they might need a lump sum of $1 million (assuming a five percent interest rate).

If their purchase price was $400,000, they would need a top-up of $600,000. If it was $300,000, they would need a top-up of $700,000.

There is therefore an "inverse" relationship between the purchase price and the personal cover. They both feed into the same pot. As one goes up, the other one can potentially go down.

One Page Summary

The one page succession plan can now be a one page summary of a business person's needs and succession plan.

It represents a worst-case scenario that enables them to obtain an estimate of the premium cost of the strategy.

If the estimate is not acceptable, they can then use the summary to prioritise what risks they will insure and what risks they will assume or self-insure.

The Traditional "Multiple Policy Approach"

Traditionally, the different needs have been addressed on separate insurance policies owned by different parties.

It is common for business people to have four or five different insurance policies. After a few years, they have no idea what they have, who owns it, whether it is the right amount, or who will get it. They are no longer in control of their succession plan.

The "One Policy Strategy"

If we can get a business person's needs onto one page, we can also get them onto one policy.

The benefits of a single policy strategy are:

- Simplicity;
- Reduced policy fees ($50 to $100 per policy per annum);
- Volume discounts on the premium (between 5% and 30%); and
- Flexibility.

Flexibility

One of the major benefits is flexibility.

A business person's needs change over the course of their life or career.

In the personal sphere:

- they pay off their home loan;
- they build personal wealth;
- they educate their children; and
- their children become independent (eventually!).

Their need for personal insurance therefore goes down.

At the same time, the business debt should be going down.

Over time, you would also expect that the value of the business would go up.

In summary, two of our needs tend to go down, while one goes up.

If we combine all three needs on one policy, we might have the right total for the indefinite future. Only the mix will need to change.

Changing Needs

The coloured worksheet illustrates some typical changes in needs over a five year period.

Let's assume that the cover was written on separate policies.

Firstly, as the debt is reduced, the debt reduction cover should be reduced, to avoid any risk that it might be treated as key person revenue cover (and taxed upon the payment of a claim).

This involves administration and contact with the insurance company.

Secondly, as the purchase price increases, the buy/sell policy should be increased.

This involves not only administration, but new underwriting and medical tests. Thus, the cover might not be available, if the life insured cannot satisfy the requirements.

In contrast, the single policy strategy is designed to place all of the cover under the one roof. Once it is under the roof, it is not necessary to deal with the insurance company, unless additional cover is required over and above the total sum insured.

Thus, changes are a management issue, not an insurance company issue.

Business Insurance Trust Agreement

The agreement is a buy/sell agreement. However, it is also an engine that drives the one page, one policy succession plan. It ensures that each component of the cover is paid to the correct recipient securely and tax-effectively (with ATO approval).

However, unlike a traditional buy/sell agreement, it also results in substantial cost savings and flexibility for a long-term succession plan.

Worksheet for “One Page, One Policy Succession Plan”

Apportionment of Total Needs and Sum Insured Showing Changes over Five Year Growth Period

Insurance Company Pays Total Sum Insured to Trustee (Policy Owner) →						Trustee Pays↓
Name of Insured Person		**Michael Damien Adams (Case Study Only)**				
	PURPOSE	**AMOUNT OF EACH COMPONENT**			**NOTES**	**RECIPIENTS**
		Year 1	**Year 3**	**Year 5**		
ASSETS +	Pre-agreed Sale Price of Equity	$400,000	$500,000	$700,000		Vendors
	CGT on Pre-agreed Sale Price					Vendors
	Stamp Duty, Legal & Accounting Fees					Business
LIABILITIES +	Bank Debt, Lease & Other Liabilities	$200,000	$100,000	Nil		Creditor
	Loan Account					Creditor
	Key Person (Income)					Business
	Key Person (Capital) (Reduced Goodwill or New Working Capital)					Continuing Proprietors
PERSONAL =	Personal Loans (Home Loan, Equity Loan, Other Liabilities)					Insured Person (Debts)
	Living Expenses (See Personal Needs Analysis Worksheet)	$600,000	$600,000	$500,000		Insured Person (Living Expenses)
	Future Sale Price Provision					Insured Person
	Self-Managed Super Fund					Self-Managed Super Fund
TOTAL		**$1,200,000**	**$1,200,000**	**$1,200,000**		