



▶ **CORPORATE PLAN**

Crisis Control - Smooth handover

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Crisis Control - Smooth handover

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IDENTIFYING THE RISK

In today's competitive environment survival depends on the ability to respond to change. The change that could hit your business could be the loss of a key director/shareholder through death, disability or unplanned retirement.

Many small to medium size businesses rely on the complementary skills and abilities that shareholders bring to a business for day-to-day survival. Shareholders often undertake considerable personal financial commitment, bear the increasing responsibilities of compliance and invest much time and expertise in planning for the ongoing success of the business. With so much at stake a business survival plan should cover:

➤ *The untimely loss of a shareholder through death or disability*

➤ *A solid succession plan for loss of a shareholder on retirement*

STATISTICS

FACT: Over the 2000/2001 year the average age of Fidelity Life's Critical Care claimants was 46.

FACT: The average age of our death claimants was 49

FACT: The average age of our Income protection claimants was 47-average duration of claim was 20 months.

Given that most of us expect to retire when we reach the 60 to 65 age group, this snapshot of our claims profile shows that a crisis could bring our working days or our capacity to work to an abrupt end long before we could ever imagine.

COMPANIES ACT

Throughout a period of crisis the business will continue to exist as a separate legal entity with enduring financial and legal obligations. One of these ongoing statutory obligations is the prudent management of risk. The Companies Act 1993 Section S135 states that a director of a company must not "agree to cause or allow the business of the company to be carried on in a manner likely to create substantial risk of serious loss to the company's creditors".

➤ *Will there be a loss to your business on the death or disability of a shareholder?*



THE RISK

DEATH OR DISABILITY OF A SHAREHOLDER

It takes as little time as a few weeks after the death or disability of a shareholder for the impact on the financial bottom-line of the business to be felt. This could mean:

- *Possible restrictions on credit terms*
- *Severely reduced ability to service debt*
- *Foreclosure by creditors/lack of liquidity*
- *Personal guarantees are called up placing personal assets at risk (in most cases estate settlements will be delayed as assets are frozen until guarantees are satisfied.)*
- *Loss of key relationships/goodwill*
- *Public perception of instability/staff instability*

LIQUIDATION

On the sale or liquidation of a business that has lost a key shareholder, the true value of a business is lost. A 'fire sale' situation may occur:

- *Stock may be sold at a loss*
- *Fixed assets do not realise their book value*
- *Debtors start disputing their accounts*
- *Substantial legal and accounting costs incurred*

The investment, goodwill and personal exertion that shareholders have put into the business over the years can be lost. It may also mean loss of employment for the remaining shareholders.

TRANSFER OF SHARES

The permanent loss of a shareholder could mean significant reorganisation and potential upheaval to the ownership structure of the company. Without a specifically designed plan to manage the consequences of death or cessation of a shareholder's employment, ownership of share are automatically passed onto the deceased's estate or fully retained by the outgoing shareholder.

HOW WOULD A TRANSFER OF SHARES AFFECT OTHER SHAREHOLDERS?

A deceased shareholder's share of the business will form part of his or her estate and will usually pass to his or her spouse or children.

- *Will the spouse or children contribute to the business?*
- *Will they get along with existing shareholders?*
- *Will they want to draw dividends rather than reinvest retained earnings?*
- *Will they accept reasonable salaries for work performed?*

The remaining shareholders may desire to purchase the estate's interest. There may be issues relating to the willingness of the estate to sell, determining share value and the finance method of the acquisition of the shares. In the absence of funds to complete the transaction, the estate may seek an outside buyer. The availability of a suitable buyer willing to pay the desired price may be an additional challenge.

THE SOLUTION

THE SOLUTION

Whether the shareholder's incapacity to work is permanent or short to medium term, it is in everyone's best interests – shareholders, beneficiaries of the estate and family trusts, to formulate a contingency plan to ensure:

- *A predictable outcome in the event of crisis*
- *Smooth handover of control and ownership on death or retirement*
- *Financial reserves to offset loss and keep the business going through an adjustment phase*

The two key tools in an effective strategy to preserve business value are:

- *An appropriately structured buy/sell agreement*
- *Comprehensive risk insurance*



FUNDING THE SOLUTION

Cash is an important solution to most financial problems

- *No Tool provides instant liquidity like insurance*

Fidelity Life's Corporate Plan provides liquidity to fund the solutions to a business crisis at a time when other finance arrangements may be unavailable or heavily restrictive. Up to six lives can be included on the Corporate Plan with beneficial ownership of the various benefits under the plan transferred to separate entities as required. The buy/sell agreement should clearly outline the insurance policies to be effected to fund the agreement and the transfer of these benefits.

BUY/SELL AGREEMENT

A buy/sell agreement sets out the rights of shareholders in relation to shares in the event of death or disability. It can allow the surviving shareholder(s) or the company the right to buy the shares of the deceased shareholder at a pre-agreed value.

Under a specified range of conditions such as death, critical illness, resignation or retirement, the conditions of a buy/sell agreement come into force. This binding contract protects a business from unstable outcomes of changed circumstances by specifying:

- *A commitment from outgoing shareholders to sell shares and for remaining shareholders to buy them*
- *A predetermined valuation method of the sale of the shares*
- *The means of financing this share purchase*

The advantages to surviving shareholders:

- *Control of ownership and continuity of the business*
- *The assurance of a predictable outcome*
- *Purchase price and method of payment is guaranteed*
- *Enhanced reputation through the ability to meet statutory requirements*
- *Stability for employees, creditors, suppliers and clients*

*Outcome = Protection
of business value*

THE SOLUTION

THE OUTGOING SHAREHOLDER BENEFIT FROM:

- ⇒ *Guaranteed purchaser and a fair price assured in cash*
- ⇒ *Simplified administration by a commitment to a course of action as set out in the buy/sell agreement*
- ⇒ *Fair compensation*

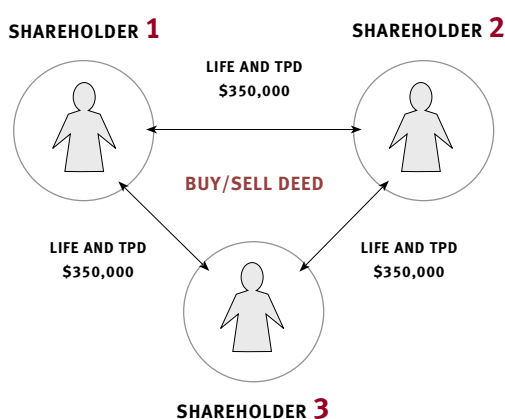
Outcome = Protection of estate

The buy/sell agreement can be tailored to various company structures and the desired outcomes of a contingency plan. It is ideal for partnership situations such as accountants or lawyers.

EXAMPLES OF VARIOUS STRUCTURES:

- ⇒ *The compulsory sale of share to surviving shareholder on the death of a co-shareholder*
- ⇒ *The optional sale of share on death (for example – a child who is an heir may wish to come into the business)*
- ⇒ *Options for major shareholders to purchase minor shareholders' interests in the business. The sale of minor shareholders' interests to major shareholders on a specified event is usually compulsory under such an agreement.*
- ⇒ *Agreements involving family trusts (shareholding is held in a family trust to protect from creditors)*
- ⇒ *Agreements between companies (in the event of the death of a shareholder the company is sold to a competitor)*
- ⇒ *Companies Act buyback (the company buys back the shares from the estate at the discretion of the directors)*

BUY/SELL AGREEMENT



IF SHAREHOLDER 1 DIES OR BECOMES DISABLED:

Shareholder 2 and Shareholder 3 each receive cash from their Corporate Plan. The buy/sell deed is then operative requiring the surviving shareholders to buy shares from Shareholder 1's estate. The estate receives cash from Shareholders 2 and 3. The family of the deceased or disabled Shareholder 1 have cash for investment.

THE SOLUTION

NEEDS ANALYSIS

A review of your current levels of planning for a range of contingencies will assist in determining your exposure to risk and the potential impact of these events.

HAVE YOU IDENTIFIED THE RISKS ON THE BALANCE SHEET?

Balance Sheet NEW ZEALAND COMPANY

ASSETS

Cash	\$5,000
Debtors	\$50,000
Stock	\$1,000,000
Insurance Policy	\$50,000
Fixed Assets	\$450,000
Goodwill	\$200,000
TOTAL	\$1,755,000

LIABILITIES

Shareholders Funds	\$755,000
Shareholder Current Account	\$300,000
Overdraft	\$150,000
Mortgage	\$500,000
Creditors	\$50,000
TOTAL	\$1,755,000

CORPORATE PLAN

A single plan with a range of risk benefits to protect all your company assets and provide an investment for the future.

RIDER 1

Life Cover and TPD on each shareholder with cross ownership through a buy/sell agreement

RIDER 2

Life Cover and TPD on shareholders owned by the company.

RIDER 3

Life Cover and TPD on shareholders transferred to the bank.

RIDER 4

Life Cover and TPD assigned to the lender.

CORPORATE LIFE STRUCTURE

RIDER 1 Buy/sell – transferred to other shareholders

RIDER 2 Current accounts – transferred to company to pay debt

RIDER 3 Overdraft – transferred to bank

RIDER 4 Mortgage – transferred to lender

RIDER 5 Income protection –personal/client

RIDER 6 Investment – transferred to company

The flexibility of the Corporate Plan allows the choice of arranging cover under either a risk-only plan or taking a split dollar approach where risk and investment premiums are provided by different parties and owned accordingly. This enables business and personal needs to be secured under the same plan and transferred accordingly.

THE SOLUTION

FOR EXAMPLE:

1. \$350,000 life and total and permanent disablement cover for the future funding of a buy/sell agreement.
 - *Transferred to a trustee who ensures compliance with the deed of arrangement in effecting the buy/sell agreement*
 - *Or transferred to the company to repurchase the shares*
2. \$300,000 life and total and permanent disablement cover for shareholder's current account.
 - *Transferred to the company to pay debt of a deceased shareholder*
3. \$150,000 life and total and permanent disablement cover for company overdraft.
 - *Transferred to the bank*
4. \$500,000 life and total and permanent disablement cover for mortgage.
 - *Transferred to the lender*
5. Income Protection in the event of a disability
 - *Transferred to individual shareholder and used as part of a personal protection plan*
 - *or transferred to the company as part of a salary to a shareholder*
6. Investment plan for the company.
 - *Transferred to the company – asset on the balance sheet*

The premium for the policy is usually paid by the company who is normally the owner of the policy. Each shareholder is charged for the premiums that relate to them through their individual current accounts. Fidelity Life uses a 'transfer of rights' form to transfer the beneficial right to each rider to the appropriate party once the policy has commenced. Notice about the policy will be sent to the company.



RISK OPTIONS

LIFE COVER

A single lump sum is payable on death. This is ideal for securing loans, financing business situations and providing income to a surviving partner.

TOTAL AND PERMANENT DISABILITY

Linked to the life assurance benefit or as a stand-alone plan, this option enables a benefit to be paid if you become totally and permanently disabled. The payment is made after you have been absent from work for six months and fulfil the terms and conditions of the policy.

CRITICAL CARE

A lump sum is payable on the event of one of the specified critical conditions. This benefit can be linked to life cover or can form a stand-alone plan. This benefit helps meet the costs of a serious illness and subsequent recovery and it enables the insured to meet a number of financial obligations during a period of recuperation.

LIFE CARE BENEFIT

Life Care Benefit is linked to life assurance and provides a lump sum equal to 20% of the sum assured if the insured suffers one of the specified conditions. Up to five claims can be made during the term of the policy with cover available for life. This is a cost effective way of retaining critical care cover throughout one's lifetime.

FAMILY INCOME PLAN

This benefit pays a regular monthly income to the policyholder on the death of the life assured. This is an ideal way of replacing income that would normally have been received for a part of the working life of the deceased. A flexible range of benefit periods is also available.

INCOME PROTECTION

This benefit protects a key person's personal income during a period of disability by paying a monthly benefit if he or she is unable to work due to sickness or injury. Premiums are calculated on the basis of age, smoking status and occupation. The benefit, which will not exceed 75% of pre-disability income, is an essential form of protection from financial hardship if the insured is unable to work due to sickness or injury. Fidelity Life's premiums take into account ACC's responsibility to cover accident related claims in the first instance.

BUSINESS OVERHEADS/LOCUM COVER

The liability of ongoing business overheads can be met with cover specifically designed to meet those costs during a period of disability. Business Overheads is ideal in situations where a key person is a partner. Alternatively the benefit can meet the cost of a replacement employee to carry on the business operations. Up to 100% of your share of business expenses or cost of a locum can be covered for the first 12 months of a claim reducing to 50% in the second year.

GUARANTEED INSURABILITY OPTION

Corporate Plan provides an option where 20% of the original sum assured on life and total and permanent disablement can be purchased each year for a period of 5 years. This increase is not subject to further medical evidence. This benefit assists in keeping insurance cover abreast with the evolving protection needs of a business as identified in regular reviews. Businesses are required to supply financial information to support effecting this option.

Independent accounting and taxation advice can outline where premiums may be tax deductible. Expert advice should be sought on the formulation of buy/sell agreements.

INVESTMENT AND RETIREMENT PLANNING

Part of the Corporate Plan premiums may be designated to be an investment for the company. This can be used as collateral to secure loans and guarantees, or it can be an asset on the company balance sheet for enhanced solvency. Accumulated funds may also represent an important source of financing future share purchases.

The investment component of the Corporate Plan can be a designated sinking fund to wholly or partially finance future share purchases. The cessation of an active shareholder's employment may require dissolution of shares. This is a likely outcome if a retiring shareholder plans on the sale of shares to form part of a superannuation package. Retirement planning can be built into the buy/sell agreement and pre-funded by the investment component of the Corporate Plan. This will ensure:

- *A commitment from relevant parties to complete the buy/sell transaction at an agreed value*
- *Protection from a possible shortfall between the expected sale price and the actual sale*
- *Funding for the succession process*
- *The buy/sell deed provides a schedule for updating the share value on a regular basis.*

Fidelity Life offers a range of attractive investment options with both managed funds and investment sector funds that can be combined according to the risk profile that suits the company. Corporate Plan allows for a combination of up to four different portfolios at any one time. These options carry underlying minimum rates of return and valuable loyalty bonuses from year 6 onward.

Fidelity Life's investment strategy focuses on the services of leading independent investment managers who are carefully selected for their expertise in each sector, offering policyholders the benefits of complementary management skills to maximize returns. Our investment statement and funds management profile provides additional information.



