

## A GUIDE TO SHAREHOLDER PROTECTION INSURANCE

This provides a brief summary of the cover provided. The actual policy wordings should be reviewed for specific details of coverage.

This contract is often more correctly referred to as Business Continuity Planning.

### Recognising the Problem

This issue is particularly appropriate where a business is owned by multiple shareholders or partners.

The problem exists where a partner/shareholder dies prematurely, or is totally disabled and is unable to continue as an executive or non executive owner.

### The Alternatives

The alternatives facing the surviving shareholders/partners are:

- [1] Under the deceased partner's/shareholder's will it is most likely the shares will pass directly to their spouse or to their estate.

Are the living shareholder/partners then happy to be in business with the deceased partner's/shareholder's spouse?

The answer in all probability is no.

- [2] Funds then need to be raised to buy out the shares – how can funds be raised?
- i) Cash from bank deposits held in reserves (unlikely in this business climate) Cost 100 cents in the dollar, after tax.
  - ii) Borrowing from a lending institution – cost 10 cents in the dollar.
  - iii) Proceeds from the sale of business assets – cost 100 cents in the dollar. It is likely that asset sales will be heavily discounted to raise the required cash in the required time frame.
  - iv) Proceeds from the life insurance policies set up specifically to fund the Buy-Sell Agreement, reviewed annually to ensure that the policies truly reflect changing share values. The probable cost of this funding is less than 1 cent in the dollar.

### Recommendation – Share Purchase Insurance

Option (iv). The Life Insurance funding vehicle is often the most appropriate option today.

- Why:**
- 1. Cost
  - 2. Funds are immediately available
  - 3. A Buy-Sell Agreement sets out in advance the formula for share value, and allows an orderly disposition of shares in exchange for readily available cash.

**Result:**

The spouse receives the cash in exchange for shares now, and the business continues to be owned by the remaining shareholders.

**Tax Position:**

Under current legislation premiums are paid by the proposers of the insurance policies (owners) personally and are non-deductible. The proceeds are net of tax on receipt.

**Recommended Contract:**

**Term Insurance**

Generally, Term Insurance with a CPI annual adjustment is used. The contract must be reviewed annually, particularly where a Buy-Sell Agreement stipulates a compulsory sale of share on death. Total and Permanent Disability and Trauma Cover should be included where it can be obtained (subject to medical underwriting).

In the situation of multiple shareholders, it is recommended that a Custodial Trustee owns the policies on behalf of the shareholders.

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