



Business Protection Customer guide



Introduction

You may have already taken steps to protect your business against major catastrophes and put together a business continuity plan to ensure its future if things go wrong. But have you considered insuring against the loss of your most important business assets – your key employees?

If one of your key employees or co-owners were to die or suffer a critical illness, it could have a major impact on your business, possibly leading to a fall in sales, loss of major contracts, or an inability to repay business loans.

Business protection insurance is a way of helping you protect against possible financial losses when serious illness or death affects you or your employees.

What is business protection?

Business protection insurance is a way of helping you protect against possible financial losses when serious illness or death affects you or your employees. It can help ensure that your business survives and continues trading under seriously challenging circumstances.

Little can be done to minimise the impact on morale from the loss of a business colleague or key employee. However, by including business protection in your business succession and continuity plans, you can prepare for the unexpected.

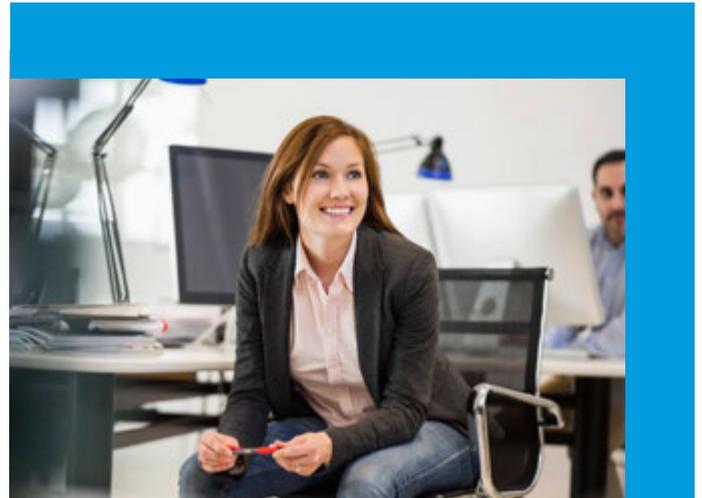
Is business protection for you?

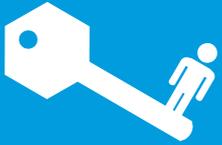
Whether you are a limited company, sole trader, in a partnership or a limited liability partnership (LLP), you should consider the contents of this guide and choose the protection that is best suited to managing your 'people risks'.

AIG offers a range of solutions, from key employee protection to business loan protection and share purchase protection for shareholders and partners. Whatever your protection needs, we could have the right solution for you.

How do I decide what protection my business needs?

This is a major decision, and it is important you seek professional advice. Your financial adviser will be able to help you decide which protection insurance is right for you and your business while a professional or tax adviser can advise on any tax implications for you and your business.





Key person protection

What is key person protection?

Key person protection allows a business to insure against the financial loss it may suffer if a key employee (also referred to as a 'key person') dies, is terminally ill or suffers a critical illness.

A key person is an individual whose skill, knowledge, experience or leadership contributes significantly to the company's continued financial success.

You can buy insurance to financially protect your business against the death or serious illness of a key person. You or your business will be the policy owner. The key person is the life assured. The business is protected and receives the proceeds of any claim.

Why does my business need key person cover?

The adverse financial consequences that can result from one (or more) of your key people dying or being diagnosed with a critical illness can be huge. The shock to the business and the speed of unfolding financial issues that follow can have a severe impact on even the most successful business.

What will key person protection from AIG do for my business?

AIG key person insurance offers:

- protection for most business types;
- a choice of life insurance, or life and critical illness cover;
- a choice between the amount of insurance needed and how much your business should pay; and
- a range of insurance increase and extension options, giving you the flexibility to change the cover when the financial needs of the business change.

Are there any tax incentives for holding key person protection?

This depends on the tax status of your business and any agreement between you and your local inspector of taxes.

Tax relief is available where specific conditions have been met. Your financial or tax adviser will be able to give you more information.

How is a key person valued?

There are a number of ways in which an individual can be valued for key person protection. This may simply be a multiple of the life insured's salary or a percentage of the individual's contribution to the business's profits. There will also be a maximum value we are prepared to insure an individual employee for. Your financial adviser should be able to show you how to calculate this value before making an application.

How long should the cover last?

Insurance against the loss - through illness or death - of key employees is usually held for relatively short periods, such as five years but not less than three years.

Are benefits paid as a lump sum or in instalments?

The proceeds of a claim will be paid in a lump sum to the business or the business owner.

KEY PERSON CASE STUDY

Jim Bailey is the Sales Director of EZE Electronics. He has been with EZE for five years. He has established a network of industry contacts and built strong business relationships with five of EZE's largest customers. He is essential to the success of the business and has a salary of £130,000 per annum as well as a bonus of up to 50% of salary, dependent upon sales targets being met. Jim unexpectedly suffers a serious heart attack and, sadly, dies.

WITH KEY PERSON PROTECTION IN PLACE

Two years ago, EZE took out key person cover on Jim for a death benefit worth £700,000, based on a maximum of five times Jim's salary plus annual bonuses. The policy was a short-term insurance lasting five years, and cost a premium of £58.54 per month*. EZE took out the key person insurance to cover any potential loss of profit caused by the loss of Jim through serious illness or death, and to contribute towards the cost of recruiting a suitable replacement. In addition, EZE also arranged 'death in service' benefits and a pension for Jim's wife and two children**.

WITHOUT KEY PERSON PROTECTION

Although the company was in a healthy trading position, the loss of Jim resulted in an estimated fall of 20% in profits for the financial year in which he died. This put the company's financial position at risk, significantly reducing the amount of share dividend to the shareholders.

* This is an example price based on the industry average paid in September 2016 for a five-year insurance policy, for a 46-yr old non-smoker.

** AIG does not currently provide access to death in service or pensions products. You should consult your financial adviser for more information about these products.



Business loan protection

What is business loan protection?

Business loan protection is a life insurance or life and critical illness policy, usually taken out by the business to insure the loan. You can also choose to set up the insurance to decrease in value as the capital debt decreases. When a valid business loan protection claim is made, the amount claimed or sum assured is paid to either the business or directly to the lender.

If your business has outstanding borrowings such as a loan, commercial mortgage or a director's loan, business loan protection can help repay these if the individual covered should die or suffer a critical illness.

Why do I need loan protection for my business?

Being unable to repay loans can present significant commercial problems for any business. A good example of this would be a director's loan that must be repaid on death. Without business loan protection, the business could struggle to find funds quickly enough to repay such a loan.

What type of loans could be covered?

The following loans may benefit from protection:

- commercial loans;
- venture capital loans;
- directors' loans; and
- personal guarantees.

A lender will often make business loan protection a condition of the loan before they are prepared to release any funds, and owners of the business may be asked to sign a personal guarantee for the loan.

How quickly can loan protection be arranged by AIG?

Loan protection is often needed more quickly than any other type of business cover. AIG has a reputation of quickly authorising the cover our customers need, thereby ensuring funds are released as soon as possible by the lender. We also provide comprehensive cover throughout the term of the loan.

Is business loan protection the same as key person protection?

There are similarities between loan protection and key person protection but there are some notable differences:

- The way in which the cover is calculated and the term of the cover. The amount of loan protection needed is more easily defined than key person cover. Insurance should equate to the size of the loan rather than be measured against the loss of profits.
- The tax treatment of premiums and proceeds of a claim differs to that of key person cover. You should consult your professional tax adviser to understand the tax position.

What will AIG's business loan protection do for my business?

AIG's business loan protection insurance offers:

- loan protection for most business types;
- a choice between life insurance or life and critical illness cover;
- a 'reducing benefit' version, which allows you to structure loan protection efficiently; and
- the flexibility to change insurance cover to complement changes made to the loan.

Are benefits paid as a lump sum or in instalments?

The proceeds will be paid as a lump sum. We will make payments to the policy owner or to the person or business making the loan if the policy is assigned to them.

LOAN PROTECTION CASE STUDY

John Wilson is the managing director and driving force behind a company supplying parts to the aerospace industry. He is one of three shareholders. He is looking to negotiate a bank loan of £1 million for new machinery, to increase the company's production of aircraft navigational equipment for UK and overseas customers.

The bank has agreed to lend £1 million to the business over a period of five years on an interest-only basis. However, a vital part of the loan agreement is that the loan must be immediately repaid if John were to die during the loan period. The business agreed to the terms of the loan and the loan was completed and the machinery purchased. Sadly, John was involved in a serious car accident 12 months later and died shortly afterwards.

WITH BUSINESS LOAN PROTECTION IN PLACE

A few days after the loan was agreed, John was advised to take out £1 million in loan protection by the firm's financial adviser, for a term of five years at a monthly cost of £78.55 per month*. On John's death, proceeds of the life insurance or term assurance claim were paid directly to the business. The finance director immediately repaid the outstanding loan in full, using these funds.

WITHOUT BUSINESS LOAN PROTECTION

The business was required to repay the loan immediately from its existing funds. The firm had insufficient liquid capital to make an immediate repayment and was forced to sell some of its assets at below the market value. This in turn led to a restructuring and downsizing of the business.

* This is an example price based on the industry average paid in September 2016 for a five-year insurance policy, for a 46-yr old non-smoker.



Shareholder/ partnership protection

What is shareholder/partnership protection?

If one of the business owners were to die or become either terminally or critically ill, shareholder/partnership protection insurance could give the remaining business owners enough money to buy the insured partner's or the shareholder's interest in the business.

Shareholder/partnership protection gives business owners the financial reassurance they need to keep the business on track during an unsettling period for the owners.

What will AIG's shareholder/partnership protection do for my business?

The loss of a business owner can destabilise a business and result in financial difficulties for other shareholders or partners. AIG shareholder/partnership protection insurance ensures the remaining partners or shareholders have the opportunity to stay in control of their business, following the death, terminal illness or critical illness of one of the business owners.

AIG's shareholder/partnership protection offers:

- shareholder/partnership protection for most partnerships and limited companies;
- a choice of life insurance or life and critical illness cover; and
- the flexibility to change the cover when the financial needs of the business change.

Why hold shareholder/partnership protection?

- To protect against the possibility of financial loss if an owner dies, or becomes terminally or critically ill;
- To give the remaining owners in the business the option of buying the shares held by their colleague and therefore keep control of the business; and
- To make sure the business has the financial power to prevent unwelcome shareholders or partners becoming involved in the future running of the business.

How is the level of protection calculated?

The amount of insurance held will relate to the value of the business interest held by the person insured, and should be based on a professional valuation by a certified accountant. It is therefore important that regular revaluations are carried out and the level of insurance cover is changed accordingly.

Who will pay the premiums?

Premiums can be paid in the most appropriate and tax-efficient way you choose. AIG can collect premiums from either an individual partner, from a shareholder's personal account or from the business bank account.

Can a company apply for shareholder/partnership protection?

Yes. If a company has the authority to 'buy back' shares from the shareholders, the company could take out insurance on the lives of those shareholders. The appropriate option agreement* should be completed to ensure the share purchase takes place in the event of the death, terminal illness or critical illness of one of the owners. Your financial adviser will be able to give you more information.

Can partners in a partnership apply for shareholder/partnership protection?

Yes. What usually happens when a partner dies is the partnership is dissolved and the beneficiaries of the deceased are entitled to the value of the deceased's interests in the business. A shareholder/partnership protection policy can be used to provide funding so the value of these interests can be paid out without damaging the business.



*An option agreement gives the surviving owners the option to buy shares from the deceased's estate and gives the estate the option to sell the shares to the surviving owners. A double-option agreement is used when a partner/shareholder dies as it allows the deceased's estate to sell the shareholding and the remaining partner(s) to buy. A single-option agreement is used should a partner suffer a critical illness, so they may sell their shareholding. The remaining partner/shareholder has no right to demand their sale under a single-option agreement. Speak to your professional adviser for more information.

What are the tax implications of a shareholder/partnership protection policy?

The premium may be treated as an expense and could be offset against corporation tax if the business pays the premium. However, HMRC will treat premium payments as part of the shareholder's gross salary and be subject to personal rates of tax and National Insurance.

Are there any inheritance tax (IHT) advantages to holding shareholder/partnership protection cover?

Yes. Providing the arrangement between owners is established on a commercial basis, HMRC will not treat the premiums paid as gifts or transfers of value for IHT purposes. The share purchase will also be subject to business property relief and the share value within the deceased's estate, in most cases, will not incur inheritance tax.

SHAREHOLDER/PARTNERSHIP PROTECTION CASE STUDY

Joan Simmons is one of three shareholding directors of the Mistro Research Company. The company is worth £1.2 million and each director owns a third of the shares in the business. Joan was only 50 years of age when she suffered a severe stroke, but made a full recovery within six months.

WITH SHAREHOLDER/PARTNERSHIP PROTECTION IN PLACE

All three shareholding directors were advised by their financial adviser to protect their shareholdings and arranged for life and critical illness cover to be written in trust for the benefit of the other shareholders. Each of the shareholders entered into an option agreement which gave them the option of purchasing shares should the others die or suffer a critical illness. The business's Articles of Association were also updated by the company solicitor. A critical illness claim was submitted to Joan's insurer, who paid the claim shortly after receiving a medical report from Joan's neurosurgeon. Proceeds of the claim were payable to the business trust and held by the trustees for the other two shareholding directors.

After making a full recovery, Joan decided she would like to sell her shareholding in the business but agreed to be employed by the firm on a part-time consultancy basis. The two remaining shareholders purchased Joan's share of the business with the £400,000 from the business trust and each became 50% shareholders of the business.

WITHOUT SHAREHOLDER/PARTNERSHIP PROTECTION

As there was no shareholder/partnership protection arrangement in place, Joan was unable to sell her shares to the other shareholders. Instead, she was forced to retain them and continue to deal with the pressures of business ownership. Alternatively, she may have chosen to sell her shares to the highest bidder, which may not have been with the approval of the other two shareholders.

And finally...

What are the risks associated with business protection?

Business protection only provides risk-based protection and has no investment or cash-in value. If you stop paying the premiums, your protection insurance will stop immediately.

If the information we receive when you take out your insurance cover is incomplete, incorrect or false, we may not pay any future claim. This could be information that you or the life assured give us. You must ensure you provide us with accurate information.

If the business insurance is not set up correctly, the benefits may not be paid to the business or the business trust and the arrangement will therefore fail to achieve its aims.

How are claim payments made?

For most policies, we pay benefits as a single lump sum. However, benefits are only payable in the event of a valid claim during the chosen term or period.

Are there any supporting documents to help me understand business protection?

We've developed a range of supporting documents for financial advisers to help them advise you on business situations and outcomes. We recommend you speak to your financial adviser to find out more. Our material is based on our understanding of current taxation law and HM Revenue & Customs practice, which can change. You should speak to a financial adviser to confirm current HMRC policy.

To find out how AIG can provide you with the business protection you need, contact your financial or professional adviser.

Or visit www.aiglife.co.uk



www.aiglife.co.uk

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