LIFE AND HEALTH INSURANCE FOUNDATION FOR EDUCATION

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Taking Care of [Small] Business



Smart Strategies to Help You Protect Your Business

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LIFE AND HEALTH INSURANCE FOUNDATION FOR EDUCATION
A NONPROFIT ORGANIZATION

FSB FORTUNE SMALL BUSINESS

Opportunities, Rewards and Responsibilities

Owning your own business can be one of the most satisfying experiences of your life. You can follow your dream, earn a good living, provide employment and opportunities for others, and maybe even make a difference in the world. But owning a business also entails lots of responsibilities – to your business, your employees and your family.

To get a sense of how well you've planned for these responsibilities, ask yourself the following questions:

- **What will happen to my business if I die?**
- **What will happen to my business if I become disabled?**
- **What will happen to my business when I retire?**
- **What will happen if certain key employees die or leave the company?**
- **What can I do to help ensure that my most vital employees remain loyal to the business?**
- **What do I need to do to attract and retain the best employees?**
- **How can I help ensure that my business will be able to weather unforeseen financial hardships?**

While you've probably thought about these questions before, you may not have adequately addressed all of them. That's why LIFE created this booklet. Use it to gain a better understanding of how proper insurance and benefits planning can help protect your business and family, improve recruitment and retention, and provide you with creative ways to reward employees. Once you have a stronger grasp of your insurance and benefits needs, consult with professional advisors, including your accountant, attorney and insurance professional. Together, you can develop a plan that's right for you and your business.

Inside:

Business Continuation Planning: Making Sure Your Business is Secure

One of the first things any business owner needs to consider is how to protect against events that may threaten the future of the business, like the death of a proprietor, partner or key employee. Business continuation plans, a necessity for any business, protect family and partners from unwanted debts and responsibilities when an owner dies.

Protect Your Family

Many small business owners take out loans to help grow their businesses, and often secure these loans with personal assets. If you have business loans and were to pass away before they were paid off, you might think your family could sell or liquidate the business to cover the debts and provide financial security for them.

In reality, this rarely happens. When the family is forced to sell the business quickly, they may have to sell at a discount or during market conditions that make the business less attractive. In other cases, the business may be worth very little without the proprietor or partner. **Individual life insurance** can protect your family by providing funds to cover debts, ongoing living expenses, and future plans in the event that something happens to you.

Protect Your Partners

You might think that if you die, your family could maintain their income by running the business themselves or by hiring someone to handle the day-to-day management. The fact is, your loved ones may not have the skills or the desire for the job, and your co-owners may not welcome the idea of an unintended partner. A **buy-sell agreement** is an agreement between owners to buy out a deceased owner's share of the business in the event of the co-owner's retirement, disability or death.

Buy-sell agreements are typically funded by a life insurance benefit sufficient to buy out the deceased's share, thus providing financial security for the surviving family. The amount is usually specified in a contract created with the help of an attorney. You can enter into a buy-sell agreement at any time, but if often makes sense to do so when a business is formed or when new owners are brought into the business. Because business values can fluctuate, it's important to review the contract with your accountant at least once per year or to include a calculation method in the agreement. Also be sure the insurance coverage funding the agreement is up to date.

Though not as common as insuring against death, business owners can also insure against the risk of becoming disabled and unable to work. In this case, disability income buyout insurance would fund the buy-sell agreement, allowing the disabled owners to be bought out, typically after a one-year waiting period.

Protect Your Business

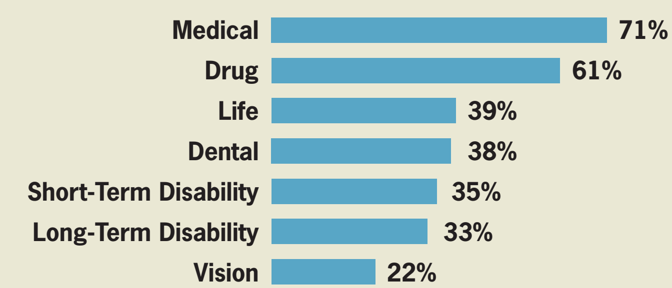
In a small business, there are often certain employees who have a particularly critical impact on the bottom line. **Key person insurance** is life or disability income insurance purchased by the business on the life of such an employee and payable to the business. The death benefit can help make up for lost sales or earnings or cover the cost of finding and training a replacement. An insurance professional can help you determine which employees, if any, are "key" to the business as well as evaluate how much and what kind of insurance should be purchased.

Employee Benefits: Take Care of Your Employees & They'll Take Care of You

An adequate employee benefit program is essential in business today, no matter what the size of your company. It's a necessary tool for attracting new employees and retaining current ones. In fact, when it comes to employee retention, benefits can make or break the deal. For instance, three out of four workers consider employee benefits a decisive factor when evaluating new job opportunities.

Employee benefits like health or life insurance and retirement plans can be costly, which is why almost all small employers share the costs with their employees. Another option for keeping costs in check is to offer a more modest benefits package. There are also voluntary benefit programs that allow employees to purchase or increase their benefits themselves, often through automatic payroll deduction. An insurance professional can help you select the right mix of benefits and guide you through the various plan options. It's also a good idea to consult with your accountant and attorney before establishing or expanding an employee benefits program.

What Benefits Do Small Businesses Offer?



Percentages are of firms with 100 or fewer employees. (Source: LIMRA, "US Small Business Market," 2000)

Health Insurance

The one thing that almost every employee wants and needs is health insurance. More than 80 percent of employees say that hospital and medical coverage is the most important benefit an employer can provide. Fortunately, there are plenty of options, each offering tradeoffs between flexibility and affordability.

One way to keep costs in check is to share the cost with employees. Another option is to choose a less expensive plan. The most common health plans are health maintenance organizations (HMOs), preferred provider organizations (PPOs), point of service (POS) plans and indemnity plans. Choosing the right program for your employees involves careful tradeoffs between cost and choice. If cost is your paramount concern, an HMO or POS plan might be your best bet. If choice is what you're after, indemnity plans and PPOs often offer the greatest flexibility when it comes to picking providers.

Life Insurance

Group life insurance is a relatively inexpensive benefit that can be easily supplemented by voluntary coverage. Typically, employers provide a life insurance benefit equal to one to two times the employee's base salary, paying either all or most of the premium cost. Some employers also allow those wishing more coverage for themselves or their families to increase the death benefit or add family members through payroll deduction. Because there are cost efficiencies in issuing one policy to cover all employees, the rates are often quite low. Consult with an insurance professional who can check around to make sure you're getting a competitive price.

Disability Income Insurance

Disability income insurance is one of the least understood types of insurance, but also one of the most important. Many people mistakenly believe that workers who become

Workers' Choices For Benefits Instead of More Pay

Health Insurance	41%
Retirement Savings Plan	36%
Pension Plan	19%
Stock Options	9%
Retiree Health	9%
Life Insurance	8%
Long-Term Care Insurance	4%

(EBRI and Matthew Greenwald & Associates, Inc. 2001 Value of Benefits Survey)

70%
of small businesses say offering health benefits increases productivity by keeping employees healthy

(Source: Employee Benefits Research Institute, "Small Employer Health Benefits Survey," 2000)

disabled will receive disability income either through Social Security, Worker's Compensation or both. But Social Security disability benefits are often quite restrictive and employees don't qualify for Worker's Compensation unless the disabling illness or injury happened on the job.

Employer-sponsored disability income insurance is much less restrictive and falls into two main categories. Short-term disability income insurance plans usually offer benefits that are paid for a maximum of 26 weeks, while long-term disability benefits generally continue for the length of the disability or until retirement age.

Cost can be affected by adjusting the maximum monthly benefit, benefit periods and waiting periods before benefits begin. This is another area where it's sometimes possible to allow employees to purchase additional coverage either by purchasing increased benefits under the group program or through a voluntary benefit program.

Dental and Vision Insurance

Once offered by only a few employers, dental insurance is now offered by 40 percent of small businesses. Dental insurance plans generally cover part or all of the cost of cleaning, X-rays, annual oral exams and fillings. Some plans also cover major items such as crowns and restorative work. Most plans do not cover orthodontics. In some areas, dental maintenance organizations (DMOs) may be available. They function in much the same way as medical HMOs and may be less expensive than traditional plans.

Vision plans are also growing in popularity. A typical vision plan includes an annual routine eye exam, an annual contribution towards prescription eyewear and a glaucoma screening.

Retirement Plans

With the exception of health insurance, retirement plans are the benefit employees desire most. The good news is that small business owners have a variety of plan options from which to choose.

Most retirement plans fall into one of two major categories:

Defined Benefit plans, commonly known as pension plans, require employers to pay a fixed annual amount to eligible employees during their retirement years. These allow employers a high degree of tax savings, and in good times, favorable growth rates can reduce or eliminate the employer's contribution. However, they can be costly to administer and may require higher contributions in times of poor or negative investment returns. They provide the greatest degree of retirement income certainty for employees, since the employees take virtually no risk. The benefits are even guaranteed by the Federal Pension Benefit Guaranty Corporation up to certain amounts.

Defined Contribution plans allow employers and employees to contribute a set amount or percentage of pay, and retirement benefits are based on the actual performance of the funds. These plans give the employer better cost control as the contribution is defined. The amount an employee can contribute is based on a percentage of their salary up to a maximum amount defined by law. Defined contribution plans can take many forms, including:

- **401(k) and Profit-Sharing Plans.** 401(k) plans allow employees, often matched in whole or in part by their employers, to set aside a portion of their salary for retirement. The employee is not taxed on this income until withdrawals are made, and the employer's cost is a tax-deductible business expense. Employees can select the investment vehicles into which their funds are deposited. Retirement benefits are not guaranteed, however, and while the sum at age 65 may be substantial, it can also be much less if the employee has made poor investment choices or the stock and bond markets have not performed as well as expected. Employees can borrow from their 401(k) plans for education, a new home, a medical emergency etc., although the loan must be repaid within a certain specified period of time. Sometimes employers elect to integrate the 401(k) plan with a discretionary profit sharing plan that can increase the employer's retirement contribution for employees.
- **SIMPLE Plans.** This option for companies with 100 or fewer employees allows an employee to contribute a percentage of his or her salary up to a fixed maximum to an Individual Retirement Account (IRA). The employer may also make contributions on a fixed or matching basis. SIMPLE plans are easy to set up, require minimal paperwork, and have low administrative costs. Plus, employees retain their SIMPLE account even if they change jobs.
- **Simplified Employee Pensions (SEPs).** Created with the small business owner in mind, SEPs allow employers to set up IRAs for themselves and their employees. The employer contributes a percentage of each employee's salary each year, up to a fixed maximum. SEPs have low administrative costs, and can even be started by those who are self-employed. Since the business owner can decide how much to contribute each year, this type of plan is often the answer for businesses that may want to adjust their contribution based on the health of the business.
- **Payroll Deduction IRAs.** This type of plan, which requires no employer contribution, is designed solely to help employees fund their Individual Retirement Accounts. Employers set up a payroll deduction system that allows employees to regularly contribute to their IRAs. Contributions are tax-deductible to the employee, just as they would be with traditional IRA contributions. An insurance professional or accountant can help you determine the best plan for you.

3 in 10
small businesses that offer retirement benefits say they help with recruitment and retention

Source: Employee Benefits Research Institute, "Small Employer Retirement Survey," 2002

Executive Benefits: Rewarding Your Top Executives

In today's competitive environment, attracting and retaining top executives is more difficult than ever, and demands creative solutions. Executive benefits may offer your best employees a higher level of benefits and compensation along with significant tax advantages. They also compensate for the fact that most 401(k) programs restrict the ability of executives to accumulate enough money on a tax-favored basis to fund the retirement lifestyle they desire. Here are a few types of executive benefits that can help separate your company from the competition.

Traditional Deferred Compensation Plans (including SERPs)

In a deferred compensation plan, the executive defers a portion of his or her present compensation until retirement. In a Selective Executive Retirement Plan, the employer will provide funding for a defined benefit or defined contribution plan for a select few people. Under a properly designed plan, no taxes are due on the money until it is received. Some plans also promise to pay the executive's spouse a benefit if the executive dies before retirement. Others will pay the executive a certain amount in the event of disability. Often life and disability income insurance policies are used to help informally fund the payments.

Section 162 Plans

Often called "Executive Bonus Plans," section 162 plans are a simple way to reward your top people. Under this type of plan, the employee purchases a permanent life insurance policy on his or her life. The company bonuses the employee the premium, which is usually considered taxable income to the employee and tax-deductible to the employer. The employee controls the policy, including the death benefit and the cash value, which accumulates tax-free until it is withdrawn.

Supplemental Disability Income Insurance

Most group long-term disability policies provide roughly 60 percent of an employee's income, up to a stated maximum. For most employees, two-thirds of their income won't exceed the employer's maximum benefit. But for highly compensated executives, the maximum benefit may amount to less than 50 percent of their take-home pay in the event of a disability. To address this problem, employers often purchase additional individual disability income policies on these executives to bring their total benefit, on a percentage basis, up to the same level of all other employees.

Five Tips for Finding the Right Insurance or Financial Advisor

[1] Get recommendations from friends, business associates or other professionals, such as your lawyer or accountant, whom you trust and respect. A list of insurance advisors can also be found in your local phone book or by contacting your state's insurance department.

[2] Check whether the professional is a full-time and experienced advisor or someone who sells insurance as a sideline.

[3] Make sure the individual has a valid license from your state to sell insurance.

[4] In addition to courses required by the state, many professionals take a series of courses and are awarded professional designations. Look for any of these accreditations next to their name: ChFC, CLU, CFP, LUTCF, REBC or RHU.

[5] Ask whether the agent or advisor is a member of a professional association. The major ones for insurance advisors include the National Association of Insurance and Financial Advisors (NAIFA), the Association for Advanced Life Underwriting, the Association of Health Insurance Advisors, the Million Dollar Round Table, the National Association of Independent Life Brokerage Agencies, GAMA International and the Society of Financial Service Professionals (SFSP).