

FINANCIAL SECURITY 101 (FOR LAWYERS)

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INSURING YOUR INCOME AND YOUR PEACE OF MIND

Your most important asset is your ability to earn a living. The key people in your firm are critical to that ability.

- **KEY PERSON** – Anyone without whose contribution the firm would suffer
- **DEATH/DISABILITY** – Partner or Key Associate
 - ▶ Disruption of the firm
 - ▶ Loss of confidence of employees & clients
 - ▶ Loss of income
 - ▶ Loss of new business
 - ▶ Loss of existing clients' business
 - ▶ Lines of credit called
 - ▶ Cost of replacing key person
 - ▶ Family of Deceased/Disabled needs income continuation

WHAT ARE THE CHANCES?

Assume *Arguendo*: 3 Partners, ages 40, 45, 50

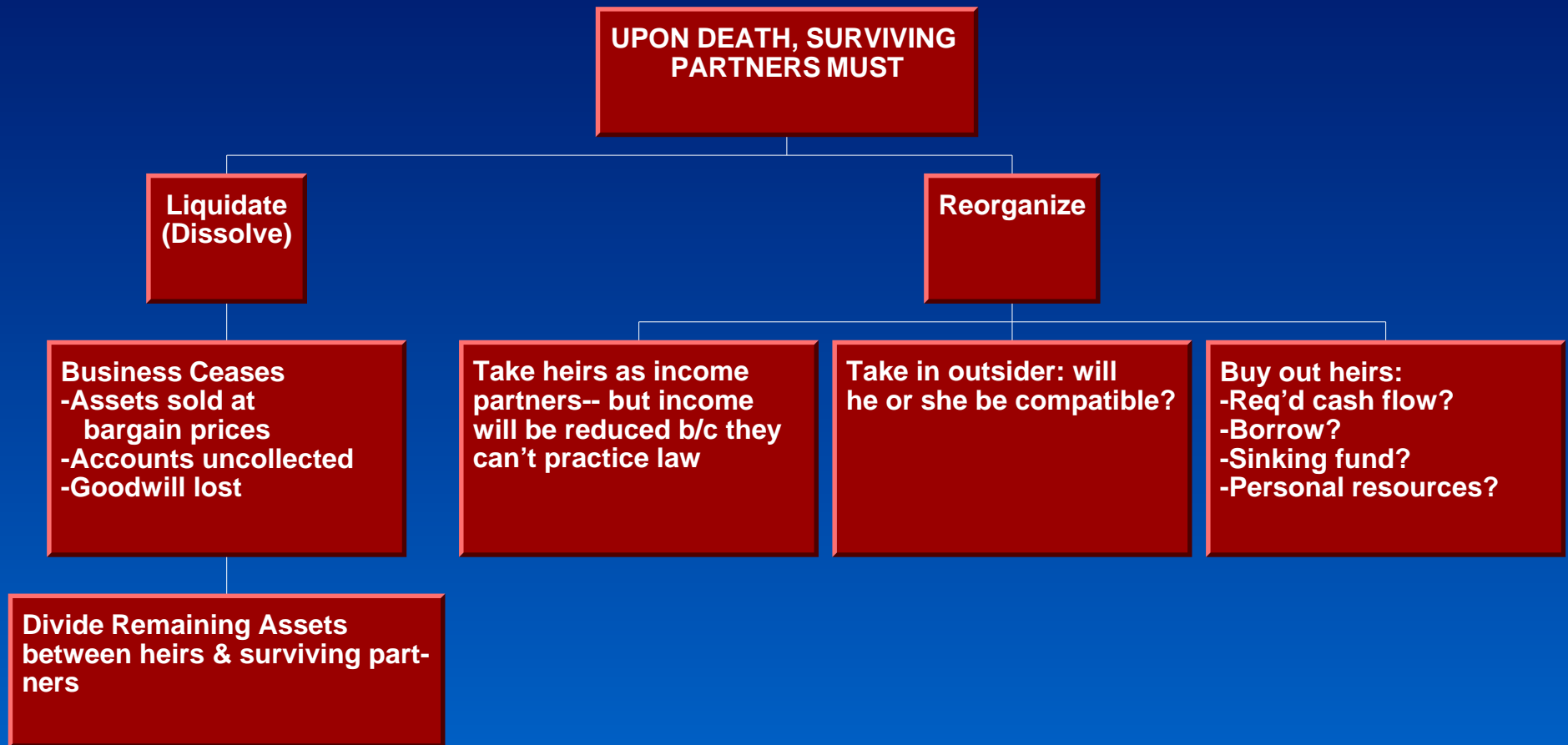
- Odds that one will die before age 65 57%*
(*Source: Commissioner's Standard Mortality Table)
- Odds of individual death/disability per 1000

Age	Disability	Death
27	38.8	1.42
32	43.7	1.72
37	50.3	2.44
42	59	3.7
47	69.2	5.74
52	81.6	8.76
57	98.2	13.41
62	117.4	19.74

TO REPLACE INCOME LOST BY DEATH OR DISABILITY

- ▶ CASH
 - Drains reserves when you need them most
 - Causes strain on partnership
 - You may not have enough
- ▶ BORROW
 - Further shrinkage of income for debt service
 - Credit suffers from loss of key person – higher rates or non-approval of loan
 - Increased pressure on remaining partners
- ▶ SINKING FUND
 - Will you have enough when tragedy strikes?
 - Temptation to use cash for other purposes
 - All gains are taxable
- ▶ DISSOLUTION – *Res Ipsa Loquitor*
- ▶ BANKRUPTCY – Unthinkable but possible

CHOICES FOR SURVIVING PARTNERS



CONFLICTING INTERESTS & GOALS

Do you really want this headache?

- **INTERESTS AND GOALS OF SURVIVING PARTNERS**
 - ▶ Continue to receive competitive income
 - ▶ Grow the practice
 - ▶ Replace deceased/disabled partner
 - ▶ Establish cash reserves
 - ▶ Pay as little as possible for deceased/disabled partner's interest in partnership
 - ▶ Provide income to the disabled partner – NOT
 - ▶ Provide income to the deceased partner's spouse – NOT

- **INTERESTS AND GOALS OF DISABLED PARTNER OR DECEASED PARTNER'S HEIRS**
 - ▶ Continue to receive income
 - ▶ Get fair price for deceased partner's interest in partnership

TRANSFER THE RISK

(LET IT BE SOMEONE ELSE'S HEADACHE)

- FAMOUS LAST WORDS: “My partners will take care of my family if something happens to me.”
- QUERY:
 - ▶ DO YOU WANT TO TAKE THAT RISK?
 - ▶ WOULD YOU WANT THAT BURDEN ON YOU?
- IF NOT, YOU SHOULD HAVE:
- A partnership buyout agreement funded with life insurance
- A disability buyout provision funded with disability buyout insurance
 - ▶ CAVEAT: The definition of disability in the buyout agreement must be the same as the policy definition

ADVANTAGES OF AN INSURED BUY-SELL AGREEMENT

- TO SURVIVING PARTNERS
 - ▶ Complete ownership and control assured
 - ▶ Haggling, hard feelings, and misunderstandings with deceased heirs eliminated
 - ▶ Financial strain resulting from long-term installments eliminated
- TO THE SPOUSE AND FAMILY
 - ▶ A fair price for interest is assured
 - ▶ Family receives money without red tape or delays.
 - ▶ Business value fixed by price or formula, may be usable for estate tax purposes.

- ▶ (Continued)

This could save estate taxes or litigation expenses.

- ▶ Cash proceeds of purchase of interest can be used by family for expenses of estate.
- ▶ The family is free from risks and uncertainty that accompany long-term installment buyout.

- **TO THE BUSINESS:**

- ▶ Policy cash values accumulate tax free
- ▶ Loyalty of employees is strengthened by insuring stability and continuity
- ▶ Credit is improved by cash values of insurance
- ▶ Neither death nor disability will interfere with continuity of the partnership

BENEFITS OF PERMANENT LIFE INSURANCE

- PROVIDES INDEMNIFICATION
 - ▶ Cash to compensate for the financial loss & cost of replacing the key person
- PROVIDES LIFETIME RESERVE FUND
 - ▶ Constantly increasing cash reserve fund
 - An asset of the business
 - Ready source of cash for working capital or emergency
 - Zero net interest loans available
- STRENGTHENS CREDIT
- INCREASES WORKING CAPITAL WHEN MOST NEEDED
 - UPON DEATH OF KEY PERSON
- OTHER BENEFITS
 - ▶ Provide or supplement retirement income plan
 - ▶ Finance salary continuation to deceased's family/spouse

TYPES AND BENEFITS OF DISABILITY INSURANCE

- **DISABILITY INCOME**
 - ▶ Continues up to 70% of salary to age 65 or in some cases, for life
 - ▶ With non-cancellable, guaranteed renewable features, all costs are known in advance
- **DISABILITY BUYOUT**
 - ▶ Pays agreed-upon price established in the partnership agreement usually over a two year period
- **DISABILITY OVERHEAD**
 - ▶ Pays fixed overhead expenses for up to two years, including:
 - Rent, leases, library costs, software
 - Employee costs, accounting costs, other fixed expenses
 - Cost of temporary replacement of disabled partner

TYPES AND ADVANTAGES OF GROUP BENEFITS

Attracting and retaining the best employees

- **DISABILITY INCOME**
 - ▶ Low cost
 - Usually not transferable (portable)
 - Own occupation qualification usually limited to 2 years
 - Rates are not guaranteed
- **TERM LIFE**
 - ▶ Low cost, but no cash value
 - ▶ No underwriting – possible guaranteed issue for groups of 10 or more
- **LONG TERM CARE**
 - ▶ Low cost
 - ▶ Many policies are portable

THE END

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