Employee Stock Ownership Plans

One of the most difficult questions for a business owner to answer is "How do I realize the value of my business without losing control?" For a growing number of businesses the answer to this question is an Employee Stock Ownership Plan (ESOP) since it allows for the transition of ownership in a controlled fashion, enabling the original owner(s) to retain control until there is an appropriate time to step aside, such as retirement. While orderly, an ESOP is not a "set it and forget it" plan and requires regular review. A major consideration in an ESOP is how to fund the repurchase obligation when participants in the plan leave the company.

What is a Repurchase Obligation?

Almost all ESOPs require that ownership interest is held by active employees of the company. Therefore, if an employee in the plan leaves the company or dies, the terms and conditions of the plan will trigger a repurchase of their shares by the company. To repurchase those shares many companies will keep sufficient cash on their balance sheet to offset that potential liability.

> ***How can Life Insurance help?*** With the use of institutional life insurance products, that cash reserve could be used to fund a Corporate Owned Life Insurance (COLI) policy on key participants, while producing competitive returns and remaining fully liquid.
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> These policies are considered a cash equivalent, do not have surrender charges, and earn interest less any mortality charges.
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> - Should a covered participant die, the proceeds would be paid to the company to fund the repurchase obligation. Any benefit amount above the repurchase obligation would be retained by the plan.
> - Should an employee leave the company, funds could be withdrawn from the cash value of the COLI policy to meet the repurchase obligation. Groups of ten or more covered persons may not require medical underwriting.

Why Does Proper Planning Matter?

Not every ESOP transaction involves an immediate sale of all the owner's shares; instead this can be completed through several transactions. In this case, there is usually a Buy-Sell agreement in place so that the remaining shares are purchased by the company, rather than being transferred to the owner's heirs.

Depending on how much of the ownership transfer has been completed, this purchase could be a considerable amount – causing a significant strain on cash flow or added debt during the time of an accelerated transition.

> ***How can Life Insurance help?*** A Buy-Sell agreement would have been established with the company, but there may not have been a funding mechanism outside of cash flow. By implementing a life insurance policy to fund this transaction, if needed, the participants in the ESOP can take comfort in knowing that should the owner die before the transfer completes, they can assume control without an additional financial burden on the company.

Learn More

Reach out to your GPAgency Brokerage Manager to learn more.