Do business owners know life insurance can be used as a bonding asset?

Bonding assets are just part of doing business for many companies. But you can show them a powerful solution they may not have thought of before – life insurance. Here's what you need to know.

What are bonding assets?

Many companies have to keep liquid assets on their books for bonding purposes. Contractors and construction companies in particular must do this as a condition of certain agreements. There are many different types of bonds with varying requirements. And, contractors are often required to purchase them to protect against any number of adverse events. These events may include disruptions in a project, failure to complete a project due to insolvency of the contractor(s), or the project's failure to meet contract specifications.

While each situation is unique, assets set aside are often significant and are often a subject of frustration to the contractor. Corporate-owned life insurance (COLI) may offer an efficient way to allow these assets to serve multiple functions.

The power of COLI as a multi-purpose asset

COLI policies have traditionally been available only to larger companies for benefit funding. But, they're often attractive to all sizes of businesses for these reasons:

COLI may allow assets held in reserve to serve multiple functions.

- Death benefit protection – This helps protect against any interruption in operations an owner's death may cause. The survivor benefit may be shared between the business and the business owner (for personal protection) in whatever proportions make sense.
- Business protection – The policy may be used for multiple purposes. These may include key person protection, buy-sell funding and key employee benefits. At the owner's retirement, the policy may also be distributed and used for tax-advantaged retirement income.
- Balance sheet enhancement – Generally these policies have cash values approximately equal to premiums paid.
- Tax-advantaged growth – Because life insurance cash values grow tax-free, they don't create taxable income.

Bonding assets held in reserve are frequently limited to certain types of cash and equivalents. However, COLI policies can provide the business owner with additional personal and business benefits not available with other assets.

Company receives important death benefit protection

Under a typical structure, the business owns the policy and uses the cash held as a bonding asset as the source of policy premiums. So, there's little net impact to the balance sheet. Policy cash surrender values show up on the balance sheet as an asset for bonding purposes. The business is named beneficiary of the policy's income tax-free death benefit. This may provide a boost to the balance sheet if the business owner dies during his/her working years, thus providing liquidity to meet other business obligations.

Death benefit provides additional protection to:

- the company
- its owner and key employees
- the company's bonding provider

Hypothetical comparison shows benefits of using life insurance

Let's walk through a quick example using a hypothetical 10-year universal life insurance policy (standard underwriting). Assume a 55-year-old business owner wishes to contribute $100,000 of incoming revenue to an insurance asset ($20,000/year over five years allocated to a conservative universal life insurance policy). The policy death benefit for this would be approximately $300,000.

Take a look at the potential results in Year 10:

Year	Cumulative premium	Cash value of asset	Cumulative net cost
1	$20,000	$19,690	$(310)
5	$100,000	$99,785	$(215)
10	$100,000	**$109,175**	$9,175

Now assume the business owner instead purchases a hypothetical $300,000 term life insurance policy, with $100,000 of incoming revenue. After the premium is paid, the remainder is allocated to a cash account earning 1%. A quick comparison shows the universal life insurance policy generates more cash-value potential for the bonding asset.

Year	Cumulative premium	Cash value of asset	Cumulative net cost
1	$803	$19,397	$(603)
5	$4,015	$98,444	$(1,556)
10	$8,030	**$99,895**	$(105)

The longer the policy is in place, the greater the benefits that are realized.

Could a business owner's family receive a death benefit?

There may be additional death benefit dollars not needed by the business. Then, the owner can arrange to have it payable to his or her family or to an irrevocable life insurance trust through a simple endorsement. This results in a small amount of taxable income that will appear on the owner's tax forms. It's necessary to keep the death benefit income tax-free.

Could an owner benefit personally from this arrangement?

At a point when the policy is no longer needed by the business, the policy may be distributed (or transferred) to the owner. He or she may be subject to income tax at the time of transfer, but may then use the policy as a tax-advantaged source of retirement income.

Is there help with managing the asset?

COLI policies from Principal® come with the support of our Business Market Administration platform. This means a business owner receives these valuable services:

Dedicated home office executive benefits administrator – Provides plan-level administrative services for the plan and coordinates with the representative to address service needs.

Economic benefit amounts – Gives information needed each year for reporting on impact to the executive's income; reflects the value of the insurance coverage provided under an endorsement split dollar agreement.

Consolidated plan-level reports – In addition to standard policy-level information, includes a census of covered employees (if more than one) and basic information about the policies that cover them.

1 **Consolidated billing services** – Allows businesses to pay premiums in one easy payment.

Internet access via principal.com – Allows businesses to view information on all policies associated with the plan.

IRS **Report on taxable value of the policy** – Upon transfer of the policy, provides the value of the policy required by the Internal Revenue Service.

Conclusion

Life insurance has both a death benefit and cash value element which makes it a versatile corporate asset. And, although the death benefit can protect the company from unplanned events in both the short and long term, the cash value element should be viewed as a long-term asset.

And, one important final note. There are many types of bonding arrangements. Ultimately, it's the decision of the bonding provider to determine if it's appropriate to use life insurance as an alternative or supplement to other assets.

Let's connect.

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