Audio file

KN8 - Rick Jaye.wpp.m4a

Transcript

Hello and welcome to the Newton Knowledge podcast. My name is Mark Summer partner with Newton Advisors and I'm joined today by my colleague Stephen Target, managing partner and principal of our firm, Steve. How are you today?

Mark, I'm doing great. Thanks for asking. How are you?

No complaints here. All good. So the the New Knowledge Podcast will approve meaningful content to our valued advisor community and clients who are interested in learning more about sophisticated insurance related topics, focusing on estate planning and executive benefits. During our podcast, we focus our discussions on content that will deliver unique insights into the people. Processes and products that make our industry so critical. New one is a national life insurance planning fund delivering customized insurance solutions structured to help clients and their advisors engaged in solving the state. Planning wealth transfer, business succession and executive benefits challenges. We are a. Member of the Financial Group offering our clients access to the nation's most prestigious insurance carriers, along with innovative products available only through our network. Today we have the privilege and speaking with Rick Jay, Managing Director at Business Transition Advisors with BTA. Bti specializes in the design and implementation of employee stock ownership plans, or esops. The firm has over 100 years of combined team experience and has worked with over 40,000 employees, 1200 stockholders and 6.1 billion in market value. Brick is responsible for expanding BTA's ESOP investment banking presence and opportunities with the US. Prior to BCA, Rick was the the Nations director of sales and Marketing for Southwest Financial Group, which is the leading third party group, benefits designs, consulting and administrator. He has a very successful career with a variety of other companies. Following his graduation from UC San Diego, he has spent most of his life in warm weather states such as Florida and California. He's also recognized speaker at investment, financial services bank and broker dealership conferences, and has been a keynote speaker at regional and National Association meetings. He was an instructor on the topics of advanced tax wealth and business entity planning through several advanced accrediting programs. Rick understands the complexities of life insurance products. And the application of life insurance in certain sophisticated and advanced situations. Again, it's a privilege to have you here, Rick. How how is everything? How are?

It's not who we're here for, as it should be, but I'm doing fine and I appreciate the opportunity today.

Great. Steve, take.

Away. Yeah. Super. Thanks Rick. Thanks for being with us. I'm really looking forward to today's conversation. I think one of the reasons I'm looking forward to it is you know many that are listening may not initially be able to draw the correlation between. Life insurance and ESOP plans, and I think you have a unique understanding of our side of the business, I'll say in the life insurance. Space. So I think this will this will help a lot of folks kind of bring these two topics together. These two planning opportunities and certainly with your experience, there's going to be a lot of education presented to our community. So thanks for being with us and and without further ado, why don't we get right into it? I'm going to start

with kind of a a softball question, but you know not. Not knowing where everyone's understanding about Esops is, let's start with maybe the most basic of topics, which is explain what an ESOP is and in the most simple terms.

See, it's a great way to start. So. And I think part of it is the the confusion sometimes that people have in the industry, the business owners along with people that are experts in the wealth and insurance planning around the topic. ESOP stands for employee stock ownership plans and the ownership is an important characteristic which is different than you. You'll hear about with Esops in the public community public, the public business community or public company communities which employee stock option plan. So we're we're referencing employee stock ownership plans and would simple form an ESOP is just a method for a business owner to. Sell their business to convert their business equity into cash that they can diversify and you're ultimately selling it to the employees to an equity transfer. It's not too dissimilar to a management buyout, but the key difference that the Nissar is which we learn as we continue to talk about this throughout the next half hour is the, you know, the characteristics, the tax benefits, the way it gets funded. In its simple form, an ESOP is. A leveraged buyout we borrow. Money against the cash flow of the company. It gets paid off by the tax savings that ultimately takes place when you're ESOP and you're ultimately giving the company or transferring the company ownership to the employees. And hopefully that ties into the both the economic philosophy of the business owner along with the philosophical philosophy with the business owner.

So in the right. Circumstances this could be a win win you mentioned key characteristics, so let's dive in a little bit. Now what? What are some of the key?

Characteristics of an ESOP. The tax benefits are really let's you know sort of the the tail that wags the dog when it comes to esops from the pure, effective or efficiency of the use of capital. There's really a number of tax benefits, but the first and foremost when an owner is looking for exceptional liquidity planning, when they're looking at selling their business or a portion of their business, all other methodologies create a capital gains at best. Sometimes ordinary income taxes to the selling shareholder or partners and ESOP. One of the fundamental key tax benefits. The shareholder, when they sell their stocks, structured correctly. The right corporate organization. They can elect something called a 1042. It's the IRS tax code and it works very similar to a 1031 real estate exchange or a 1035 exchange and life and. What it allows the owner to do is it allows them to reinvest a portion of the proceeds from the stock from the stock sale or from the equity sale, and to postpone and under current law, ultimately eliminate the capital gains tax that would be paid. So you know, depending what state you're in, we're in, states like Florida and Tennessee, Delaware, North Dakota. Texas and others with state no state income tax. The benefit of an ESOP. For the selling shareholder, as they can postpone and eliminate that dilution that normally is being paid in the form of capital gains tax and the other benefits are really what help the company to be successful and be competitive and to pay off the debt. Because as I said before and ESOP is a leveraged buyout, we're basically borrowing money against the cash flow of the company. And so that debt has to be repaid. And how that debt is repaid with an ESOP makes it very effective. The company either gets a dollar for dollar to. Auction for every dollar of stock that it's purchasing. So depending on whether it's a partial sale where you're selling a portion of your stock to the employees through the ESOP, the key is then the deduction that you get for that stock that's being purchased minimizes the ongoing tax obligations to finance that debt. Once the company is 100% employee owned through the ESOP. For us, which is a qualified profit sharing plan or a time defined contribution plan, once that stock is owned by that trust that is parsing out or allocating stock or releasing it to employees

overtime, the company has the ability and the right structure to be. Being completely tax exempt, so there's only 222 legal ways that I'm aware of in the US that you can be a for profit company and be tax exempt and that is to be a credit union competing in the banking industry, which is exempt from taxation and then being an ESOP 100% ESOP based company. And in that circumstance it's still a for profit. Company that all of the profits and cash flow that it generates stays on the corporate balance sheet and is not diluted from the from the form of of personal income taxes as it distributes K1 or corporate income taxes. If it's a C Corp. So the byproduct is under the structure of an ESOP 100%. Best corporation, esops hopefully becoming really taxing sound when you think about it. Then the tax savings by not paying taxes or having to distribute money for shareholders to pay taxes is able to get reallocated to pay the debts. You're really just leaving the company with the same or even in some circumstances, and we're working cash flow and debt provides the liquidity. That it needs to not only cover working capital requirements, capital expenditures, but also gives it excess cash flow to fund into various strategies like Holy Life insurance. Wealth managed portfolios or wealth strategies on the corporate balance sheet to build up reserve to handle executive benefits, Keeneland coverages and ultimately the repurchase liability that we'll talk about shortly. Those are the key care. Those are the real key task characteristics that make that an attractive strategy when you're looking at it over others.

Well, they they certainly sound like pretty attractive strategies and and a lot of super reasons why companies may consider the UM transaction to become an ESOP. You know as all of us know, not every company is the right company for an ESOP with your experience are there, are there certain companies or characteristics that you would say? Would lead a company to the consideration of an ESOP and maybe you know on the other side of that is, are there any, you know, definite notes you would write out out of the gate, say, you know, and esops just not going to be the right the right. Program for you.

And incredible question to be asking. It should be whenever you advisor asked. The business owner, when they're considering working at some type of exit or liquidity planning or die, risking strategy when they're converting the you know, sort of their equity in the business and converting it to cash that can be diversified. I'll start off with where it really doesn't work effectively and we'll talk about where it does and what questions should be asked. It really doesn't work when an. Owner fundamentally just wants to get a check for the full value of their business and walk away and hop on a sailboat and go forward and play golf the rest of their life, and really doesn't. Care about what they leave behind and what ultimately happens to that company once they get their their financial liquidity and that that oftentimes is where an M and a transaction comes into play. You hire a pure investment banker that shops the company, gets the highest price through bidding transaction whether it's through private equity as a financial buyer or a strategic buyer. You know the owner. And fundamentally, when you want to check and you want to walk away and you really, you're done with the business and you've got no other family in the business. That's really where in my mind an ESOP is not something that even should be discussed or considered. The other point is an ESOP, since it's a leveraged buyout. If you think about it, the cash flow of the company. For me has to be able to support the ability to buy the company within a reasonable period of time and kind of the rule of thumb I use is if you can buy a company and finance it because of all the tax benefits of the ESOP. If we can finance it and pay off that debt in an 8 to 12 year time frame, that typically puts it in the framework where the price of the company. From the multiple of the earnings that it generates, which is how you create enterprise value, ultimately that value. So you can be paid off and financed in that time frame. If it takes longer than that, it's typically the type of company that is selling for a much higher multiple a software company, a bioengineering company, a pharmaceutical company where

they're selling at, you know, 1215 or 20 times on current earnings. You could never afford. To finance that type of acquisition and those companies. Again, even if the owner has the philosophy where an ESOP may make sense philosophically, it's not going to work financially because an esop's not not going to be able to purchase the company at that kind of multiple and afford the finance that we create a time that would be something that we would suggest through state working with somebody like you. Not an ESOP. They can look at selling it. We can hire an investment banking firm we can support and help a client do that. But even before that takes place, help the client struct. Sure, some type of executive benefit, Phantom stock plan or stock option plan for their key management. So that upon that type of equity event and sale, the owner is getting taken care of getting what he wants, which is that very high multiple. But he's doing something to protect or reward their key management team in a financial way. So if the buyer comes in and then 12 months later. And it takes care of weighing off or terminating your subway and top management team. They've got some significant economic reward that they've gotten that puts them in a position that, you know, the the owner is taking care of them and fulfilled his philosophical approach. So what he wanted to do, which is to protect key people. That's really in my mind, where esops don't work now where they do work, you know, they work very well when you've got an owner and this gets back to the fundamentals. We talk about the financial flaw or the financial requirements that has to be a company that generates cash flow, has consistent cash flow, is sells or ultimately the value is somewhere between. 5 to 8 times as a multiple of that of earnings or profits. Maybe she calls it EBITDA earnings before interest tax. Is depreciation and amortization businesses sell for multiple of those, so construction companies, engineering firms, manufacturing firms, those that are sort of the foundations of of America today, the mom and pop businesses, you know that, you know, can run anywhere from 10 million to $500 million in value, but owners that. Realize and believe the business has that kind of value. Nation, they fit the economic approach. Now it comes down to the philosophy. Where does these soft work? It's an owner, fundamentally that loves the company, cares about the legacy, believes in the community and protecting and preserving the the workforce within the the the sort of the geographical marketplace where they are, who cares about their customers and their employees. It's kind of owner that when they walk through their. Manufacturing plant is referring to people by name. Those their kids is invited to weddings and graduations and that kind of that sort of philosophical approach that is a business owner fundamentally that really cares about the company. And in those circumstances many of the owners don't want to walk away. You know the business is. The family and they want to stick around in an ESOP. Done the right way, structured the right way. All you're doing is converting their equity in the company to cash that they can redeploy and put other places, but they can still operate it and run it back as the CEO, draw salary, qualify for benefits and in some circumstances qualify for participation inside the ESOP as an employee like everybody else. But the legacy of the business will continue. Those are that's really when you look at an ESOP and when it fits the criteria, what an owner wants to do.

I like the way you explain that. I mean, legacy planning is a lot of what we do in Newton. One understanding that there's an opportunity to capitalize on the successful business, but also taking care of all the people that help them get there. You know, I I wonder if there's been any any studies or any kind of evidence that might link performance. The productivity or more? Now of employees that are part of an ESOP who might be performing in a in a better manner, because you know they're they're eligible for the, for the profits and the proceeds of the company, just like there was that founded the company. Have you seen anything like that? Is there anything or is that just kind of a something that is difficult?

To measure. Yeah, that's there. There is there's. There's two key associations in the ESOP industry. The EO employee ownership. And then there's the Nceo national. And they're ESOP ownership. And then there are a number of academic institutions. So my alma mater, undergraduate alma mater, UC San Diego, has something called the Vices Institute, which is part of their graduate program, their Business School that does research and supports esops around the US and does a lot of as an academic institution, they have the financial resources. To polling and research reports and marketing reports to ESOP companies to determine what had been the impact. Any industry to companies when they convert from ownership to employee ownership, Ohio State is another one, and also Keene State. These institutions not only do they promote within their communities and nationally esops, but they also do a tremendous amount of research around the business changes that take place for companies that do it. And I think and don't hold me. Because it's been a while since I've seen some of these academic reports, but I believe it used to be that when a company converted from stock ownership owned by individuals to to ESOP with. Ownership across across the platform of eligible employees. They saw an increase in annual productivity, meaning in the form of increased EBITDA and top line revenue that ranged anywhere from 2.3% to as much as 3.5% per year. So you know that was relatively early in the cycle. And so if you think about a company that normally is growing. Let's say 5% per year and now you start applying. You know a 7 1/2 to an 8 1/2 percent growth rate. You know, that's pretty significant where companies are really doubling size. You know in every you know every seven to 10 years and so and the employees start, the more they're the more the ESOP is in place, the more stock that gets released the longer the time frame is and the faster the debt for the acquisition gets paid off, what ends up psychologically happening is the employees get their statements every year as their retirement plan. They see how many. Here has been released to them with their vested benefit is and with the stock value increase is and you'll see exponential growth that takes place for those that play hockey. It's kind of like a hockey stick the first few years when we first do an ESOP, your blade is sitting on the ice and you're having moderate growth, but you still have a lot of debt on the balance. As I mentioned before, the the proper value for business is one that can have the have all the debt for the acquisition paid off in an 8 to 12 year time frame. So two to three years in the in the into the transaction you are paying off debt, but you still have a lot of the balance sheet. You are growing the company, but it's early in the business cycle. And So what starts to happen by that. You know 3rd, 4th and 5th year. You start moving up the blade to the to more the handle and you start seeing that exponential stock value growth that takes place. An ESOP is the only real way that an employee who is a participant in retirement plan can have direct control over what they do impacting the size, the benefit and the value of their retirement account. Because we all know, you know, if you own fidelity, Magellan or fuel Prices technology fund in your 401K, you know you go out and buy. A new Dell computer. You're not going to have any impact. That's not going to impact the, the, the performance of Dell therefore impact the performance of your mutual fund. But if in turn you and a group of your employees and your company are able to more effectively manage. Based on increased productivity and be more effective where you're not having in a construction company that has a defect and you control that you do quality, quality work up front where you don't go back to the job site a second or third time to correct those defects that were done originally, you become more effective and more efficient. You increase your margins and increase your profitability. And you'll see that impact directly in. Statement at the end of the year when your stock value goes from $4.00 a share to $8 a share in a given year because of increased profits which gave you more cash to pay down debt, and because the company is valued based on a on a multiple of its net income. As we talked about that multiple of EBITDA, EBIT increased EBITDA. Therefore you're going to

see that direct impact in the increasing. Increasing stock value that you helped create. It's really incredible when you look.

Yeah, right. Yeah, it just did. So powerful. And it it it speaks to the opportunity of of employees at any level to help kind of set their future in, in, in privately held company. So it's just it it's it's a it's a wonderful opportunity. I'm going to circle back now and and try and help our audience understand the correlation that you and I know about. With life. And I I think maybe maybe the place to start would be to ask you to do a little bit of an explanation of what ESOP repurchase obligation studies are because you know that's where where we've seen the the most impactful application of life insurance. But what what, what does that mean? What's a repurchase obligation study?

Yes. So the repurchase obligation, if you think about it, you've got privately held stock. The ESOP is a qualified profit sharing plan. And so the only asset typically in the ESOP trust itself, that retirement plan is the underlying stock in a company that employees are Gray. And that stock is released and it can be over 20 years, 25 or 30 years. And so they build up that stock, they vest the benefit. And when they ultimately retire or die, get disabled or trigger through either severance or termination, they're due the value of that stock. And so it's since it's privately held stock, we don't allow that. Thought to be taken out of the trust, it stays in the trust and so if I'm entitled, as an example for A and I'm benefit. I've worked for a company for 10 years and I'm owed $300,000 cause that's my stock value. We don't give them the 300,000 in stock. The stock was repurchased. The idea of the repurchase liability it is repurchased by the corporation or by the ESOP itself. So that the stock stays within the organization and the employee then gets their payout that they can turn around and take as a taxable retirement plan distribution just like a 401K or an IRA distribution or they could roll it over into a 401K if they go to work for another employer or they can roll it over to their IRA account and avoid paying. Current taxation on it. So the idea of the repurchase is one of the largest and most important characteristics of an ESOP because as companies become more successful profitable. They all pay off their debt and more stock is released and companies grow. That repurchase obligation that put obligation between the ESOP and the employee and the company becomes larger and larger. And so one of the things that we do and not all companies in our industry that do what we do, perform the service and we. Don't know why. Because we think it's that we and the client have a fiduciary obligation to understand this. We when we do a transit. Action extrapolate both the employee group so we look at the actuarial census and the employees carry that out over projection of 20 years. We look at what the current value of the company as pre transaction and then we look at it post transaction model out the debt repayment model out of projected growth rate of the company at a moderate rate over time. To project based on the age of the employees, a turnover rate, the death rate and mortality and morbidity rate for disability, a termination rate. Along with a retirement rate and that allows us to understand on a projected basis over 20 years what we think ultimately the obligations that repurchase obligation is going to be in a year by year basis. And so in in understanding what that is, it allows the company and the Board of directors of the company to understand how much money they should be setting aside. On an annual basis and what those obligations are to buy the stock back from those employees in in years by which you have requirements to repurchase their stock. And so in understanding what that obligation is actually and preparing. But on the front end protects the company on a long term basis as far as the legacy for perpetuation perpetuation of the company for multiple generations. Because unfortunately in my career in, in this world, what I have seen far too many times is very successful companies do esops they do them, the owners want to do it for all the right reasons. They care about the company, but they want to get their

fair market market value. They deserved to because they took. Risk in building it, they wanted to. Justify. They also want to protect the legacy of this business and reward key employees and long term employees for. The for for. Helping the family that own the company to be successful and they want to give back and the problem is, is if you don't take that repurchase funding and understand that obligation seriously, you don't set money aside and let that money come down. And grow overtime. It was Albert Einstein was asked the question once, which was the most powerful force in the universe. It's compounding of interest. Well, it was only partially right. It's actually tax free compounding of interest. And so the byproducts of putting money into instruments, like life insurance, structured properly, compounding overtime allows you to meet your future. Purchase obligations with the reserves that you build up and. When you're using. With a large organization using corporate owned life insurance and you're doing it in a way that you're ensuring a larger block of people, the unfortunate part of all of our lives is at some point we're going to die. And the point of using a large block of employees is there's going to be some premature guests that take place. So you can turn their mortality into a profitable event that increases the underlying rate of return. You normally are getting just on the cash value growth and the policies over time and that's why life insurance makes so much. Sense as part, if not all of the funding requirements to looking at that repurchase obligation, the cash value growth that takes place on a normal IR basis in addition to the mortality gains that you get over periods of time on the block of business that you're purchasing. And that's just one of in reality the refunding requirements that really take place in most ESOP. Transactions through the corporate.

Like I think the I'm going to go back to the legacy comment you made earlier and the ESOP understanding that this liability is out there and there will be capital required in order to purchase the shares back at some point. And in addressing that on an annual basis and what we've seen in the market is traditionally the companies, the ESOPS will will start putting away. Capital short, mid and long term investment structured assets. And we, we would call that the three legged stool which is which is stable, it helps them offset some of the future obligations they may have. But by coming in with the death benefits and and I couldn't have said it any better we're we're we're now utilizing death benefits that overtime will pay out and if the policies are structured appropriately the. Rate of return. The internal return of the premiums against death benefit at normal life expectancy are very compelling, but what we know is that, unfortunately and tragic. Some folks may die prematurely, and so those rates of returns may be greater for those premature deaths. And for those that have lives that that, that extend beyond traditional mortality, you know the the returns are still very competitive. And what what I want to note is when we jump into the life insurance. Here there are some clearly defined rules and regulations. About who can be insured, and frankly, there's also a lot of regulations around making sure that those individuals who are insured have authorized the company to go out and buy insurance on them. So you know, this is not a a backdoor writing, a life insurance policy on someone. It's a very mathematical financial calculation that's done. Full disclosure and then acceptance by the employees, the executives that that have the insurance written on their lives and that's part of the the art and the science of of the insurance part of the business is is understanding who can be insured, who should be insured. 3rd and then the appropriate premium structure so that the policies work efficiently. So that's our involvement there. I you know, I I think that you you understand that you explained it really well. Sometimes it's it's something that takes a you know a little bit more of a of a creative outlook from the ESOP standpoint. Is there anything else you you would? Add to the insurance application that I might. Kind of address.

Yeah, I think those. Are all very valid points, and it's important you know what we find is you know the idea of, you know, well designed, well structured, very efficient use of quality insurance and quality insurance products that are really investment driven. Provide tremendous, tremendous opportunities for containing very favorably for let's say a managed portfolio. And and restructure very cost effectively, which makes it very competitive from that standpoint. And especially today when you've got interest rates as low as they are, you know people say well, you know historically in the investment world you'll have investment managers that talk about using bonds as the fixed asset. You know the the this, the stable asset within a portfolio told you have today. You know the Fed is very clear. They're they're they're going to most likely tighten. It's part of that. Interest rates are going to go up. So the problem you've got now in, in, in putting together portfolios is how do you find? You know bonds that provide favorable returns for stability and and have protection of principle and the insurance products are just so well designed for that purpose. The other two components are we we just briefly talked about the one sales or the one opportunity which is the purchase obligation and that's often oftentimes the biggest the long term. The key characteristic of where long term investments and insurance can be deployed. But on a short term basis, you've got really key man coverage. So in turn, especially you're doing partial sales. You know, if I'm, if you and I are partners, Steve and let's say, you know, at my age, I'm much older than you and I want to retire and you're going to buy me out. We do it through an ESOP, which is an effective way of doing it because of the tax efficiency. The the problem is, is I I want to make sure that, God forbid, something happened to me. You know, my family gets paid off. And so as you know, key man. Coverage can be deployed and put in place for that purpose, and the banks. Oftentimes we're doing bank financing for a portion of the the the debt financing the banks are going to mandate it and you can use term insurance for that. But I've never been one to want to waste. So when you start looking at, you know, people like you that are sophisticated in the the well side and the management side and have experience in that world of how to design insurance, you can actually solve the the key man coverage requirements for the for death benefit while the same time on an interim basis, while that death benefit risk is high, make sure that the policies are building up cash to get that. Normalized IRR, it's the way of looking at multiple multiple, solving multiple problems that we're trying to solve and using a common set of strategies and compass set objective and then the same is true almost in every ESOP that. Do for the non selling shareholder, but key executives we layer on top of some type of executive benefit plan. So either in most cases we like using what they call a Cyrus plan Stock Appreciation rights plan and the trustees that are brought in to represent the employees in the ESOP trust like using these strategies so they can tie on team management. Their company, on top of what they get in the ESOP, they can tie them into these executive benefits and again, you know when you're laying on that type of strategy. Energy. You know, you can either have, as you know, in the world that you work in unfunded or funded, that funding responsibility, so only funding liability on the balance sheet or you can fund it over time. So when there's a training event, so those key keys actually has reached the point where they're doing money. You've got the reserves that are set aside to go ahead and accomplish it. Those 3 strategies on the corporate balance sheet. Our common strategies that are deployed and oftentimes you're going to use one set of policies. That will be able to be designed to meet all three of those objectives. The shorter term objectives for the key man, the mid term objectives for the executive benefits and then the long term objectives for the repurchase liability, all solving multiple strategies but using a common set of policies to accomplish the overall objectives does that makes.

Sense makes a lot of sense. The Old Swiss Army knife company. Perfect, Rick. Thanks for being with us today. I know we covered a lot of material. I'm just going to ask if there's anything else that you feel would be important or you'd like to share with our?

Audience. Well, the only thing I would say is there's, there's been a lot of discussions and conversations on through the end of last year talking about theoretical tax law changes that could either negatively or. Positively affect. Will the ESOP world and you know again, I'm not a political strategist. I mean, I vote in every election, but the byproduct is I don't know where tax laws are going to go. And if Biden's gonna be able to get any kind of tax legislation will be passed. But I will just say, as it related to what was being proposed, nothing in the proposed legislation was going to have a negative effect. The Esops there was a complete contrary. There was potential positive legislation that was going to impact the ability to do 1042, so. Today we talked about the 1042 the ability to postpone and eliminate the capital gains tax. The key to that is you gotta be a sea Corp when you're doing the transaction to qualify those provisions that were in the potential by the Biden tax bill that would have allowed the 1042 for US corporations, which would have simplified the restructuring. When you're doing esops. To provide equal rating from the tax perspective to escorpi esops and C corporate esops. So that would have been positive. The only that was positively affecting ESOP, which is why most companies in this space had record years last year. Anybody who is expecting or anticipating doing any kind of transaction. Wanted to get it done before the tax laws increase because one thing that esops do very attractively because of all their tax benefits, guilty become corporately tax exempt, the ability for the owners to minimize and eliminate capital gains tax, the higher tax rates would become the more emphasis and the more and the more likely. More business owners would be looking at an ESOP. An option, even if it doesn't fulfill every one of their their qualitative and philosophical on characteristics. When you look at money and money out what I get net of net of taxes ultimately even though I've got to wait for all my money to an ESOP, the present value of that, the way the ESOP works would would provide a much larger. Economic benefit because of the tax savings. If tax rates would have gone up, which puts more emphasis on it. But that does happen. So maybe really I would add, I do appreciate the time today and hopefully you guys found value in this.

Absolutely. Thanks for being with us, Rick. Enjoy the day.

Thank you so.

Much thanks, Rick. Have a good one. Alright guys.

Burial and opinions voiced are for general information only and are not intended to provide specific advice or recommendations for any individual to determine what is appropriate for you, please contact a member of our team.

KN1 - Tom Hollinger.m4a

Transcript

Hello everybody and welcome to the Newton Knowledge Podcast. My name is Steve Target and I'm one of the partners here at Newton one. I'm joined today by my colleague Mark Singer and today. We're gonna have the. Great opportunity to hear from our founder, Tom Hollinger, the New Knowledge Podcast is intended to complement our. New knowledge webinar. First, we're going to hopefully provide meaningful content to our valued advisor community. And generally anyone interested in learning more about sophisticated insurance related topics focusing on estate planning and executive benefits, we're

going to focus our discussions on timely issues that provide you with unique insight into the people, processes and products that make our industry so critical. We're also going to occasionally highlight individuals who have been meaningful in new one and therefore have contributed to helping us serve our clients. New one is a national life insurance planning firm delivering sophisticated solutions help. Clients interested in estate planning, wealth transfer and business succession and executive benefits. We're a member of the and Financial Group and we offer our clients access to the nation's most prestigious insurance carriers. We would also develop innovative products available linked through our network. So without further ado, we're on to our program and. I think we really have a unique opportunity to hear from our founder, Tom Hollinger. Tom, welcome and welcome from Arizona. We understand you're in the warmer weather than we sitting here on out on the East Coast. Thanks for being with us. Well, thanks, Steve. The weather is in mid March right now, 85° in Arizona. So it's not too bad right now. It's sunny. No clouds. So not a lot to complain about. And thanks for having me. Appreciate it. 2022 is it is a is. A big year for you? I I don't know if I'll share the number of years, if you if you care to you. Right, but you've. Been in the insurance business for for a couple of years and. Anyway, and a lot's changed. What do you think? Are there a couple of positive changes that have occurred in the industry maybe since you began or over the years that that, you know, you look back and you say, boy, these these really help our clients and help the insured marketplace? Further question then? And and Full disclosure, I've been in the insurance business 50 years and in 1972. There are only. Two policy life insurance policy choices, term insurance or whole life. And if you didn't like turn insurance, you bought whole life. You didn't like whole life. You bought term insurance. There were no other choices. What has happened over those 50 years is today? We have term insurance and we have whole life plus probably 7-8 nine different permitted policies like variable life or index variable life. Or universal life, or no last guarantee. There are so many more different policy choices today rather than back in the early 70s in the 80s, where there was only two policies to. At all today we have the opportunity to have different policy choices, which I think is really good for the clients. It's very good for the public. We have the we have the opportunity to expose to our client all the different policy choices and we will explain the advantages and disadvantages of those. And I would. Rather take the choice of. Policy design, particular most most comfortable. That's a huge change and moving forward it continues to be that and transparency of policy designs has also changed. It used to be back in the in the 70s, we used to call the whole ice house. It was the black box. Nobody could ever figure out. Except for an actuary and life insurance company, how they ever came up with the premium Co. Today there is total transparency in the illustration that is given. To the client. On how the premium is made-up, whether the asset based fees or the how, the cost, administrative costs or what have you. So there has been a lot of changes and and for the good then they should become and more changes should be coming in the future. Yeah. Yeah. So that that gives our clients more freedom to pick and and choose based on what their personal goals and objectives are and helps them for those who want want to see behind that black partner inside the black box, what's happening in there. So let's Fast forward. To current times. We've had a change. Of administration, there's been some talk about. Tax changes. Are there any opportunities that you see in front of of us right now planning opportunities based on where we are? Are you hearing about anything that may be coming in? In the future, that would benefit our clients from a planning perspective. Well, I think there's probably. Two major planning opportunities that may be coming open for US planning with clients with the new administration. One is in the estate tax area for individuals to pass assets to the next generation either at the. In the form of a gift, the poses are then that could go down as low as $5,000,000 which is substantial. So you know couple that used to have $22 million could pass as over generation to today it's

gonna it could go to $10 million. So that's a huge huge. Change. I think the planning opportunity is that it's very clear that from a gift tax standpoint, we can gift it right up to $11 million. So for somebody who has an estate tax, I. Two in that range, we can just property right to its generation 2 today and if they change it down to $5,000,000 it will never be brought back to an indoor state. So I I think there is a real planning opportunity there and winter trust is called slats, maybe an opportunity for us to look at with. Clients, I think the other opportunity is that. Income tax rates are going to go up for people and our clientele. Life insurance has some very unique advantages. One, the death benefit is tax free. We can get the death benefit out of the estate for estate tax purposes. The only issue is that today life insurance got the cash rate is. Also, grow income tax rate and I think we may in the future if income tax rates. Do go up. We may see life insurance being used as accumulation vehicle to accumulate wealth. For pure investment purposes, lower their debt benefit as much as possible and put as much money in it in the policy as you can because you can grow income tax rate, you can take out basis income tax free. And you can. Make a loan from the policy income tax free so that becomes pretty attractive. So the offset is. You're paying cost of insurance charges versus some taxes in the regular investment account. And I think that income tax rates going up, I think it may be a planning opportunity for everyone. You know one of the. Things that you've installed in the in the Newton one firm that we take to our clients on a daily basis is open and honest conversations and and as you mentioned before, transparency, if you look on the other side that all the people that we serve as clients is, is there something that you know when you look back that you want to make sure that. Everybody understands about the life insurance business as a consumer. Well, I guess probably the biggest frustration that I can use that terminology. Is that life insurance illustrations that are published by a life insurance company and insurance agents or insurance professionals use those to create a premium are basically wrong because they're wrong is to say that the premium is based on the interest. Assumption and the only thing we know is that the interest assumption that we're using today to create the premium cannot be consistently constant for the next 40 years of the power. Policy. So if the policy interest assumption to create this $10,000 premium was 5%, the only thing we know for sure is the crediting rate will not be 5% every single year for 30 years. But there's only one policy design that is an exception to that. And my concern is that. And my frustration has always been that advisors, some advisors and proposed in shorts look at the planner and say, oh, it's $10,000 and they say well. It can't go up or go down. If I pay $10,000, everything will work out fine. That is completely false. The premium is based on an interest assumption, as you know. See what we do at new one is we track this interest assumptions every year to see where above or below the buggy. So if the interest assumption is 5%. When we started out and we made six, well, we had extra cash value. The policy on the other hand, if we made three, we have less cash value in the. Policy. So the interest assumption on life insurance is frustration because it creates a premium and the only thing you know for sure is the premium is incorrect, that's for sure. Let's go back in 1999, you were a successful business owner at that time. You decided to make the move over to bring your home. Going over to the M Financial Group, could you share with us a little bit about what you wanted to build on Newton one and maybe a little bit about the end Financial Group as well for those who are not familiar with? Well, I have been a career agent with Provident Mutual Health Insurance Company for many, many years. Well over 25 years. One of my frustrations being our career agent with their primary company. Is that you don't necessarily have the opportunity to get exposed to what are the other life insurance products. Is there something better out there for a particular client and particular need our firm and groom? And I was frustrated having only primarily. One product design. Time. So I had the opportunity to join the in Financial Group, which then opened up the door to many policy designs. Many insurance carriers total

transparency and gave me the flexibility and design of the life insurance policy and career choice that I did not have before. That was the reason that I did it, and I've been thankful ever since for doing it, and I think our clients clients would feel the same way because I'm creating proprietary products. What I always say retail pricing versus wholesale pricing. Has made a huge difference in our designer policies for our clients. In time, and also has its own reinsurance company. What what does that mean for the policy owners that are and the new one clients that may be exposed to the reinsurance market through the M rate? But you know. It's I I give a lot of credit to the Board of directors of own financial and. Over the last 25 years or so, or 20 years, 23 years or whatever, I want to know all the Board of Directors that I was on the board of them. But one of the. Things that we. Had to be very sure of that and financial corporate. Is that we knew that our relationships at the life insurance company level, they used all mortality cost rather than their mortality cost to create a premium, which is why our premiums are lower. Than normal, and by doing that we had to have a reinsurance company also where we reinsured approximately $1,000,000 of debt benefit of any policy we wrote. So what that allowed us to do is to sit in the exact same side of the table with a life insurance company and designing the policy. And administering the policy over year over the. Years to make sure that that the life insurance carrier is going to do what they say they're going to do and what they promised to do and they have to do it because we have this reinsurance company. So we're part of the game. We have the risk in the policy, if you will. There is no other distribution system in North America that I'm aware of that can say that. As a group in designing and helping their clients being in the same side that payable as a life insurance company makes sure things. I'll go wrong, yeah. That's important. So let's say with that being, we're sitting at. The table what? We know is that these types of projects and engagements that we work at in Newton one are typically sophisticated state planning projects, executive benefit programs. There's all these other parties at the table with us along with our client and we're all sitting on the same side of the table. So the attorneys that are representing the client, the CPA firms and the accountants, sometimes the wealth managers, you know, all of those professionals that work in collaboration with us. And you've done a really. Good job of building those relationships and helping. Our clients understand that that we're, you know, we're really interested in and and frankly we consider it part of every project. So important to be working with the other advisors is. There something that? That you think helps build those relationships or what? What do you think makes the collaboration with the other advisors working with our clients so effective? The bottom line is the client is the most important person in that transaction. Two or three brains, or four brains is better than one. I've always felt that the more advisors we can get to talk about the client situation, the tax strategies, the non tax strategies, the emotional strategies are much more important than just one person. Trying to help a client figure out a situation. Tom, I have a question to go back to the reinsurance component with them being one of the main factors in regards to how M firms receive such exclusive products and pricing. Does persistency and premium amounts come into play in regards to? Our ability to provide exclusive. Yeah, it's, it's good. Good point, mark. It does. Our persistency is so much better than the industry average life insurance companies. Make money in. Life insurance policy, as long as it stays in the books, but along the life insurance policy, stays in existence, the better the insurance company can make the profit. And our persistency is 20%. Better than industry average. And the policy size is huge. I mean it's very simple. I go to the hardware store and I want to buy one not and 1 bolt. I pay X, but if I buy 2000 I would have had a lot less than X -, 1. So the size of the policy in the emerald is substantially higher than industry average and persistency. How long the policy stays in the books is so much longer than industry average, which is all profitable things we bring to the insurance company and saying This is why we should have better, better. I'm gonna. I'm gonna tie together a couple

thoughts here, and then I'm gonna ask the question and the first thought I wanna present is in really a compliment is when you started Newton one. And to this day maybe better today than when in many years past. You know, there's a. Normalized succession plan in new. One with multiple generations of advisors that are going to be there for your clients, for our clients, for getting one clients for generations to come. So helping clients understand that you know policy that is bought or sold and put into place is not a is not a one time transaction. It needs to be serviced. Overtime and that the death benefits will be benefiting future generations so that it's important new one future generations are connected with client future generations. But I want to talk a little bit about the audit process and the annual review process. And Newton won. And why that's so important. You know, it gets a little bit back to your earlier comment about illustrations on paper are just that, that they change. And so therefore it's it's important to monitor and and make adjustments if adjustments need to be made. But talk a little bit about your your background on on why you've implemented. You know, really. A strong annual audit annual review process. Well, see if. The the annual audit situation really came about when we when we when we started with them financial. Since we totally. Understand that a premium is based on an interest assumption that we know cannot be the same for the next 40 years, which means the premium has to change or the policy will not perform the right originally. Illustrated we do an audit every year on the policy to determine are we ahead of schedule or behind schedule based on that interest assumption. And we keep doing that each and every year. The policy will then absolutely perform the way we originally designed it. Whether the interest assumption is lower than expected and we have to put more money in or the interest assumption that we're using is less than expended and we can put less money in. But the audit process guarantees that the policy. Will perform the way it should. Has too many policies today, unfortunately. If they're not, have. Audits the insured gets the age 85 or 90 or whatever age later in years he gets a letter from the insurance company and says you used to pay $10,000 a year to keep this policy for us. Now you gotta pay $85,000 a year because it was not the the interest assumptions. Did not work out as anticipated. Well I I've gotten. Phone calls from attorneys who represent those clients, saying what the heck is going on and there's nothing wrong with the insurance company. It was a good policy design, but when it started in 1970, the interest of Sumption was 80% of the day. The interest assumption was to. It goes from 8:00 to 2:00. The policy can't perform as well, so the audit is a is a big transaction that we do every year. And I believe our advisors that clients appreciate that the only thought that you mentioned, Stevie, is that when you deal with multiple generation families, generation one, generation two, generation three, yeah. Well, it's a question this time, you know, you're a good guy, but you know your weight here is getting whiter and it's getting thinner and. I don't think you're. Going to be here 35 years from now or 40 years from now, when generation 2 needs to help on redesigning this policy or helping us change it or doing the service work on. And that's really where realistic such a plan. To do 1. We're just like any other major company. We have partners in their 60s, their 70s to 50s in their 40s and soon to be in their 30s. So we have we're able to service contracts multi years into the future, which is something that should be done. Which allows the policy to stay in force, which makes the insurance company happy, but more importantly, allows the benefits to be paid as anticipated. I'm going to bring up the topic. Of underwriting and. You know, for our individual clients, we're we're implementing placing individual life insurance policies for state plan recorded some of our corporate clients on the corporate marketplace, maybe some of the the medical underwriting is abbreviated because of the number of contracts or the types of policies. But you know the only way the process is overwhelming for a client. We're looking in the medical backgrounds and sometimes it takes longer than any of us. Would like us to take. You know, I've said that underwriting is both an art and

science, but what you've done in in implementing the art and the science effectively in Newton one again I think is unique. Can can you speak a little bit to the process that you have implemented to walk clients through the underwriting process? Yeah, sure. So so you know the underwriting process. Is boring. It's not flashy. Our clients would desire the best design life insurance contract for the best death benefit and the best premium. Well, we know at the end Financial Group we have proprietary pricing, wholesale pricing rather than retail pricing. But that only works very well if the insured comes out as a standard rate or preferred rate as a super preferred rate rather than rated. So we may have the best product design. In the world. But if our underwriting does not enhance our pricing. It's not going to do any good. When I realized that coming with MI don't want the underwriter at a life insurance company dictating what my clients status will be, is there going to be standard preferred super preferred or rated? I don't want that one person making all the decision. I'd like to know that information. Before we even send the policy, the policies out for underwriting purposes to the Life insurance company. So what we've done and even when is we. Do exactly that. We do all the other, all the medical information in house into our Wilmington office and we have our underwriters go through every single page to make sure all the things are completely exposed and understandable before we send it to the underwriters at 10-15 different life insurance companies. And when we set it up, we know the individual standard. We know that proposed client is preferred and if we don't get preferred, we're going to be asked why, because our medical people in the House have already gone through the file. The other factor is if there are things missing in the file, we need to find that. Now we get paid to provide great pricing for our clients for pricing is not only the premium from the insurance company, it's the underwriting process that really creates a good premium. Maybe even said another way, Tom is it allows us to be proactive on behalf of our clients and also. Really advocate for. For them, rather than being reactive, you know in many cases in the insurance industry, the process is a reactive process for the clients and the advisors, we don't want it that way. We want to be step ahead anticipating and then making sure that everything's cleaned up and buttoned up by the time they get to the to the carriage. And and see. Another good example is some. Barriers have a lot of knowledge on analyzing the health. If somebody had a heart attack, other carers may not have that kind of knowledge. There are a lot of kind of different diseases that people may have, and some carriers have more knowledge in one area. Than another area if you will. We also have to understand that and know. Which care to go to with those particular problems? Which makes a makes a big difference. Underwriting really determines many times what carrier would we reuse for a particular client. So I'm I'm going to close up here with a comment and then a question and the and the comment is one that you would ask me not to make, but I will and it's that all of us a new one and our advisor community and our clients appreciate what you've done for us. You have an amazing way of looking forward, a great positive attitude. We appreciate that. So thank you for that. So that's my comment. I I don't expect any response from you because I know it would be. So my question is looking forward, what are you most enthusiastic about for Newton, one for end financial for our clients maybe for the? You know, to see what I'm most. Excited about at my age today at 70. Is the quality people we have a new one, including yourself, Mark Singer and everybody else in that. I've not built the firm. We have built a firm. We have built relationships with advisors all across the country. And more importantly, we've built clients. They're just super, super people to deal with. Our clients are wonderful to deal with. I I think that's that's the thing that makes me the happiest and I know we will continue to do that in the future. Well, we thank you for sharing your your valuable time with us today. I know that there's some some tidbits in here, some diamonds. That ways that listen to this podcast. We'll take away. And thanks for being with us. Thank you, Steve. Thanks. Thanks mark. The material and. Opinions voiced are for general

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