



Dealing With Post-Termination Obligations Within The C-Suite.

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In these volatile economic times, companies find themselves making difficult decisions with respect to their staff and leadership. With ever greater frequency, board terminations and mergers drive corporate benefit managers in search of unique insurance solutions to fulfill corporate post-termination obligations to their top officers. It is at this point that well educated and prepared insurance advisors can add considerable value to their already stressed clients.

The typical problem

Issues often arise when an attorney drafts otherwise well-written employment, change of control and severance agreements. The problem generally occurs when the attorney does not feel the need, or does not have the ability, to consult the corporate insurance advisor relative to post-termination benefits obligations.

Most commonly, we will see language in such agreements that stipulate the following: "In the event Mr. CEO is terminated for any reason other than Cause, he shall be entitled to receive all benefits consistent with the Company's policy for a period of XX months following termination." When you start breaking down the components of Mr. CEO's benefits package, problems start to emerge.

Case study no. 1

To illustrate, consider Middle Market Bank, of which CEO and CFO both execute employment agreements, including "change of control" provisions that obligate the bank to maintain equivalent benefits as afforded to the severed executives prior to termination, for a one-year period post-employment. Both senior executives are terminated due to the bank being acquired by a larger competitor.

The health insurance is easy to manage via COBRA. And the modest life insurance obligation is fulfilled by converting the group life plan and having the corporation fund the premium. Then group long-term disability income insurance is addressed— and the first major problem emerges.

Prior to termination, both senior executives enjoyed a group long-term disability plan that provided 60% of their compensation to a maximum of \$20,000 per month. Unfortunately, but for good reason, group long-term disability contracts do not have conversion features to help manage such a situation. Further, the simple fact that both executives are currently or soon to be "unemployed" makes it impossible for traditional individual disability income (IDI) underwriters to even consider the risk.

Fortunately, underwriters in the specialty insurance space offer niche programs to manage these exposures and provide some relief to corporations stuck with a potential multi-million dollar uninsured loss. Here is an example of how the program works:

- Pre-termination group long-term disability benefit equals 60% of annual compensation to a maximum of \$20,000 per month payable to age 65. Coverage terminates on severance date.
- Prior compensation of Mr. CEO, age 51, equals \$600,000.
- Prior compensation of Mrs. CFO, age 47, equals \$425,000.

The solution

A program is designed whereby the bank self-insures the first year of benefits in the event of a loss. If either of the two executives becomes totally disabled, a lump sum payment equal to the present value of the bank's obligation would be paid out to the executive. This benefit delivers meaningful value to the bank through substantial balance sheet protection. The payout also satisfies the bank's obligation to the executives, enabling them to maintain coverage the next year while they negotiate new employment opportunities.

Case study no. 2

As a second example, consider a CEO of a public entity in the technology space. The company's board terminates the CEO and executes a negotiated severance agreement. Within the agreement is a provision obligating the employer to provide "benefits consistent with benefits provided to the CEO prior to termination for a two-year period."



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The CEO is a 46-year-old male in excellent physical condition.

His annual compensation prior to termination was \$1 million exclusive of bonus, options and stock incentive awards. Two problems exist for the insurance advisor:

(1) As an employee, the CEO was provided with \$2 million of accidental death & dismemberment (AD&D) coverage on a “24-hour, business and pleasure basis” and the group accident policy did not have a conversion feature.

(2) While the company did have \$15,000 per month of individual disability income insured, both the executive's Group LTD and supplemental, high-limit disability protection were going to lapse with his termination, leaving a gap of \$35,000 per month.

The solution

The solution is to secure a custom-designed policy underwritten through a special risk insurer that combines both the AD&D and disability obligation under one policy form. The present value of the corporate obligation under its promise to maintain similar disability benefits was in excess of \$5 million. When combined under one package, pricing efficiencies are achieved, and an otherwise complex underwriting challenge is solved.

Keep in mind that these contracts are not ideal for providing the best disability insurance protection available to executives. These specialty policies are designed to provide an employer with a substantial contractual obligation, the ability to shift most of the risk to an insurance company for a commercially reasonable premium.

By design, these insurance policies have certain limitations and lack many of the bells and whistles found in traditional individual disability income policies. Ideally, companies will maintain a high level of individual disability income protection that is portable in the event of termination.

Summing up

Given the challenge of delivering insurance on a complex risk that typically involves only a modestly cooperative insured person, advisors would do well to understand the market for post-termination corporate obligations and how they can access solutions to protect their clients. They thus will avail themselves of substantial opportunities to increase client loyalty and earn a substantial commission check in the process.

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