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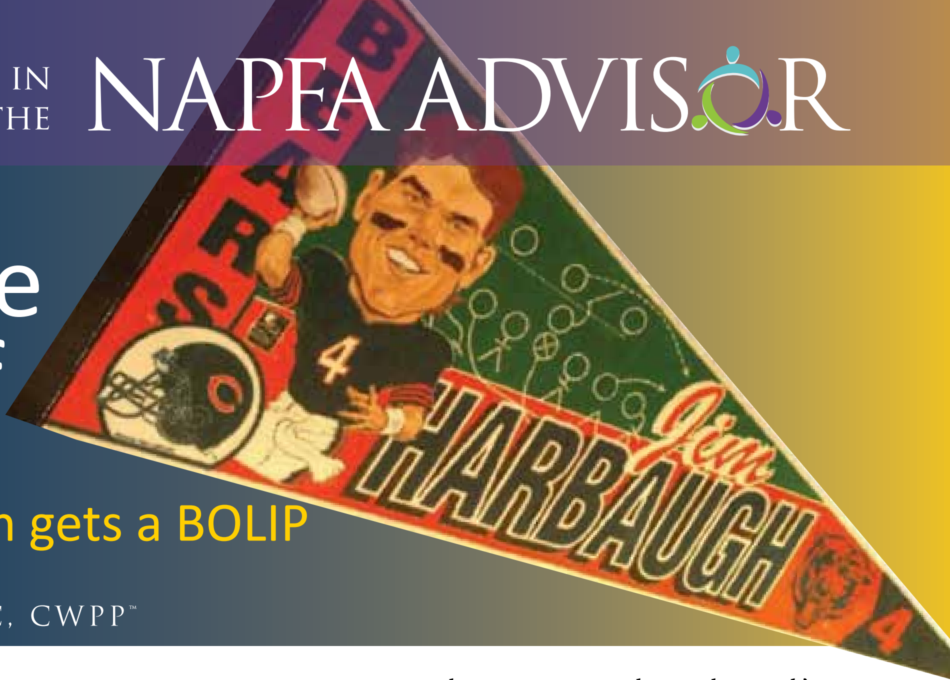

Using insurance to reward staff

University of Michigan Head Coach Jim Harbaugh gets a BOLIP

By Robert M. Barnes, CLU, ChFC, CWPP™

I am a HUGE Chicago Bears football fan. A sign in one of my stairways says, “We interrupt this marriage to bring you football season.” In fact, the picture at the start of this article is of a pennant I still have today. I discovered an intriguing article about former Bears player Jim Harbaugh’s life insurance. Jim is now the head coach for the University of Michigan. The school is clearly a fan, too, because it made an interesting move with insurance to reward and retain its star head coach.

“Jim Harbaugh’s pay now up to $7 million with UM paying insurance premiums” was the title of the article in Crain’s Detroit Business. As I read the story, I realized the university used a split-dollar technique called collateral assignment. Essentially, the university is lending Harbaugh money to purchase a Big Ole Life Insurance Policy (BOLIP). This is a strategy that businesses use to reward and retain their key people.

Lending money to buy life insurance

I decided to show Harbaugh’s arrangement with a life insurance ledger so you can understand how it works, and how both sides benefit. An employer and employee might want to implement something similar – perhaps with fewer zeroes on the end of the check. I cannot guarantee that the analysis I did is correct because I have not been involved in Harbaugh’s contract or planning any way. However, I believe it to be a pretty close approximation, assuming I am correct that either indexed universal life or blended whole life insurance is used.

It appears that the university will lend Harbaugh $2 million a year for seven years. When you use seven-pay testing with the intent to avoid a modified endowment contract (MEC) you will acquire a death benefit valued at about $35 million. The university will get its money back – without interest – either at the coach’s death or at rollout at age 70. At that time, the school will withdraw the $14 million from the policy, while Harbaugh keeps the policy and remaining cash value. Harbaugh will be the owner of the policy and can name his beneficiary. The school will have a collateral assignment on the policy, which will restrict his use of the cash value and ability to surrender the policy without first paying back the university.

Variations are possible when an employer is not comfortable with this type of decision because it gives too much control to the employee. In those cases, you tend to see endorsement split dollar plans. With an endorsement split dollar plan, the company owns the policy and “endorses” some of the death benefit to the executive’s desired heirs. In this situation, the company retains full control of the policy. You will often see

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Age	University of Michigan			Coach Harbaugh		
	Annual Premium	Net Cash Value	Death Benefit	Income Tax Due	Net Cash Value	Death Benefit
52	$ 2,000,000	$ 619,000	$ 2,000,000	$ 13,650	$ -	$ 33,000,000
60	$ -	$ 14,000,000	$ 14,000,000	$ 95,550	$ 771,000	$ 21,000,000
65	$ -	$ 14,000,000	$ 14,000,000	$ 95,550	$ 5,899,000	$ 22,862,000
70	$ (14,000,000)	$ -	$ -	$ -	$ 11,454,000	$ 26,342,000
75	$ -	$ -	$ -	$ -	$ 14,624,000	$ 26,342,000
80	$ -	$ -	$ -	$ -	$ 18,510,000	$ 26,342,000
85	$ -	$ -	$ -	$ -	$ 23,611,000	$ 28,805,000
90	$ -	$ -	$ -	$ -	$ 29,945,000	$ 34,737,000
95	$ -	$ -	$ -	$ -	$ 37,634,000	$ 41,774,000
100	$ -	$ -	$ -	$ -	$ 47,405,000	$ 51,671,000

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this enhanced with a salary continuation agreement at retirement. The participants use the policy cash value as a syncing fund and the death benefit for ultimate reimbursement of their costs.

The dollar values

Coach Harbaugh is expected to pay $1.4 million in income taxes on what's essentially a tax-free loan over 18 years. Looking out 18 years (when Harbaugh will be 70), he will have a cash value over $11 million and a death benefit above $26 million if the policy performs as projected. Harbaugh has an equivalent investment yield over 20 percent because he spent $1.4 million and has over $11 million.

Why would the University of Michigan do this?

The quick answer is likely both to retain and reward the coach after a successful first year that convinced the school to enhance Harbaugh's compensation package. The university is essentially giving him an interest-free loan. If you consider that it's using money normally allocated to cash or bonds, it is not sacrificing a tremendous amount of interest or opportunity cost. Life insurance is often used for certain non-qualified executive benefits because of tax benefits and cost recovery.

Think about it this way: If the school gave Harbaugh $2 million more in salary, it would be able to deduct the additional salary, but would never get the money back. The approach we're discussing ensures Michigan will get $14 million back if Harbaugh completes the seven-year tenure (early if he dies, or at rollout). If the coach quits, he must pay back the cumulative debt balance, and the collateral assignment protects the school. In the meantime, the coach wants to stay and continue to win so the university will continue to pay his premiums. Thus, the arrangement helps with both retention and reward.

Why would Coach Harbaugh do this?

I think the better question is: Why wouldn't Harbaugh do it? True, there are costs to him. He will pick up the imputed income (essentially the forgone loan interest from the university) as taxable income. He needs to pay the tax on this amount each year. Based on our numbers, he is likely to pay a little over $1.4 million in taxes over the next 18 years.

What does Harbaugh get for this cost? He will have a death benefit for his family that would fluctuate through the years from as low as $21 million to a starting high of $33 million. After the university recoups its money, Harbaugh will retain a policy with a death benefit in excess of $26 million and cash value over $11 million. The coach will have an equivalent investment yield of over 20 percent if the policy performs as projected. If the policy underperforms, he will likely still be in a cushy situation, with an extremely attractive return and minimal risk to him.

What do the attorneys and accountants think about the situation?

I spoke with a few attorneys and accountants with expertise in this area. They agree this is a fairly basic collateral assignment form of split dollar. A few expressed concern about how it was used in this case with a non-profit institution, observing that it could be in violation of 457(f) rules regarding separation from service. There is very little concern if your client used this in a true for-profit business for which section 409A regulations would be in play.

What can we learn from this arrangement?

Is this a unique situation for a high-priced coach, or is this relevant for a wide range of business owners to retain key talent? How would they feel about the idea of offering a benefit that can return every dollar they spend on their key people? Wouldn't your clients' key employees – or your clients who are key employees – want to know about this type of benefit?

I think there can be great value in a key-employee situation when the employer helps the employee prepare for a smoother retirement. Imagine retiring and taking a $1 million life insurance policy with a long-term care rider with you. What would that do to the employee's retirement safety and flexibility? As an advisor, you can bring this concept up with your business owners and/or the key employees you serve.

Seek an experienced life insurance agent

Plans like this are not used enough, in my opinion. They are especially useful for employers who want to take care of their most important and productive employees. They can help employees who are reverse-selected against with qualified and ERISA benefit plans. Arrangements like this can be layered on top to alleviate the discrimination. Employees, of course, want to be rewarded for their loyalty and hard work.

Unfortunately, an advanced life insurance agent capable of implementing a plan like this is harder and harder to come by. In the next 10 years, we will be losing some of the best life insurance agents in the business to retirement. Younger advisers do not seem to be following the path of an advanced life underwriter.

Split dollar and other non-qualified arrangements are sometimes very complex situations. It's important to have the right team on your side when you are beyond a simple family term insurance situation.

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