

BUSINESS

A GUIDE TO PLANNING

SHAREHOLDER PROTECTION



Interface 

Independent Financial Advisers - Financial Life Planners

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Introduction

For those of you owning shares in a company the value of those shares will, in most cases, be very important to you.

As with anything which is valuable to you, the reasons for seeking to protect the value built up are considerable. For example, you may want to ensure that the value is there for your retirement, or to help your family out, if you die whilst holding the shares.

If you are in business with others and your company has two or more shareholders, then you may also be interested in making sure the company is protected should a fellow shareholder die.

These are common concerns: to look after your shareholding value and, separately, to look after the longer-term interests of the company.

What may seem a straightforward position can be complex

All Companies have their rules determined by their Articles of Associations.

These will include provisions for transferring and selling shares. The rule around transfers or sales may not always be in line with your wishes.

Many companies have articles that were drawn up many years ago. In some cases, the articles are model articles, not ones purposefully drawn up for your requirements.

Most shareholders express a wish to have a 'pre-emption' clause in their articles, giving the remaining shareholders first refusal should shares be offered for sale. However, many articles do not have this clause in them, which means a Shareholder can sell to anyone they like.

In this instance, in the event of the death of shareholder, their representatives, or next of kin, can sell without restriction.

NOT having a pre-emption clause almost certainly creates this position, but many shareholders don't know if they have such a clause or not, even though when asked they say that this protection is important to them.

It may seem, therefore, that the answer to this is to check the articles and make sure there is a 'pre-emption' clause in there. It is not that straightforward, though. A pre-emption clause helps protect an unwanted sale to a third-party shareholder, but it does not address other factors.

If a shareholder dies, how are their shares to be valued? Will their death impact upon the Company's value? How are the other shareholders going to raise the money to buy the deceased's shares?

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How you can protect the share value in your business in the event of the death of a shareholder

Typically, this is what most shareholders would like:

- The surviving shareholders would like to take control of the shares of the deceased
- The next of kin of the deceased would like the cash value of the shares

Rarely do both parties want to end up in business together. Without a pre-emption clause there is no protection for either party.

Even with a pre-emption clause the desired position may not be reached because for the surviving shareholders to gain control of the shares left to the next of kin, they will have to find the money to buy the shares.

This may be difficult, unpalatable, bad timing or could mean that the surviving shareholders aim to force the price down.

You can see that in virtually all situations, the death of a shareholder can create a very messy and unsatisfactory situation. The answer to all this is to put into place shareholder protection arrangements.

Shareholder Protection

There are two aspects to putting robust protection arrangements in place:

1. Having appropriate legal frameworks and documents for setting out what happens on the death of a shareholder
2. Putting in place insurance to pay-out on death so that the shareholding value can be afforded by the remaining shareholders

Although we are referencing the death of a shareholder it is worth adding that these protection arrangements can also cover the critical illness of a shareholder, plus in respect of the articles, they can deal with the transfer of shares between the shareholders at any time or for any reason.

The death of a shareholder can cause a serious disruption to the best laid plans and the best of relationships. Shareholder Protection Insurance aligned with appropriate legal agreements not only places money into the right hands at the right time to protect the value of the shareholding, but also automatically ensures the shares revert back to the remaining shareholder(s).

It is protection all-round. This is good for the Company and for the families of a deceased shareholder.



How to put plans in place

The construction of an insurance solution in these situations is going to vary from Company to Company, situation to situation. It is not our aim within this guide to go into the technical detail.

The actual solution which is most suitable in any given situation will be determined by a combination of factors including:

- What the Articles of Association say about the transfer of shares
- The number of shareholders and the percentage shareholding of each
- The wishes and requirements of the shareholders
- The family position of each shareholder
- The tax position of both the Company and the shareholders
- Whether the shareholders wish to protect against death or death and critical illnesses

There are generally three ways an insurance solution can be formed:

- Own life plans under Business Trusts
- 'Life of Another' plans owned by the Shareholders
- Company owned plans to buy back shares

All aim to achieve the same end. This is to put an appropriate sum of money into the hands of either the Company or the remaining shareholders, with the specific intention that the sum is then used to pay to the beneficiaries of the deceased shareholder. The beneficiaries then transfer the shares to the remaining shareholders or back to the Company.

Put simply the shares come back to the Company/ remaining shareholders, the deceased's family get the cash benefit of selling the shares.

Documents and agreements

When arrangements and a solution are formed, it is crucial that the right legal agreement and documentation is added. In some cases, this could be a trust (or trusts) and in others what is known as a cross option agreement. How these interact with a standard shareholder agreement, if there is one, is also important to weigh up.

Valuations

There is another factor which must be carefully considered and sorted – some form of valuation needs to be placed upon the shares. This requires either having a formula or an agreed way of valuing the shares.

Tax

Finally, just to complete the list of considerations and variables, the Company, the shareholders and advisers must be wary of taxation. Business Property Relief is a valuable tax break and one that could be jeopardised if plans and paperwork are not structured correctly.

We are specialists in this area and we can work through any Company situation, with any shareholder split and/or requirements and construct a bespoke solution. We have described this as a situation which applies to the death of shareholder but in reality the position can also be addressed to cover serious illnesses (which could force a shareholder to leave the Company).

Likewise, there can be variable situations around how costs are met, for example in some situations the costs can be payable by the company not the individual shareholders and so on.

We will help you work out the solution that fits your Company and individual circumstances perfectly and get the protection in place that works for the Company, the shareholders and the next of kin of the shareholders.

Your solution and getting advice

The main point to take from this guide is that solutions can be adapted to suit circumstances. The solution that works for one Company or set of shareholders, may not work as well, or at all, for another.

As described, there are several factors that need to be taken into consideration before deciding the structure that works best. This requires expertise and getting appropriate advice.

Our advice will include a complete overview of your position, your wishes and objectives and then we can support you to get the correct documentation and insurance in place to provide long-term protection for everyone involved and for your Company.

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History, structure, and expertise

Interface Financial Planning started providing independent financial advice in 1992. From the beginning it had the aim of providing professional advice and quality service to people with modest income and wealth.

Its key value was putting people before profit, and contribution before reward. This mission statement has been our torch to light the path ahead and has been the reason that we have endured for over 24 years.

Alan has lead the company with his personal values of: Integrity, Compassion, Respect, & Loyalty, and he is proud that over the years he has worked with clients who share similar values. Like him they want to help others and make the world a little better.

Client care and service is important and he is proud that his first two clients from January 1990 remain his clients today.

We believe that every client should have access to highly qualified advice and expertise.

Technology is used to the full to maximise efficiency and engage expertise from throughout the UK. The business has been paperless for 10 years and for over 5 years has been 'cloud' based. This structure reduces costs and allows support staff to operate anywhere - from Colchester to Honiton to Leicester and elsewhere.

Clients are encouraged to access their online account where they can exchange messages and documents securely. They can view their investments and reports, and they have immediate access to their paper file. Clients love the transparency and openness of being able to view and print paperwork going back for years and many clients use it as a source of reference.



ALAN MORAN
Owner, Director
Interface Financial Planning

Alan Moran is one of the most highly qualified advisers in the UK. He became a Certified Financial Planner in 1995 and he was one of the first Chartered Financial Planners in 2005.

He is a Chartered FCSI, a holder of the IMC certificate and member of CFA UK. His expertise has been called upon by The CII, The IFP, The Kinder Institute, and others, where he has trained and examined other financial advisers.

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Compliance

Readers should not rely on, or take any action or steps, based on anything written in this guide without first taking appropriate advice. Interface Financial Planning Ltd cannot be held responsible for any decisions based on the wording in this guide where such advice has not been sought or taken.

The information contained in this guide is based on legislation as of the date of preparation and this may be subject to change.

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