PROTECTING YOUR BUSINESS FROM THE LOSS OF A KEY PERSON

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Charles de Gaulle once remarked, "The graveyards are full of indispensable men."[1] While we know that life goes on regardless of the loss of any "indispensable" person, for a small business, the loss of a key person is not only a human tragedy, it can represent the potential for significant financial loss.

Though business owners cannot protect themselves from the unexpected and sudden loss of a key employee, they may be able to protect themselves from the financial consequences of such a loss through the purchase of what is called "key person insurance."

Who's Key?

There is no legal definition for who a key person is, but he or she is someone whose loss due to death or disability would cause a material financial setback to the business. For example, a key person may be a top salesperson whose production would take considerable time to replace. Or, perhaps it's someone who is guaranteeing the business access to needed future capital.

Key person insurance is a standard insurance policy that is usually owned by the business and whose premiums are paid by the business. These premiums are generally non-deductible. The benefits of the policy are paid to the business in the event that the insured key person dies or becomes disabled.[2] (Coverage for death and disability are separate policies.)

Calculating Costs

When considering the coverage amount the business owner should first calculate the financial impact of the loss of a key person. The next step is to ascertain the cost of insurance for that amount. With that information, the business owner will then be able to make a decision that balances his or her protection needs with what the business can afford.

The proceeds may be used in any manner deemed appropriate. For example, the proceeds may be needed to meet day-to-day expenses, pay off debts, or to recruit new talent to the organization.

For most businesses, their most important asset is their people. Yet, while they insure their other assets—such as buildings and cars—they often overlook the wisdom of doing the same for those individuals who are critical to their business success.

1. Brainyquote, 2014
2. Several factors will affect the cost and availability of life insurance, including age, health and the type and amount of insurance purchased. Life insurance policies have expenses, including mortality and other charges. If a policy is surrendered prematurely, the policy holder also may pay surrender charges and have income tax implications. You should consider determining whether you are insurable before implementing a strategy involving life insurance. Any guarantees associated with a policy are dependent on the ability of the issuing insurance company to continue making claim payments.