

KEY PERSON INSURANCE

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BUSINESS CONTINUITY and making a profit are key goals of any business plan. Reaching these goals can be much more difficult after the loss of a key employee due to death, disability or defection to another company. Understanding the benefits of key person insurance and helping clients plan for and deal with the possibility of such situations is another sign of the true insurance professional.

Key person insurance provides compensation to the business should a key person die, as well as replacement funds to minimize business disruption during the time it takes the business to rebuild. It is estimated that only 20% of businesses will still be in business three years after such loss. Some businesses will shut down immediately. (www.mozdex.com)

This insurance was popular in times when key executives stayed with the same company for their entire career. In recent years, job security and loyalty has diminished, and long term employment by one company is not as common. However, there is still a need for the coverage. A key employee can be someone such as the business owner, a partner, best salesperson or someone with specific skills or knowledge that is considered especially valuable to the company. If the employee

dies or is incapacitated, the business could suffer substantial losses.

Key person insurance is different from typical life or disability insurance, which protect the income of the individual or their family, rather than the business. The policy is owned and paid for by the business entity, and the business is often the beneficiary of any proceeds.

When purchasing key person insurance, several questions need to be answered. What would happen if a key person died or became disabled? How long would it take to find a suitable replacement? What would the cost of interviewing, training, and bringing the new person up to speed be? How much income would be lost by the business with the death of the key employee? The coverage limit should be based on what the company can afford to pay in premiums as well as the amount of insurance that will be needed to address these potential losses.

Either whole life or term insurance are used for key man coverage. Term insurance may be a preferable option, as it is a less expensive alternative to



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whole life. Some policies offer the option to split the death benefit between the business and the surviving spouse of the key person (split dollar). This will help to replace the spouse's lost income. Policies that combine a cash value with deferred compensation to the key employee can also be an incentive for the key person to remain with the company.

Many insurance agents are very good at providing insurance protection for the visible and tangible assets of their customers – the building, loss of income, liability and vehicle exposures. Unfortunately, sometimes it is the unseen exposures that can lead to a devastating consequence – the failure of the business. Understanding the need for key person insurance and providing important information to your clients is another value-added service of the professional insurance agent.

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