

Protecting Against the Loss of Key Employee

The vast majority of small-business owners accept the wisdom of insuring the firm against the loss of its property values. We take care to insure the physical assets against fire, tornados and other disasters. Yet, protection from the loss a key executive may be far more important.



First, the probability of losing a key employee is far greater than a loss due to fire. It has been estimated that the chances of death of a key executive is 14 times greater at age 45, 17 times greater at age 50, and 23 times greater at age 55 than a loss caused by fire. Further, about one out of every three individuals dies in the working period of life with a consequent loss to his or her business.

Second, the loss due to a fire is temporary. Plants and factories can be rebuilt. Inventory can be replaced. The new building is likely to be more useful and valuable than the old one. On the other hand, a new hire may need several months or even years to become as productive as her or his predecessor. In fact, the deceased employee may prove impossible to replace.

Who Is Key?

Every corporation has at least one key executive or an employee who makes a substantial contribution to the operation, profitability and success of the business. Any individual who has critical intellectual information, sales relationships, bank relationships, product knowledge, and/or industry contacts that may adversely affect profits in the event of their absence, may be considered key.

The Role of Key Person Life Insurance

Although life insurance cannot ever fully replace the value of a key employee, it can indemnify the business for the financial setbacks that can occur. Life insurance can provide the business with needed funds to keep the business running, to assure creditors that their loans will be repaid, to assure customers that business will continue operations, to cover the special expenses of finding, hiring, and training a replacement.

How This Strategy Works

There is no particular form of agreement or special contract needed by the business to obtain key employee insurance on an executive or owner. However, the board of directors should authorize the maintenance and payment of the policy.

The applicant is the company. The application is signed by an officer of the business other than the insured party. Generally, the premiums will be paid by the business on an after-tax basis and are not deductible as a business expense. The business will be designated as the beneficiary and the insurance proceeds received upon the death of a key executive are not subject to federal income tax.

Replacing a key person may be difficult, but the proceeds from the life insurance policy can help ensure a smooth transition following their passing. With key person life insurance, that's one more risk that small-business owners can worry a little less about.

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