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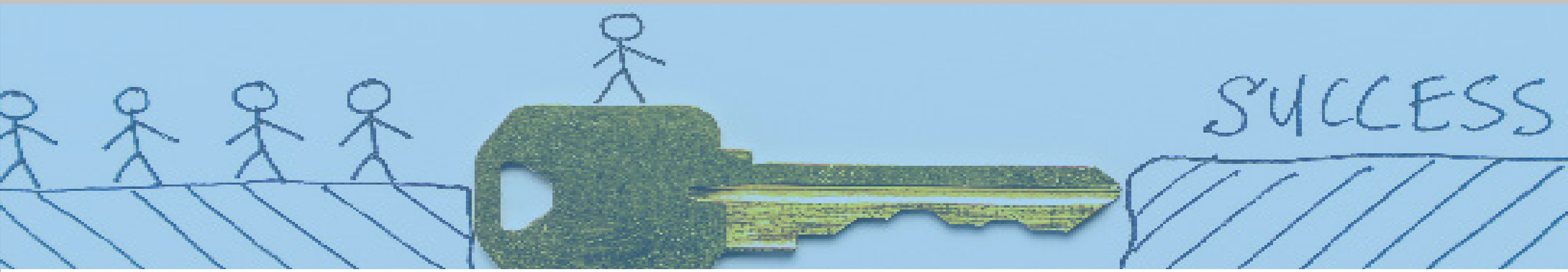

Taking Care of Business - Key Person Coverage

What would happen to your business if something prevented you from returning to work or you lost one of your key employees? Would your business continue to run smoothly or would projects be stalled, customers lost, and productivity reduced? Would creditors become nervous about continuing to extend credit? How would the loss affect the bottom line of your business?

As a business owner, you probably didn't think twice about the need to insure the building, inventory, and equipment of your business, but have you overlooked protecting the business against the loss of its most valuable assets – its key people?

How Do You Identify a Key Person?

A key person can be anyone – an owner or nonowner. What distinguishes someone as a key person is that his or her loss would severely impact a business until a replacement is found. Key people can be found in a variety of positions and with various titles. They are business management executives such as presidents and vice presidents, as well as research and development executives, production executives, and key sales representatives. The bottom line is that any person considered vital to the success of the business and essential to its profitable operation is a key person.

Why Should a Business Establish a Key Person Plan?

The primary purpose of insuring a key person is to help the business get through potentially difficult times should that individual die. Depending on who the key person is, the business may need funds to hire and train replacements, pay expenses while the business stabilizes, and/or maintain confidences of employees, customers, and creditors.

Key person life insurance can also help a business access credit. When a banker is dealing with a business that has a key person whose loss would disrupt the business, the banker will often make key person life insurance – with benefits equal to the credit line assigned to the bank – part of the approval process. This is especially true where the business is a sole proprietorship or a closely held business.

Finally, in a closely held business where the loss of an owner can have a devastating impact on the operation of the business, especially if other key employees are enticed to leave the business, key person coverage on the owner can help fund the cost of a stay bonus plan to retain key employees.

Why Use Life Insurance to Fund a Key Person Plan?

While cash or loans can be used to pay the costs of replacing a key person, life insurance may be a more cost-effective alternative. Using cash takes money out of the day-to-day operation of the business. Loans come with the disadvantage that the business will have to repay the loan plus interest. Furthermore, the company's credit may be adversely affected due to greater debt.

Life insurance, on the other hand, is easy to administer and funds are immediately available, even if death occurs shortly after the policy is issued. When funding a key person arrangement with life insurance, the business applies for the policy and usually names itself as owner and beneficiary. It's also important to note that, prior to policy issue, the business must provide the key person specific written notice of its intent to acquire coverage and receive his or her consent. It's suggested that the business retain this notice and consent to substantiate the annual tax filing on Form 8925.

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Common Uses for Key Person Insurance Coverage

- **Securing loans for business growth.**
- **Strengthening the business credit position.**
- **Providing funds for recruiting and training a replacement key employee.**
- **Paying expenses while the business stabilizes.**
- **Purchasing the business interest from the estate of a deceased owner.**
- **Salary continuation for a surviving spouse.**
- **Executive compensation arrangement.**

The loss of the talents of key employees, owner or otherwise, can financially cripple a company.

With an estimated 95% of U.S. businesses made up of 10 people or less, a lot can hinge on very few people.* The figure is even more alarming when you consider the statistics in relation to death before age 65.

The probability of the death of at least one of two people at an age prior to 65 is surprisingly high.**

Probability of One Death

Ages	**Prior to Age 65**
30/30	32.90%
40/40	30.55%
50/50	25.90%
30/35	39.30%
40/45	36.80%

*Source: Information is based on U.S. Census Bureau survey of firms with and without employees.
**Source: Information is based on Table 90CM, which is the table used by the Internal Revenue Service to calculate life expectancy.

How Much Life Insurance Should The Business Purchase?

The amount of insurance coverage should reflect the estimated monetary loss the business would suffer from the death of the key person. Varied approaches exist to estimate the monetary loss to the business. Your financial professional can provide you with guidelines to help you with this decision. Determining the correct amount of key person coverage is important to the future financial health of the business. Purchasing too little coverage leaves the business exposed to sudden and unexpected financial risks. Purchasing too much coverage creates unnecessary expense for the business.

Taking Care of Your Business

It's the skill, knowledge, ability, judgment, leadership, and experience of key people that makes it possible for a business to produce profits. The loss of the talents of key employees, owner or otherwise, can financially cripple a company. Whether your business is a sole proprietorship, a partnership, a limited liability company, or a closely held corporation, insuring the people who are vital to the success of your business may prove to be one of your most important business decisions.

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