

commercial coverage



2006, No. II

Benefits Of Key-Person Insurance

Most businesses don't hesitate to insure their physical assets, but what about personnel assets? A key person's unexpected death can devastate a company. Even if your business can replace a key person, that takes time and money. Key-person insurance can play an indispensable role in maintaining business continuity under dire circumstances. But be aware that the policies might carry ERISA implications.

The Benefits Of Key-Person Insurance

Key-person insurance provides multiple types of security. Your business can use the policy's proceeds to:

- Help the key person's family pay estate tax without endangering the business
- Reassure your creditors and clients that the business will indeed carry on
- Pay expenses related to finding and training a replacement
- Fund obligations to the person's family, such as deferred compensation or continued salary, or buy out the deceased's shares according to a buy-sell agreement

Key-person insurance can also work as an employee incentive, because your business can give a share of the proceeds to an employee's family at death.

How It Works

Who qualifies as a key person? Basically, you should consider covering anyone considered critical to your business' success or profits. The owner, partners, majority shareholder or top salesperson could all fit this description, as well as middle managers who handle significant accounts or have established relationships with clients or suppliers.

Your business buys a policy on the life of the designated key person(s). It becomes both owner and beneficiary of the policy, paying the premium and receiving all death benefits. The insureds and their heirs hold no interests in the policies, though you must tell them that the policies exist.

The insurer might require your board of directors to pass a resolution affirming the policy's purpose. The insurer also will likely require the business to submit a business-continuation plan.

The Coverage Question

Key-person insurance payouts typically range from \$250,000 to \$1 million. When determining the appropriate amount of coverage, consider such relevant factors as:

- The value of the person to the company
- Projects or clients that would be lost
- Sales generated by the person
- Replacement and training costs
- Reduced profits during a transition period
- Any loans that might come due as a result of the death

Even if the remaining partners or family don't wish to continue the business, they'll need funds to cover expenses until a seller is located.

Term coverage is usually more affordable than whole or universal coverage and will apply—with a locked-in premium—until the key person retires. Then the business can transfer the policy to the person as a retirement benefit or transfer it to another key person.

From: Legal Alert, Axley Brynelson Law Firm, Madison, Wis.