



momentum

Key person protection

Effective and well trained staff, especially those with specialist skills or knowledge, is vital to a business's success. If such an employee were to die or become disabled tomorrow, what would be the cost to that business?

The risk - upon the death or disability of the key person

Losing a key person could mean increased costs for recruiting and up-skilling, a slowdown in turnover and stricter terms from suppliers. In addition this loss could lead to difficulties in raising finance, having to pay back loans, delays in finding a successor and time lost during the settling-in period.

The solution

Key person protection is an arrangement where an employer insures the life of a key employee for the purpose of compensating the business for the loss of income it would suffer in the event of that employee's death or disability. The benefits received upon the death or disability of the key person can then be used to absorb disruptions to the business, protect credit facilities and provide funds to recruit and train a replacement.

A resolution will be prepared to formalise the decision to implement the key-person policy and this resolution will identify the key-person and determine that the funds will be applied to absorb the losses and costs associated with the death or disability of the key-person.

Who is the key person in the business?

Anyone who significantly improves or contributes to the profitability and effective management of the business could be considered a "key person". For example: anyone with specialist, expert skills vital to the success in that industry, someone whose presence in the business increases the creditworthiness of the business or someone who builds goodwill for the business, etc.

How to calculate the value of the key person?

In practice, the amount of cover that a business should take out on the life of a key person is usually determined by a combination of the following methods:

- The estimated number of years that it would take for a replacement to reach the key person's present level of profitability, multiplied by the drop in profits as a result of the death or disability of the key person; or
- Itemising the actual costs involved in replacing the key person.

Benefits to the business

On the death or disablement of the key person, the lump sum payment from the life insurance policy will provide cash to ensure that:

- Funds are available for recruiting/training/development of a replacement;
- The business and its development can continue seamlessly;
- The creditworthiness of the business is not affected; and
- Premiums may be tax deductible or proceeds may be tax-free.