

ASK SAVA: Why smart businesses have a “Key-Person” Policy.

Q – I am about to hire a new Senior Executive for our firm who will take the lead on driving our business to the next level. They will be bringing with them the expertise we have been lacking to drive a new product line as well as a slew of contacts and customers. I am concerned about the impact on our bottom line if something untimely like a disability were to occur after we get this Executive and new product line up and running. I've heard about Key Man Insurance, would that be a smart move?

A – Key-person coverage is a unique form of Life and Disability Insurance that provides invaluable protection of critical employees. Any person with a uniquely valuable contribution may be deemed a key person. A scientific or medical company may rely on a specific scientist working on a new drug, while a manufacturing company may depend upon the talent of a specially qualified engineer.

Why consider a key-person policy? A small business is often extremely vulnerable to the loss of one or two key people. In the event of an untimely death or disability, the policy would provide the financial means for the small business to continue operations despite the loss of the critical employee. Business owners also opt for key-person protection to satisfy the concerns of investors, shareholders or partners.

What is commonly covered? In general, key-person coverage protects a business against lost profits directly related to the specialized skills or contribution of the designated employee. Losses related to the need to hire or replace a critical employee as well as to protect shareholder or partner interests is also a typical provision.

Key-Person versus Life Insurance – small-business owners often confuse key-person coverage with life or disability coverage. In fact, some business owners purchase life insurance on a key employee rather than key-person coverage. Unfortunately, that may be a mistake. Both life insurance and key-person coverage protect a critical employee, but there are a few important differences that every small-business owner needs to understand in order to make an informed decision. For example:

- **Protecting the Business:** The main difference between the policies is the emphasis on protecting the business versus the employee. In the event of disability, the impact on the company may be substantially different than on the individual. Key-person coverage recognizes that impact and provides valuable protection for the business.
- **Minimal Coverage:** One of the most significant reasons to purchase key-person coverage rather than a company-owned life insurance policy is the dollar amount of potential damages. The coverage of most life insurance policies is fairly minimal when compared to the real value of the company. For example, a life insurance policy in the amount of \$1 million or even \$5 million may be very small in relation to the full value of the company itself. Investors, partners and other stakeholders need assurance that they are protected in the event a critical contributor is no longer able to perform.
- **Tax Free:** Last, but not least, most proceeds received by a business in the event of a claim are tax-free, which is a significant advantage to a small business required to justify long-term expenditures during a period of adjustment and growth.

By minimizing risk and locking in affordable long-term security, it's possible for a small business to generate impressive investor interest, especially given the relative scarcity of alternatives in today's tough economy.

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