Key Person Protection

*A business continuation strategy using life and critical illness insurance*

**Meet Bill.** Bill owns ProductCo, a manufacturing corporation that owes much of its success to the efforts of general manager, Jim. As a key person in Bill’s company, Jim (age 45) has established relationships with clients, suppliers and the bank. He is largely responsible for the company’s rapid growth. If ProductCo were to lose Jim, the company could suffer lost revenue plus the costs associated with finding a replacement and getting back on track.

**The challenge** Bill’s business could be seriously impacted if Jim passed away or suffered a critical illness requiring a lengthy recovery.

After speaking with his advisors, Bill realizes that the loss of Jim’s expertise could mean a loss of about $500,000 (about 5X Jim’s income) due to:

- **Reduced profit from lost revenue and potentially increased costs** – a loss of confidence might cause suppliers to restrict credit or demand cash payments. Uncertainty may cause the bank to call loans or charge higher interest rates on the remaining debt.

- **Additional costs to find a replacement general manager** – including recruiting expenses and above-market compensation.

If Bill’s business can’t absorb these expenses, its value could be seriously reduced and its very existence may be threatened. He needs a financial strategy to protect against these risks.
Key person protection uses life and critical illness insurance policies to help you protect your business from the costs that result from death or critical illness of a key person. Here’s how it works:

- You and your financial advisor estimate the financial impact of the loss of your key person. This typically ranges from 5 to 10 times the key person’s income. In this case, the loss of Jim could have a financial impact of about $500,000.
- Your company takes out a life and critical illness insurance policies on the key person’s life. In this case, a 10-year term life insurance policy and a 10-year term critical illness insurance policy met the need.
- If the key person dies or suffers a critical illness, the policy benefit is paid to your company tax-free.

**Advantages of this strategy**

- Life and critical illness insurance let you transfer some of your risk to the insurer.
- Your total cost is limited to the premiums paid for the insurance policies.
- The expenses resulting from the loss of a key employee are no longer unexpected or unmanageable.

**Cost of insurance vs loss covered**

*Premiums are for a $500,000, 10-year term life insurance policy and a $500,000 10-year critical illness policy. Rates in effect are as of August 3, 2018. Assumes a 45-year-old male non-smoker class 3. $560 annual life insurance premium and a critical illness insurance annual premium of $3,485. Return of premium optional benefits are available on critical illness insurance at an additional cost.*

**The result**

- **For immediate but temporary coverage** — low-cost term insurance based on the key person’s age, health and expected employment period.
- **To raise additional cash during the key person’s life** — universal life turns excess deposits into accumulating tax-preferred cash values.
- **To protect against illness** — critical illness insurance pays a lump sum if the key employee suffers and survives a critical illness.

Key person protection is a cost-effective way to ensure the continued viability of your business in the face of a specific risk.

**Talk to your advisor about your business’ key person protection needs today.**