Key Person Insurance

Helping You Secure Your Investment and Your Business

Successful companies are built around a unique vision, a solid business plan, and a management team that possesses the drive and leadership skills to turn that vision into a profitable business. Whether a business succeeds or fails depends largely on how well a few key people can execute on the vision and the plan.

MOST COMPANIES INSURE TANGIBLE ASSETS FOR RISK OF LOSS. HOWEVER, THE BIGGEST RISK MAY BE THE LOSS OF ONE OF THE KEY EMPLOYEES THAT DRIVE INNOVATION, BRAND, SALES OR OPERATIONS.

What happens if one of these key people is no longer in the picture? Can the business survive?

For many companies, the death or disability of a senior executive or chief technologist can be financially devastating. Intellectual capital, relationships with key customers, and competitive advantages can all disappear in an instant. What once seemed liked a promising investment opportunity can struggle for survival.

As a preventive measure, many businesses and often the private equity firms that own them turn to key person insurance. Key person insurance can help alleviate the financial strain that results from the death or disability of a senior executive.

How It Works

To establish a key person plan, a party with a financial stake in the future of the business purchases a life and/or disability insurance policy on one or more “key people” in the organization. The purchasing party is the policy owner and beneficiary of any death or disability proceeds. The key people are insured, but have no financial interest in the policies under most designs.

Proceeds from a key person insurance policy can be used to:

- Cover financial losses resulting from the death or disability of the key person
- Cover executive search, associated relocation costs, and buy-out prospective executive’s unvested retirement benefits
- Satisfy any company obligations personally guaranteed by the key person
- Recoup business acquisition costs and provide short-term cash flow
- Provide a source of funds to purchase the key person’s interest in the business (stock, partnership capital, etc.)
- Cover the cash costs and offset the expense of any liabilities the company owes to the key person (e.g., notes payable, benefits promised under an employment agreement or nonqualified plan, death benefits to a surviving spouse, etc.)

Who Is A Key Person?

Generally, the loss of a key person will have an adverse effect on a business' profit, credit standing or overall financial health. Other characteristics of a key person include:

- Someone whose activities regularly and substantially increase business revenues
- Key decision makers
- Those responsible for or controlling major company operations
- Uniquely talented or skilled professionals who would be difficult or expensive to replace

How Much Coverage is Appropriate?

As a general rule of thumb, underwriters will agree to limits in the range of 7 to 10 times the annual compensation of the key person. For example, if the key person has annual cash compensation of $500,000, then a limit in the range of $5,000,000 is typically justifiable. Higher limits may be available if desired based on facts and circumstances.

When Key Person Insurance Is Needed Most

All parties with a financial stake in a business face some risk from the loss of a key person. According to Burson- Marsteller/Roper ASW, as much as 50% of a company's reputation is attributable to its CEO's reputation. Consequently, the loss of a CEO or other key person could significantly damage a company's reputation and send investors, customers, and employees into a panic. The existence of a key person insurance plan can help ease these fears and send a message that the business is financially prepared to move on.

Have You Identified Your Exposure?

It is common practice for businesses to insure their facilities, computer systems, and even their desks, yet many companies overlook what could be their greatest exposure—the loss of a significant leader. No company is immune to the impact the death or disability of a central figure can have on continuing operations. That is why it's essential for any parties with a financial stake in a business to be prepared. If such a loss were to occur, key person insurance can help secure an investment interest that would otherwise be at risk—or it can provide the finances necessary to keep the business afloat.

Key Person Insurance in Practice: Case Studies

Protecting an Investment

A private equity firm acquired an 85% stake in a multi-million dollar textile company. The future of the company relied on the industry reputation of two key executives. Recognizing that the loss of one or both of these individuals would place the ongoing viability of this company in jeopardy, the purchase agreement required $65 million of key person life insurance coverage on each key executive.

Keeping a Business Alive

A Fortune 500 manufacturing company spent nearly $50 million to purchase a closely-held firm. The objective of the purchase was to acquire the firm's patents and leverage the CEO's specialized expertise. Because the CEO was critical to the continued success of the newly acquired business, the company purchased a $10 million key person life insurance policy. In the event of the owner's death, the policy proceeds would be used to offset acquisition costs, and to cover the costs of finding a replacement for this highly specialized CEO.