

KEY PERSON INSURANCE

A SUCCINCT GUIDE FOR BUSINESS OWNERS

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INTRODUCTION: THE IMPORTANCE OF BUSINESS INSURANCE

"Take away my people, but leave my factories, and soon grass will grow on the factory floors. Take away my factories, but leave my people, and soon we will have a new and better factory"

// Andrew Carnegie

If that was true in the late 19th century, it is even more so now. As our workforce becomes more highly skilled, and the services sector grows, businesses are about people. Yet strangely, few businesses insure their people, whilst putting great emphasis on protecting the premises from relatively rare incidents such as fire and theft.

According to OnePath, a business with two male proprietors, aged 40 and 43, has a 51% probability of

making a key person insurance claim for either Life, Trauma, or TPD. Add a third partner of a similar age, and the likelihood of one of the three making a claim raises to 65%.

[Key person insurance pays.](#)

For many small to medium businesses, the key people are the owners. They know the clients, know the products and services, and very often provide financial support for the business through personal guarantees or mortgages over their family home. Were one of the owners to pass away for instance, in many cases the business would be unviable, leaving financial wreckage for family, staff, and perhaps business partners.

TYPES OF BUSINESS INSURANCE

The four primary types of personal business insurance are:

1. [Key Person Revenue](#)
2. [Key Person Capital](#)
3. [Income Protection](#)
4. [Business Expense Cover](#)

Income Protection is perhaps the best understood in the business community. This cover replaces up to 75% of income where a person is unable to work due to illness or injury. The person's income must cease during the period of incapacity. As such, this cover is applicable to someone who is the sole income generator for the business.

Business Expense cover is typically an adjunct to Income Protection. Claim conditions are the same, however rather than providing income for the business owner to live off, Business Expense cover reimburses for the running costs associated with the business such as rent, non-income producing staff wages, utilities.

A package of Income Protection and Business Expense cover is highly customisable to fit an individual business owner's needs.

The focus of this booklet however is [Key Person](#) cover. Key Person cover can be taken in two forms – [Revenue cover](#) and [Capital cover](#). These will be covered in detail in the following pages.

HOW BUSINESS INSURANCE HELPS

Scenario 1

Tim runs a business importing caulking products for the construction industry. Tim has an office admin/book-keeper, and a delivery person. However, essentially Tim is the business. He sources the products from suppliers in Europe, and knows the local buyers.

The business has a debt of \$400,000 for working capital and to cover the cost of a warehouse fit-out 18 months ago. Both Tim and his wife have provided personal guarantees for the debt, and the bank has taken a second mortgage on their home as security.

What happens if Tim was to die, or become totally and permanently disabled?

The business would fold. The bank would call in the outstanding debt. Recovering outstanding debtors could be difficult, whilst creditors will demand payment. The business will be unsellable. Tim's family may lose their home.

A possible solution would have been for Tim to have [Key Person Capital](#) cover sufficient to clear the debt on his death or permanent disablement. This would protect the family home. The cover might also be extended to provide funds for the orderly wind-up of the business, and to ensure Tim's family receives some value for all the goodwill he has built up over the years.

Scenario 2

Jane and Lisa run a successful PR and events management business. They have two team members who support them, however all new business is gained through the two owners contacts. Turnover is approximately \$1 million per year.

What happens if either were to suffer a serious medical condition such as cancer, which took them out of the business for an extended period? Would the business need to hire an additional person to complete the jobs currently under contract? Would revenue halve? Could the current staff be maintained? Would the business survive?

A possible solution would be for the business to hold [Key Person Revenue](#) cover. In the event of a serious medical condition, the business would receive a lump sum insurance payout, which could cover any additional costs, replace lost income, and ensure the business is able to survive.

KEY PERSON

REVENUE COVER

Most businesses take out insurance cover for assets that do not make them profits – their plant, equipment, vehicles and buildings. But it is the human asset that, through initiative, drive, skill, specialist knowledge and ingenuity can turn the capital and assets into profit.

Losing a key person can cause revenues to go down, and costs to increase.

Key Person Revenue cover is intended to protect a business from the negative effects on trading caused by the death or disablement of a “key person”.

A Key Person is someone within the business to whom profits can be directly attributed. In the SME space, this is most often the business owner, but may also extend to key staff.

In the event the insured key person suffers a serious medical condition such as the diagnosis of cancer, becomes totally and permanently disabled, or dies, Key Person Revenue cover can provide the business with funds for:

1. The recruiting costs incurred by a business to locate, attract and recruit a suitable replacement,
2. The cost of training a replacement, and
3. Cover the loss of profit suffered by the business as a consequence of being without the key person.

Key Person Revenue cover can be the key to a business surviving through a very challenging period.

KEY PERSON

CAPITAL COVER

Key Person Capital cover is intended to provide the business with sufficient cash reserve in its asset base by repaying or reducing debts owned by the business owner upon their death, disability, or critical illness.

It aims to ensure that the business can repay debts, easing the financial burden of the business at a crucial point in time. This gives the remaining business owners some breathing space to stabilise and maintain the capital value of the business. It also protects the business owner’s family, since very often the business owner will have provided personal guarantees for the business.

In addition to clearing debts, Key Person Capital cover can also replace Goodwill. It may be that the business owner’s financial plans are based upon an exit value for the business. With the business owner lost to the business, that value is likely to have diminished, jeopardising the financial position of the business owners family and perhaps the other business owners.

WHAT NEXT?

Now that you can see why Key Person insurance is relevant to you and your business, **it's time to act.**

Phone **03 9870 6544** to schedule an appointment. We can come to you.

Once we've gained an understanding of your business and financial position we will prepare a proposal for your consideration. To this point all costs have been absorbed by Guidance. With your agreement, we then work with you to implement a solution that fits within your budget constraints and provides your business with a robust financial safety net.

For you, that means peace of mind.

We welcome your feedback and look forward to working with you over the coming years.

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