

Key facts – Key Person Insurance

Protecting Your Profits

There are a number of risks your business carries every day and a number of ways in which your profits can be interrupted. A few examples of where difficulties might arise are:

- *Suppliers*
- *Credit Control*
- *Delivery dates not met*
- *Manufacturing capability*
- *Recruitment of staff*
- *Retention of staff*

These are all things that the management capabilities of your team deal with on a day to day basis.

However, there is always the threat of interruptions to your business that are outside of your control:

- *Damage to business premises (e.g. fire or flooding)*
- *Need to replace expensive equipment*
- *Loss of stock (theft, damage etc)*
- *Loss of expensive business vehicles (theft, damage etc)*

Many companies understand some of the more obvious risks and insure against them. To that end, we find that most companies have already arranged to protect:

Premises

Stock

Vehicles

Equipment

However, many companies do not quantify the risk to their business or interruption in profits that might be caused by the loss of certain key individuals within the company:

As a business owner or controlling director, you should ask yourself, who are the major contributors to your continued profits and success? Who are the people with specialist skill sets who are a vital part of your organisation?

- *The Shareholding Directors who control the company?*
- *The Sales Manager who runs the sales team and deals with customer relationships?*
- *The Creative Director who has all the ideas?*
- *The Buyer who deals with all the supplier relationships?*
- *The Finance Director who handles the internal control of the company?*

In fact, a “key person” can be anyone from a director to an ordinary employee with special expertise such as a research scientist. The death or permanent incapacity of such a person can lead to:

- *Falling profits while the business attempts to resume normal trading*
- *Succession costs in respect of recruitment and training, including time-delay in finding a replacement*
- *Loss of working capital if overdrafts are called in by lenders and lines of credit are suspended*
- *Loss of company value.*

Your company is potentially at risk due to the loss of key employees through death or serious illness.

Key Person Insurance

Key person insurance is designed to provide protection for your company against the death or critical illness of any of your key employees.

The company or firm insures the lives of key individuals for a capital sum (i.e. the “sum assured”) commensurate with the estimated financial loss to the business in the event of the employee’s death or serious illness.

Key person insurance is complex and should not be undertaken without taking professional advice as to the correct sums assured, the most suitable policies to use and the tax treatment of premiums and claims.

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KEY PERSON CASE STUDY

KRQ Systems Ltd - a successful computer network installation company in the south of England with plans to expand on a nationwide basis.

The Sales Manager, Martin Smith worked with the company for over 10 years and was an integral part of the business. His relationship with suppliers enabled the business to be competitive whilst the KRQ sales team under his guidance grew to become one of the most successful in the region. His involvement was essential to the future plans for the company.

The directors of the company held a meeting with its financial advisors in June 2007 to discuss ways in which Martin's benefits package could be enhanced. Having made some helpful suggestions, the advisors then changed the focus from Martin to the business itself by raising the question of Key Person Insurance.

KRQ Systems had two choices - they could either ignore the advice offered or take steps to protect the business.

Without Key Person Insurance

KRQ's directors could not see the point of insuring Martin's life - at 38 he was unlikely to die immediately. The directors thanked their advisors for their suggestions but explained that they were concentrating on the expansion of the business.

Three months later Martin suffered a stroke. Although he made a partial recovery, his condition meant that he was no longer able to continue working.

KRQ tried to recruit a suitable replacement for Martin but the process took six months and it was at least a year until Martin's successor was fully integrated into the role.

Over the year that followed Martin's accident, KRQ failed to get the funds it needed for expansion. The bank was impressed with their plans but also recognised the important role that Martin had played in the business.

Many of Martin's sales team left the company amid the uncertainty of the future.

The costs of recruiting Martin's replacement, the loss of staff and the recruitment and training of new staff all added to lost revenues. The company called in the receivers in October 2008.

With Key Person Insurance

KRQ's directors listened to the reasons for insuring Martin under a Key Person policy and agreed on a protection package that included death and critical illness cover.

Three months later Martin suffered a stroke. Although he made a partial recovery, his condition meant that he was no longer able to continue working.

The Key Person policy paid out enough to cover the loss of net profits that Martin had previously generated, which gave the business the time and money it needed to recruit and train a new sales manager - the process took six months and it was at least a year until Martin's successor was fully integrated into the role.

The bank was impressed with KRQ's business plan and were willing to provide the finance required for their expansion. The sales team could see that the company was still growing and there were few leavers.

By planning for the future, KRQ were able to continue their plans for expansion and successfully established its northern division in October 2008.

Your Alexander Forbes Wealth Management Consultant is able to guide you through the entire process to ensure a bespoke solution for your company.

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