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SIMPLY IRREPLACEABLE

A KEY-PERSON INSURANCE POLICY PROTECTS YOUR BUSINESS IF YOU LOSE A VITAL EMPLOYEE

by Shannon McRae

It's the one check Howard Bernstein never wants to cash. But after watching a vital employee at his small business fight a six-month battle with cancer, Bernstein realized key-person insurance might have been the one thing he was thankful for had the unthinkable happened. Fortunately, the employee is finishing the last stages of chemotherapy and expects to be cancer-free and back on the job soon. But those months of uncertainty reminded Bernstein that worst-case scenarios really can occur.

"When we secured the key-person insurance a few years ago, it was more of a logical business decision," says Bernstein, who for 20 years has owned Summerhill, Pa.-based [Penn Installations](#), an interiors contracting company. "But after watching my right-hand man and a close friend become extremely ill, it was a reminder of the realities we face every day."

Key-person insurance policies help ensure continuity in a business after the loss of a partner or important employee. Policies vary, but most pay a death benefit that can be used to cover the cost of recruiting a new employee and keeping the business stable during the transition.

How do you judge who needs to be covered? "Generally, the individual with the hardest to replace skill set is the one you start with," says Robert Garner, executive vice president of wealth management at CBIZ Insurance Services.

To determine how much coverage you need, consider how much it would cost to replace the key employee. "There is no blanket formula, but 1 percent times the key person's salary is sufficient, unless the loss of that employee would have a long-lasting impact on the company," Garner says.

Key-person insurance can also serve as a retention tool when set up as a non-qualified deferred compensation plan, according to David Houston, advanced marketing consultant for ING U.S. Financial Services. This basically means that you promise the employee the cash value of the policy as it grows. The incentive to the employee is that he avoids taxes

on that money until he withdraws it--hopefully when he's in a lower tax bracket. If the employee dies early, you use the benefits to pay his family, and then use the remainder to recruit and train someone else.

Regardless of the details, planning for the worst before you're facing it is the best way to protect your business. Some owners may count on their luck rather than absorb the cost of another insurance policy. Cost was a factor for Bernstein, too. "We asked ourselves, 'Can we really afford to do this?'" he says. "But the bigger question was, 'Can we afford not to?'"