PROTECT YOUR HUMAN CAPITAL WITH KEY PERSON INSURANCE

As a business owner, it's not uncommon to rely on a few key people for the successful operation of your company. In fact, many businesses are built around the strengths and skills of a handful of individuals whose capital, energy, knowledge or experience makes them valuable assets to the organization. But, while most business owners understand the need to protect against unforeseeable risks such as fire and theft related to their capital assets, risks related to human capital within their organization are often overlooked.

Human capital risks refer to the temporary or permanent loss of key employees due to illness or death. Similar to a loss of capital assets, such a loss can also threaten the viability of a business.

How would your business be impacted if one of the partners or key employees — a manager, top sales person or technical specialist, for instance — passed away or became unable to work? Would you have sufficient cash on hand to deal with the temporary business emergency? In many cases, the answer to these and other questions about risk is "no".

The potential risks to a business are significant

- Business performance may lag due to the absence of the individual.
- Costs to find a suitable replacement for that individual may escalate.
- Creditors may restrict or withdraw credit.
- Suppliers may tighten payment terms.
- Customers may reconsider using the business or services.

> "The good news is that these risks can be managed," says Joel Cuperfain, Estate Planning Specialist with RBC Wealth Management Financial Services. "Every business needs a contingency plan that involves insurance protection to help minimize the impact on the business of losing a key member of the organization, whether it's a temporary or permanent loss."

Compliments of The Wealth Management Team of Stephanie Woo, FMA, CIM
604.257.3234 | stephanie.woo@rbc.com | www.stephaniewoo.ca

Key person insurance can alleviate some of these risks

- It lets you transfer some of the business' risk to the insurer.
- The cost is limited to the premiums paid for the insurance policies.
- The expenses resulting from the loss of a key person may be offset and more predictable.
- There can be significant tax savings through tax-free growth.
- The risk and costs to the business resulting from the premature death or illness of valuable employees is reduced by providing capital for training, replacement or to meet financial objectives.

How does it work?

Typically, the business is the owner, the premium payer and the beneficiary of key person life insurance. Premiums are generally not deductible; however, if the insurance coverage is a requirement by a lender as collateral for the debt and certain other income tax requirements are met, the company may be able to deduct a portion of the premium. In addition, note that the death benefit of the insurance policy will be received tax-free by the company. Keep in mind that since this solution uses life insurance, the key person would also have to qualify for the insurance coverage. "Most businesses need time and capital to replace a key person," says Cuperfain. "Key person insurance can be a cost-effective way to help ensure the ongoing operation and continued success of your business."

There are three types of insurance that are often used to provide key person protection:

(Note: The following provides a selection of potential options to consider. To ensure options are best suited to your business needs and goals, it is important to consult with qualified tax, legal and estate planning professionals.)

1 Key person life insurance

Life insurance is usually the cornerstone of a key person protection strategy. It provides an injection of tax-free capital into the business upon the death of the key person. Life insurance may be a source of low-cost funding in the event of a key person loss; it can also be used to fund buy-sell agreements and may offer considerable flexibility in how an arrangement is structured.

2 Key person disability insurance

Disability insurance can be used for two purposes. One, the insurance can provide salary continuation to the key person in the event that he or she becomes disabled, usually until the earlier of age 65 or recovery from the disability. Two, the owner/manager can purchase insurance that provides continued payment of office expenses and salaries during the period of disability, usually for a limited time period.

3 Key person critical illness insurance

This type of insurance provides protection in a situation where a key person is afflicted by specified diseases or health problems that do not necessarily render that person disabled, but nevertheless affects his or her productivity or desire to work to the same extent as before. This coverage will generally pay a lump sum to help cover losses created by the individual's absence or lower productivity.

Making sure you have adequate business insurance, regardless of the kind of asset you are insuring — capital or human — provides peace of mind in the short term and can help to ensure your business' continued success in the long term.

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