

Meeting the needs of a developing business

With key person insurance



What is key person insurance, and why is it important?

Most business owners have insurance to cover their business in terms of its assets and liabilities, but what about insuring the business's most valuable assets—its key people?

Key people are owners, managers, or top employees who have an impact on the financial success of the company. If a key person dies unexpectedly, the loss of their highly specific skills, knowledge, and business contacts can impact profitability.

How would the business be impacted if a key person dies?

If a key person dies prematurely, this can result in many financial complications such as banks calling in loans, suppliers not extending credit, customers leaving, and employees seeking more secure employment. Upon the death of a key person, the business may need cash to meet immediate working capital needs, repay short-term loans, hire interim management, recruit and train a replacement, and keep cash flow disbursements to the deceased key person's family.

The benefits of key person insurance

Corporately owned key person insurance helps protect the business and can provide tax-free funds if a key person dies. This money can help to:



Offset the costs of finding and training a new person to assume the key person's role.



Assure customers that the business will continue as a viable entity.



Assure creditors that funds will be available to meet commitments.



Offset the expected reduction in sales revenue due to the death of a key employee.

Valuing a key employee

It can be difficult to assign a specific dollar value to a key employee—their value to the firm is dependent on their unique set of characteristics and skills. Typically, a key person is someone who brings substantial amounts of profitable business above and beyond other employees in similar roles, and who brings business goodwill by virtue of their presence.

When valuing a key employee, consider features that will produce a more precise value. What will the key person produce in the future? Take into consideration the timing of the key person's contribution to the business, and the fact that their contribution is unlikely to remain constant—it may change over time. Recognize that at some point, their contribution will end, and the key person will have to be replaced.

Business owners can use these steps to help value a key employee:

- 1 Determine the planning period.**

The planning period is the number of years required to recruit, train, and develop a new employee until they are as valuable to the company as the person being replaced.
- 2 Determine net revenue.**

Determine the net income for each year of the planning period. To calculate this figure, you need to know the amount of gross sales as well as the cost of goods sold.
- 3 Determine the key person's contribution.**

Calculate the key person's expected percentage contribution to the company's gross sales for each year of the planning period.
- 4 Calculate the key employee's compensation.**

Estimate the key person's total compensation for the entire planning period. This figure should include the cost of employer-funded benefits.
- 5 Calculate replacement costs.**

Add the total direct costs of finding, hiring, compensating, and training the replacement, established for each year of the planning period.
- 6 Estimate replacement contribution ratio.**

Estimate the contribution that the newcomer would make to the company for each year of the planning period, expressed as a ratio for the contribution made to the company by the key person.



At Equitable®, we're not your typical financial services company. We have the knowledge, experience and ability to find solutions that work for you.





Key person insurance can help protect the future of your client's business

Life insurance is an affordable solution compared to the potential net loss a company could face following the death of a key person. The proceeds from key person insurance can provide business owners with a financial solution to help prevent losses and reassure existing employees and customers that the company will have the means to continue if a key employee dies. Clients should talk to their financial advisor to learn more about insurance solutions that best fit their business needs.

Please contact your wholesaler for more information.

About Equitable

At Equitable we believe in the power of working together. This guides how we work with each other. How we help our clients and partners. And how we support the communities where we live and work.

Together, with partners across Canada, we offer Individual Insurance, Group Insurance and Savings and Retirement solutions. To help our clients protect today and prepare tomorrow.

We believe the world is better when we work together to build an Equitable life for all.



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