BAIRD
Private Wealth Management

Key Person Life Insurance

Protecting Your Business

The key to business profitability and growth often lies in the hands of one or a few key executives or employees.

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An owner, majority stockholder, successful sales person or someone with a high level of expertise can be vital to your company's future. Are you prepared for the impact of the loss of a key contributor?

PLANNING FOR YOUR COMPANY'S FUTURE

The loss of a key person can have a crippling financial impact on any business, however it is particularly pronounced for closely-held businesses. Replacing a key person takes time and money and could possibly cost your business valuable clients during the transition. The good news is that companies can insure their most valuable employees through a key person life insurance policy. The tax-free death benefit[1] can cover financial losses that occur at the death of a key person, helping to provide stability and continuity of the business for employees, customers and creditors.

VALUING A KEY EMPLOYEE

The first step in planning for the unexpected loss of a key employee is to actually place a dollar value on what the employee brings to the business. While there is no easy formula to determine the value of a key person, there are methods that are most frequently used to help estimate the worth of an employee to a company.

- Multiple of Compensation - This method is one of the easiest ways to estimate the potential impact to the company. Assuming the employee's value is accurately reflected in his or her total compensation package, the replacement cost is determined using a multiple of the current compensation. The multiple that is used will depend on the type of business and the estimated difficulty in finding a replacement.
- Contribution of Replacement - This method totals the direct expenses involved in finding, hiring and training a replacement and then adding the estimated lost opportunity cost.
- Discount Approach - This approach applies a percentage discount to the fair market value of the business. This percentage can range from 15% to 45% depending on the impact the key employee has on the future of the company and the estimated time it is believed to take to find, hire and train a replacement. This figure should be worked out with the company's attorneys and accountants.

OTHER IMPORTANT FACTS ABOUT KEY PERSON INSURANCE:

- Coverage is a business asset that enhances your company's creditworthiness for commercial borrowing
- The policy's cash value may be available to your business through a withdrawal or loan if needed[2]
- The policy can be transferred to the employee at retirement as a bonus
- The business pays the non-deductible premiums
- The death benefit and any guarantees are subject to the claims-paying ability of the issuing insurance company

For more information about key person life insurance or other business continuity planning options, please contact your Baird Financial Advisor.

Baird does not provide legal or tax advice.

[1]For federal income tax purposes, life insurance death benefits generally pay income tax-free to beneficiaries pursuant to IRC Sec. 101(a)(1). In certain situations, however, life insurance death benefits may be partially or wholly taxable. Situations include, but are not limited to: the transfer of a life insurance policy for valuable consideration unless the transfer qualifies for an exception under IRC Sec. 101(a)(2) (i.e. the "transfer-for-value rule"); arrangements that lack an insurable interest based on state law; and an employer owned policy unless the policy qualifies for an exception under IRC Sec. 101(j).

[2]Both loans and withdrawals from a permanent life insurance policy may be subject to penalties and fees and, along with any accrued loan interest, will reduce the policy's account value and death benefit. Depending upon the performance of the policy, the account value may be worth more or less than the original amount invested in the policy. Assuming a policy is not a Modified Endowment Contract (MEC), loans are free from current Federal taxation and withdrawals are taxed only to the extent that they exceed the policyowner's basis in the policy. Distributions from MEC's are subject to Federal income tax to the extent of the gain in the policy and taxable distributions are subject to a 10% additional tax, with certain exceptions.