

Keyperson Protection

Business owners are usually the most important employees of the business. They provide the organization with direction, leadership, and management; but they also provide the history: how the business got started, who the people were, and how the business has grown.

There may be other key individuals in the business organization who make a significant contribution to the success of the business. They could be "heir apparents" who have not yet obtained a share interest in the business.

In the event of premature death of the business owners or the other key employees, the business may face an uncertain future:

- creditors may demand payment
- banks may call loans and be less helpful in extending credit
- employees may seek more stable employment elsewhere
- customers may not comeback
- the business may be faced with a forced sale or liquidation of the business and suffer heavy losses

Business succession plans should generally include senior management succession planning. The risk may be self insured through business revenues or other cash reserves the business may have, or it may be transferred to an insurance company through the purchase of keyperson insurance protection.

Example

John, Susan, and Bob have a computer consulting corporation in which they are equal shareholders. They have 10 employees, and their clients tend to be large corporations.

John, 35, is the technical expert: he is the person that understands the problems of the companies he works with, and he knows the job that has to be done, the time it will take to do it, the cost of labour, etc.

Bob, 33, is the project leader; he works closely with the 10 programmers and coordinates their efforts to get the project done in time, under cost, and to the clients specifications.

Susan, 30, is the marketing force behind the company; she the person responsible for opening new contracts and attracting new business.

The loss of any of these three people would be a serious setback to the business. The company generates about \$2million in business revenue per year and has about \$250,000 in equipment; but more importantly, these individuals have a high degree of goodwill and trust with the companies they work with. A loss of any of them would be serious blow to their company.



John, Susan, and Bob figure that the loss of any of them would result in a 25% decrease in business revenues. Such a decrease would have serious effects on the viability of the company, and replacing the lost person would be time consuming and costly both financially and emotionally. The company doesn't have enough cash to carry it through such a loss, and they agree that the best solution would be corporate owned Keyperson coverage.

The company purchases a Multi-life universal life policy on the three of them with the following details:

Name Coverage Cost

John \$500,000 \$1,947

Bob \$500,000 \$1,737

Susan \$500,000 \$1,206

Total \$4,890

In this particular case, the company owns the policies and pays the premiums because it is able to utilize the small business preferred tax rate of approximately 20% on the first \$200,000 of business income; this is cheaper than having three personally owned policies and paying the premiums with the 50% after tax personal dollars that these individuals would be using. Note that there is no tax deduction for any part of the premiums (a deduction of insurance premiums usually exists only where the insurance is used for a collateral loan or a charitable giving situation.)

The clients chose universal life because it gives them flexibility to add more key people to the policy, increase or decrease the amounts of insurance at a later date, increase premiums payments to create a tax deferred cash value, or make other changes if the business needs change.

By purchasing Keyperson insurance, John, Bob, and Susan have ensured that in the event of one of their deaths, the company will have the financial means to keep the company afloat as well as search and pay for a new partner.

Please note that MetLife is no longer on our approved list of insurers. Existing applications will be processed, but no more Metlife applications are being accepted.

This publication has been prepared by ScotiaMcLeod, a division of Scotia Capital Inc.(SCI), a member of CIPF. This publication is intended as a general source of information and should not be considered as personal investment, tax or pension advice. We are not tax advisors and we recommend that individuals consult with their professional tax advisor before taking any action based upon the information found in this publication. This publication and all the information, opinions and conclusions contained in it are protected by copyright. This report may not be reproduced in whole or in part, or referred to in any manner whatsoever, nor may the information, opinions, and conclusions contained in it be referred to without in each case the prior express consent of SCI. Scotiabank Group refers to The Bank of Nova Scotia and its domestic subsidiaries. TM Trademarks of The Bank of Nova Scotia.

All insurance products are sold through ScotiaMcLeod Financial Services* companies. ScotiaMcLeod Financial Services companies are the insurance subsidiaries of Scotia Capital Inc., a member of the Scotiabank Group. When discussing life insurance products, ScotiaMcLeod advisors are acting as Life Underwriters (Financial Security Advisors in Quebec) representing ScotiaMcLeod Financial Services.

*ScotiaMcLeod Financial Services includes: ScotiaMcLeod Financial Services (Ontario) Inc., ScotiaMcLeod Financial Services (Quebec) Inc., ScotiaMcLeod Financial Services Inc.

