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What is Key Person Insurance?

Key person insurance is taken out by a business to compensate that business for financial losses that would arise from the death or extended incapacity of an important member of the business. The insurance payout is a lump sum and is used to offset the costs (such as recruiting a successor) and losses (such as a decreased ability to transact business) which the business is likely to suffer in the event of the loss of a key person.

The most valuable resource of any business is its staff. Loss of key staff can affect every aspect of a business – revenue, profit, goodwill and ultimately the value of your business.

This means that most small to medium businesses are carrying significant financial risk should the unexpected happen to one of their key people. The big question you have to ask yourself is:

'Would your business be able to maintain its revenues and profits if one of its key people died or couldn't work for an extended period due to a serious illness or accident?'

If your answer to this question is no, you need to consider transferring that financial risk to an insurance company.

Your financial adviser can help you do that, as well as answer any questions you have about key person insurance, and then calculate how much key person insurance you need to safeguard your business in the event something should happen to one of your key people. And, if you wish, your adviser will use our sophisticated computer program to 'broker' the major insurers to find you the right cover at a competitive price.*

Who can be a key person?

A key person can be anyone directly associated with the business whose loss can cause financial strain to the business. For example, the person could be a director of the company, a partner, a key sales person, key project manager, or someone with specific skills or knowledge which is especially valuable to the company.

Types of insurance

There are three types of risks that can be covered by key person insurance:

- the death of a key person (life insurance)
- their total and permanent disablement (TPD insurance)
- them suffering a trauma such as heart attack, stroke, cancer, and paraplegia (trauma insurance).

Insurable losses

There are two categories of loss for which key person insurance can provide compensation:

1. A revenue purpose: this protects the business against lost revenue and increased costs in the event of the loss of a person who makes a significant contribution towards the profitability of the business.

   Examples of revenue purposes include:

   - Recruiting costs
   - Training costs
   - Fall in sales or profits
   - Bad debts.

2. A capital purpose: this protects the business through the provision of capital in the event of the loss of a person who make a significant contribution towards the capital value of the business.

   Examples of capital purposes include:

   - Pay off business loans
   - Protect credit rating
   - Offset loss of goodwill
   - Protect against loss of a major supplier.

It is important the business documents the purpose of their key person insurance (i.e. revenue or capital purpose) to ensure that the taxation treatment of the premiums and end benefits is not compromised.

Tax considerations

If you take out key person insurance for a revenue purpose, your insurance premiums are usually tax deductible. However, the insurance proceeds are typically taxable.

If you take out key person insurance for a capital purpose your insurance premiums are not tax deductible. The proceeds of the insurance policy may be taxable.

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Ownership of the policy

Key person insurance is often owned by the business, as the business is generally the entity that will require the proceeds of the policy.

How much cover does your business need?

Calculating the amount of key person insurance needed for a business requires consideration of: the remuneration of each key person; the cost of recruiting a replacement; the business debts; the business value; the likely impact on the capital value if the key person was lost; and their effect on the revenue and profitability of the business.

Case study 1 - Protecting for loss of revenue

Colin owned a successful and growing small business. Colin's strength was his ability to win big contracts. Colin recognised that he wasn't a strong business manager, so he employed June as a professional manager. June dealt with the employment arrangements of staff, office renovations, marketing and client billing, and helped reduce the business expenses and increase the profit.

Colin saw that June was a key person to his business, so the business took out life and trauma insurance on her.

When June was diagnosed with terminal cancer two years after she joined the firm, her insurance policy was effected, and the business received the insurance payout. This helped Colin's business maintain its profitability until he could find a replacement for June.

Case study 2 - Protecting business debts

Franca's business needed to buy premises to cater for its growth. Franca obtained a business loan to purchase a suitable property. Franca backed the loan with a personal guarantee, a mortgage over the unit and her home.

Franca realised that should she become critically ill she would need to sell the property, the business or the family home in order to repay the loan. Franca took out key person insurance for the capital purpose of paying off the loan.

Three years after taking out the insurance Franca suffered a serious illness. The insurance paid out the loan, leaving the business and Franca debt free.

* Insurance cover is subject to eligibility criteria.

Our services

Health

- Health insurance
- Overseas visitors cover
- Dental services
- Chronic disease management
- Hospital in the home

Wealth

- Investments
- Estate planning
- Trust and estate administration services
- Financial planning
- Investment, education and funeral bonds
- Banking and home loans
- General insurance

Living

- Aged care and accommodation
- Personal and business insurance
- Aboriginal home care
- Disability services
- Retirement communities

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