



# Key Person Insurance

Presented by:  
R. Richard Roark, MBA

The Ohio National Life Insurance Company  
Ohio National Life Assurance Corporation  
Ohio National Equities, Inc.  
Member NASD/SIPC



Ohio National  
Financial Services®

*Life changes. We'll be there.®*

The Ohio National Life Insurance Company and Ohio National Life Assurance Corporation issue a variety of life insurance and annuity products. Product availability varies by state.



# Protect your business against the loss of a key person

# Key People are Valuable



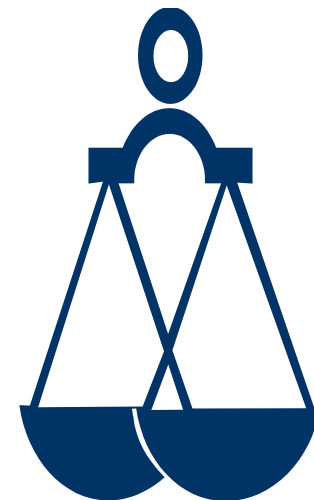
- ◆ If a key person in your company died today, would it adversely affect your profits?



# Purpose of Key Person Insurance



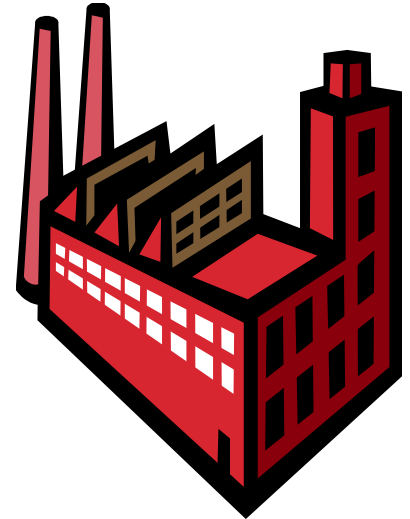
- ◆ To indemnify a business – to replace the monetary value of the services that would be lost due to the death of a key person.



# Key Person Insurance is Similar to Property Insurance



Just as equipment and buildings are insured against physical loss, so should key employees or owners.





After all, key people  
are the most  
important assets of  
your business.



# Who is a Key Person?

Focus on people whose:

- ◆ Contributions are significant to your business.
- ◆ Death would result in financial strain to your business.



# Who is a Key Person?

- ◆ High salary level
- ◆ Top sales people
- ◆ Decision-making power
- ◆ Implementation authority
- ◆ Financiers
- ◆ “Highly visible” employees
- ◆ Special or unique talents

*A key person may possess only one or several of these qualities.*



# Challenges Created By Loss of a Key Person



- ◆ Disrupted management
- ◆ Reduced earnings
- ◆ Impaired credit
- ◆ Replacement cost
- ◆ Lost confidence
- ◆ Cash needed to fulfill obligations to deceased employee's family

# Key Person Valuation

## Valuation Methods:

- ◆ Capitalization of salary
- ◆ Contribution to earnings
- ◆ Replacement cost
- ◆ One year's profits
- ◆ Present value of lost earnings



# Key Person Valuation



**Tip:** No set rules exist for determining how much coverage is needed. Instead, focus on a reasonable and practical amount to handle your business' needs.



# How Key Person Insurance Works

# Step One

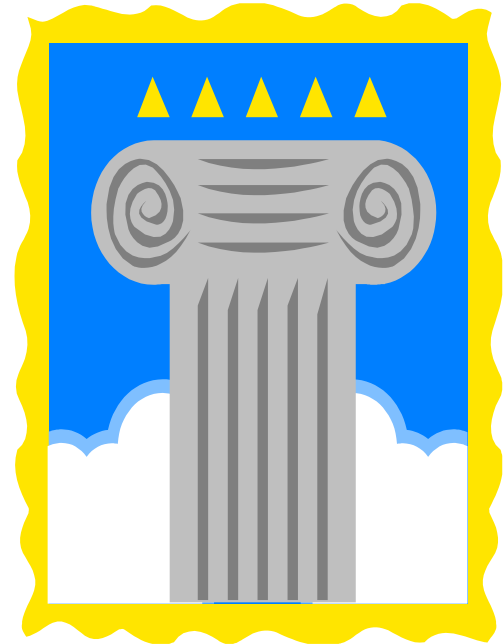
- ◆ The business sets a value and then applies for insurance on the key person's life.
- ◆ The employee must be notified of and consent to the purchase of life insurance.



# Step Two

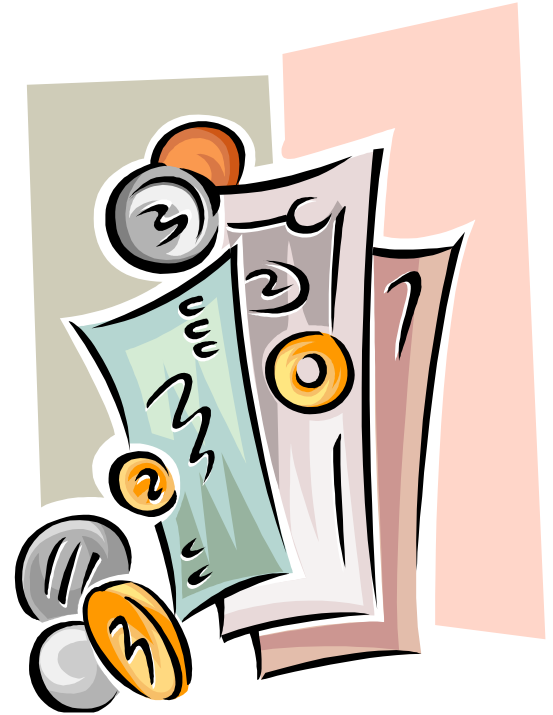


- ◆ The business pays the premiums and is both owner and beneficiary of the policy.



# Step Three

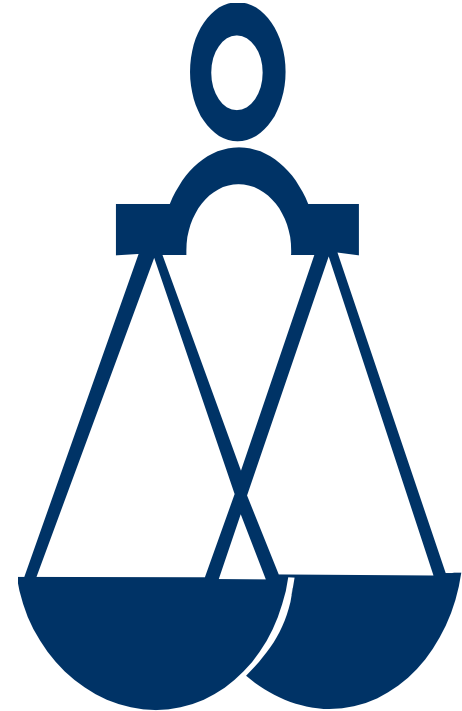
- ◆ If the key person dies, life insurance death benefits are paid to the business - tax free.



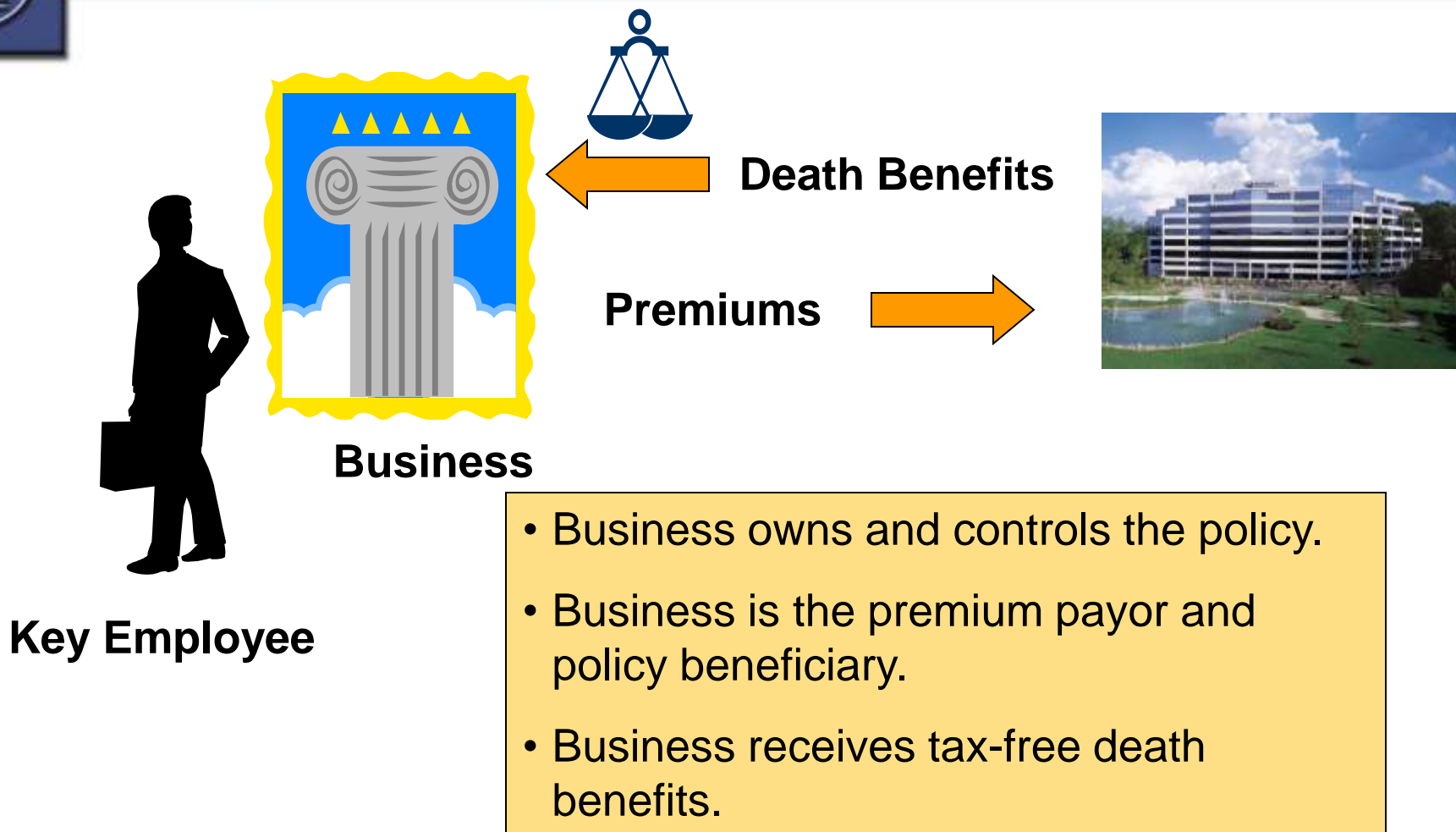
# Step Four



- ◆ The business uses the proceeds to offset losses in sales, productivity, credit and/or replacement cost.



# How Key Person Insurance Works



# Your Business Controls the Policy



The business is the policy:

1. Owner
2. Premium payor &
3. Beneficiary

*Employee has NO rights in the policy.*

# Tax Aspects



1. Premium payments
2. Death proceeds
3. Accumulated earnings tax
4. Corporate resolution



# Premium Payments

- ◆ Premium payments are nondeductible.
- ◆ No income tax consequences to the insured.

# Insurance Proceeds

- ◆ Generally, death benefits are received income tax free\*.
- ◆ Policies are not included in a key employee's estate unless the employee is the owner of the business.

*\* Some C corporations may face alternative minimum tax (AMT) exposure. While the AMT doesn't pose a problem for many corporations, you should check with your tax specialist to see if the AMT might apply in your case.*

# Accumulated Earnings Tax



- ◆ For C corporations.
- ◆ Applies when accumulated earnings exceed \$150k - \$250k (depending on business type).
- ◆ Amounts held for reasonable business needs may exceed allowable levels
  - ◆ **Key person insurance is a reasonable business need.**

# Corporate Resolution

- ◆ Key person insurance does not require a written agreement or IRS filing.
- ◆ Board of directors may wish to adopt a resolution.



# Type of Insurance Policy

- ◆ Permanent life insurance for a permanent need
  - ◆ And access to policy cash values!

OR

- ◆ Term life insurance for maximum affordability

# Insurance Riders

- ◆ Waiver of premium rider to protect against disability.
- ◆ Business exchange rider for situations involving employee turnover.

# Alternatives to Insurance

- ◆ Sinking fund
- ◆ Borrow funds
- ◆ Use surplus



# Sinking Fund

- ◆ Timing
- ◆ Opportunity Cost
- ◆ Difficult to accumulate large sums



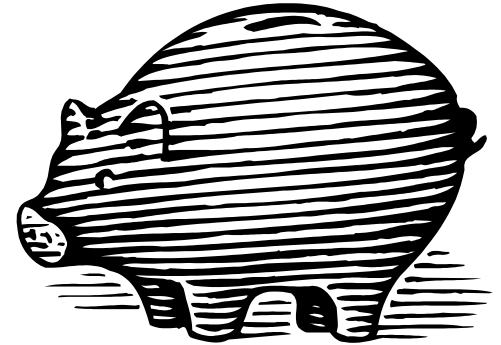
# Borrow Funds

- ◆ Interest added to cost
- ◆ Will creditors be willing to loan the amount needed?
- ◆ Interest rate risk
- ◆ Default risk
- ◆ Opportunity cost



# Use Surplus

- ◆ Enough surplus on hand?
- ◆ Will surplus be there tomorrow?
- ◆ Highest and best use of business funds?



# Key Person Insurance

- ◆ Self-completing sinking fund
- ◆ No interest payments
- ◆ Opportunity costs minimized
- ◆ Access to policy cash values
- ◆ Tax free benefits\*
- ◆ Creditors often require insurance on key personnel



*\* Some C corporations may face alternative minimum tax (AMT) exposure. While the AMT doesn't pose a problem for many corporations, you should check with your tax specialist to see if the AMT might apply in your case.*

# A Final Thought . . .

*Key people make little mistakes - a company can absorb little mistakes. The lack of key person insurance can be a big mistake. Big mistakes often absorb a company.*