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Firms can insure crucial members

Key-person insurance can save a small business if an owner or another crucial employee dies.

Miami Herald Staff and Wire Report

Losing a top sales person or a top executive can be a fatal blow to a small company.

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Like buying protection against fires, theft and hurricanes, businesses can buy insurance in case a critically important employee dies.

Known in the insurance industry as "key person" insurance, it's primarily life insurance, but the company is the beneficiary, not the executive's family, said Charles Vodicka, vice president of InSource, a Dadeland insurance agency.

"The need for such coverage is even greater for small companies," added Vodicka. "Large companies have more employees. One person isn't so critical to a large organization, except perhaps Warren Buffet in the case of Berkshire Hathaway."

He recalled how one client, a doctor, chose to insure a highly sought-after specialist in his practice rather than himself because this physician was a key part of the revenue generated by the practice.

Vodicka added that key person disability insurance could be a bigger benefit to a small company. Chances are greater that a critical member of a firm's staff could be disabled and not able to continue working than passing away suddenly.

REPLACING INCOME

Cathy Weatherford, executive vice president with the National Association of Insurance Commissioners, noted that key-person insurance serves another critical function: Providing cash to help a company replace lost income if an owner or key employee dies, and to cover the costs of recruiting and training a replacement.

"It means having funds to be sure you can get all of that done and be back at the level you were at prior to the loss of that person," said Weatherford, whose group is an organization of regulatory officials from the 50 states, the District of Columbia and five U.S. territories.

Vodicka noted that key person coverage is often tied to buy/sell agreements between partners in a company. The surviving partner can use the funds from the policy to buy out the family of his deceased co-owner and keep control of the company.

He stressed it's important that the terms of the sale agreements match what the policy covers.

Weatherford noted that some lenders will require a business to have key-person insurance as a condition or collateral for writing a loan. She also noted that it's very common for key person insurance in the first few years that a company is in operation, when it's most dependent on its founders in order to survive and thrive.

The key person in your company might not be an owner or a chief operating officer.

"You may want to look beyond that to someone who is your creative person -- you may want to cover them," Weatherford said. "With recruiting costs, with finding the right fit and putting in some training, you can be anywhere between 16 and 18 months in the replacement process."

SAME REQUIREMENTS

While other states are more restrictive, there are no requirements on which key executives or owners are covered by this type of insurance, said Vodicka.

Companies seeking to buy key-person insurance will find they're facing some of the same requirements and conditions as individuals -- for example, if the insured owner or employee has health problems, the company might not be able to buy insurance, or the premiums might be much higher. The insurer is likely to look at driving records and lifestyle choices such as smoking and drinking.

Also like regular life insurance, there are generally two kinds: Term insurance and whole or permanent insurance. Weatherford noted that some companies choose term insurance for periods of say, five years, to protect themselves in their formative years; after that point, a founding partner, for example, might not be as critical to the survival of a business.

The NAIC website has a page that explains key-person insurance at www.InsureUonline.org/smallbusiness/topic_group_key_life.htm

Weatherford advises owners to shop around, much as they would with their personal life insurance.

"It's pretty easy to compare coverage on price and benefits with a variety of insurers," she said.

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Miami Herald business writer Beatrice E. Garcia and the Associated Press contributed to this report.



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