



PROTECTING YOUR BUSINESS FROM THE LOSS OF A KEY CONTRIBUTOR

The value of key person insurance

RAYMOND JAMES

Like many businesses, yours may also rely on someone for the majority of your earnings

This “someone” is often referred to as a key person because his or her knowledge, skill set or work contribution is considered both highly valuable and necessary to the company’s success. For this reason, it is important for a business to protect itself against the sudden loss of this individual. As a result of being proactive, the business can maintain continuity and cover the costs of hiring temporary help or recruiting a successor, as well as handle any losses that may occur from a decreased ability to conduct business until the successor is trained.



KEY PERSON INSURANCE OFFERS PROTECTION AGAINST THE SUDDEN LOSS OF SUCH AN INDIVIDUAL

In and of itself, key person insurance isn't a type of insurance policy, but is the name given to life insurance that pays upon the death of a specified individual within a company – one who possesses the attributes previously listed. As the owner and beneficiary of the life insurance policy, the company uses the proceeds to help it and its employees survive financially should an unplanned event happen to the insured. Depending on cost and other factors, a company usually chooses between the following:

- Term life insurance: a policy purchased for specified periods – five, 10 or 20 years – that only pays a benefit if the insured dies during the specified period
- Permanent life insurance: a policy in which the face value of the policy is paid upon the death of the insured and a policy that also accrues a cash value that may be paid out at the end of the policy

Of course, the main purpose of key person insurance is to provide a benefit to the company upon the loss of the insured. However, a secondary purpose may be to provide the key person with a retirement benefit, such as the cash value of a permanent life insurance policy.

Key person insurance is a business decision that can help protect your business, but depending on the policy selected, may also benefit the insured in retirement.

BUSINESS	KEY PERSON
Buys life insurance policy on the life of the key executive	No interest in the policy
Owner and beneficiary	Family does not receive any benefit when death occurs
Pays entire premium and will receive entire death benefit	Can receive retirement benefits (business can access the potential cash value of the policy)

The proceeds from key person insurance can be used to:

- Keep the business running
- Assure creditors that everything is fine
- Assure customers that the business will run as usual
- Cover the expense of hiring and training a suitable replacement

DETERMINING THE RIGHT AMOUNT OF COVERAGE

The typical rule of thumb for deciding the proper coverage is five- to 10-times the person's annual compensation. Other considerations include:

- How much it will cost to replace the person (search, hiring and training)
- How much the person is worth to the bottom line
- If something happens today, what it would cost the business
- How much of the company's actual loss you are willing to insure

You can also use this formula:



1. Estimate the average income over the life of the key person and deduct federal and state income taxes



2. Determine the life expectancy or number of years until retirement



3. Select a rate of interest at which future earnings will be discounted

Now, multiply No. 1 by the present value of \$1 per year for the number of years determined in No. 2, discounted by the rate of No. 3.

Talk to your financial advisor about key person insurance options for your business today.

A key person can be a founder, owner, partner or employee of a business who possesses specialized skills, credentials or knowledge necessary for the success of a business, whose death may also result in catastrophic financial loss to the business. To determine exactly who is a key person, there are factors a business can use.

For Business Owners:

- If something happens to this person, the business wouldn't be able to obtain financial assistance
- The person has special knowledge about the operations and products
- The competition would have an advantage if this person were gone
- The person is the customer relationship maker

For Non-Business Owners:

- The business will not be able to meet sales goals without this person
 - The person understands the market and product so well that creativity is easy but would be next to impossible without him or her
 - The person has the contacts needed to get results in an emergency situation
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