# Client Factsheet

LEBC

## Business Protection Factsheet

### What is Business Protection?

Business protection refers to insurance policies whose purpose is to ensure that organisations can continue to operate in the event of the loss of key individuals. There are two main types of business protection, each with a different purpose:

Key person protection - to insure the business against the loss of a key executive.

Shareholder protection - to insure shareholders against loss of value or control.

### Business Liability Audit

A business liability audit is the start point for planning a comprehensive protection package. The audit should be carried out by professional advisers and should include:

- Key person listing, including owners, key executives and those with vital skills or relationships which are at the heart of business continuity
- Liabilities to third parties, including bank loans and overdrafts. Sole traders and small partnerships may also need to consider personal debts
- Liabilities to owners, including any loans owed to the owners by the business
- Loss of profits and the time it would take to recover those profits
- One-off expenses, including the recruitment and training costs of replacement executives. This may also include recruitment of interim cover.

The sum of the liabilities, loss of profits and one-off costs for each keyperson will indicate the need for cover and the level required. The audit should then lead to the preparation of a business protection plan backed by keyperson insurance policies.

### Key Person Insurance

Traditionally, business protection insurance encompasses policies that are individually underwritten (i.e. the premiums are finalised after submission of medical and related questionnaires for each individual) and the beneficiary is the company or organisation.

Policies are typically written for fixed terms and may include renewal and indexation options.

The types of policy available include:

**Life protection**

Paying the benefit on death. They may also be written on a reducing protection basis i.e. the benefit reduces each month over the term of the policy. That way, the insurance can be aligned with repayment of a business loan for example.

**Critical illness protection**

Paying the benefit on diagnosis of a defined (in the policy) critical illness, subject to survival for a specified period thereafter, such as 14 days.

**Combined life and critical illness protection**

A combination of the above two types of cover which can include reducing protection arrangements. Combination policies can reduce the overall premium

**Key person income protection**

This is a new type of policy and currently only available in the UK from a handful of insurers. This policy aims to fill the gap where key executives suffer long-term sickness or injury absence for reasons other than a defined critical illness. The policy will pay the company a regular benefit in the event of a claim. This money can be used to cover any loss of profits and/or pay for interim staff. Note that these policies are not a substitute for policies which insure a person's salary or wages in the event of long- term absence.

Most of these insurance policies (with the exception of income protection) can be written on a single life or joint life first death basis. Some will also offer total and permanent disability benefits and waiver of premium options.

## Shareholder protection

Rather than provide funding to the business in the event of death or critical illness, shareholder protection policies are designed to provide the remaining shareholders with the means to buy out the shares.

### Creating a shareholder protection plan

Putting a comprehensive shareholder protection plan in place can be complicated, especially if there are multiple shareholders with different holdings. But, it can be vital for each shareholder and the future ownership of the business. The key steps in creating a shareholder protection plan are:

1. **Review Articles of Association** and any shareholder agreements in relation to transferring shares. Any variations needed can be arranged by a solicitor.
2. **Establish the value of the business**. This will drive the levels of cover required.
3. **Prepare protection plan**. This will define the nature and level of cover required for each shareholder, together with the arrangements for share transfers in the event of a claim.
4. **Determine premium payment and tax treatment arrangements.** Depending on the insurance strategy adopted, the premiums may be paid by the company or the individual shareholders. Premium equalisation may also be required and the tax treatment of both the premiums and the benefits should be clarified.

## Regular reviews

As time passes, it is vital that the business valuation, and therefore the level of insurance cover, is reviewed. Other changes may also have a bearing on the plan, such as new executives, business restructuring and new financing arrangements. A review is recommended at least on an annual basis leading to adjustments to the insurances as required.

## Insurance Strategies

**Life of another**
This is generally suitable where there are two shareholders and there are unlikely to be any more. Each shareholder takes out a policy on the life of the other shareholder and completes option agreements, covering the arrangements in the event of a claim.

**Own life in business trust**
Each shareholder applies for their own life policy for the value of their shares, with the beneficiary being a business trust. In the event of a claim, the remaining shareholders buy the deceased's shares with the funds from the trust. A shareholders' agreement will set out the requirement for the trust funds to be used to buy the shares. Cross option agreements may also be used to cover circumstances where only one party wishes to buy or sell their shares.

**Company share purchase**
Instead of the remaining shareholders buying back the shares, the compa-ny can do so in the event of a claim, subject to the requirements of the Companies Acts. Such shares will be cancelled, thereby increasing the remaining shareholders' percentage holdings. Again, option agreements will be needed to ensure that the repurchase can proceed.

*The FCA do not regulate trusts*

### KEY ISSUES

Loss of an executive shareholder may also expose an ownership risk for the other shareholders. Their attorneys or estate may wish to liquidate the stock. Even if there are provisions for the sale of shares in the articles, are the other owners obliged to buy them? And if they are compelled to buy them, do they have the cash?

Having shareholder protection insurance in place helps to ensure that the shares can be liquidated.

Furthermore:

Full and fair values are realised by the estate or shareholder. The loss of a key person might otherwise be seen as a case for reducing the share valuation and thus the price being offered on an open-market basis.

Shares remain within the hands of the existing shareholders - rather than being disposed of to third parties or even retained by the individual or their beneficiaries.