



Business protection: a small price to pay

Philip Carter was a non-executive director of Chelsea FC. Like fellow director Matthew Harding, he died returning from a Chelsea game when the helicopter he was travelling in crashed.

Philip's main job was running Carter & Carter Group plc, a highly successful training business valued at £500 million the day before he died. On news of his death the shares dropped in value by about 20% and within six months fell to just 85p, when they were suspended from trading on the stock exchange. Shortly after, the administrators were called in and the business was shut down.

Philip was the founder of Carter & Co and as CEO was key to its survival. He gave it direction and vision, and he had the leadership skills required to bring the board together into an effective team. Creditors had confidence in this ability, and with Philip no longer there, they realised that his skills were not being replaced. They withdrew their support, an action which contributed to the closure of the business.

The value of shares evaporated into nothing

Carter and Co did not have keyman insurance cover for Philip. When the company was wound up, the valuable shareholding he left to his wife and daughter evaporated into nothing. This is one high-profile example of how important business protection insurance can be to a business, its shareholders and their families. This applies to all businesses, quoted and unquoted, companies and partnerships.

Loss of a key person leads to loss of confidence

If a business loses a key person a number of things could happen:

- competitors may see it as a chance to win business from the business
- suppliers may get nervous about payment and change credit terms or ask for cash on delivery
- pipeline customers will probably not commit
- the bank may call in their loan or reduce the overdraft facility.

However, demonstrating that the business has an appropriate level of key person insurance in place is likely

to go a long way towards restoring confidence and make replacing that key person easier.

Directors' loans need to be covered

Determining how much cover is required depends on the nature of the business. A good starting point is a proportion of gross profits. In addition, loans need to be covered, including directors' loan accounts and partners' loans on a pro rata basis. This is particularly important if directors have provided personal security, for instance second charges on their homes.

Getting the structure right

How the cover is structured will vary, depending on the type of business entity and its circumstances. For instance, the rules governing partnerships in England and Wales mean that each equity partner usually takes out an individual policy for the amount of key person cover required under a business trust for the benefit of the surviving partners, who will then invest it back into the partnership.

Flexibility versus tax-efficiency

For directors and/or shareholders of smaller companies (especially two person companies) where the directors want total flexibility in how they deal with the company following the loss, keeping the money outside the company can offer more flexibility. However, this flexibility usually comes at a price – it is more expensive in terms of tax-efficiency for the directors – although if a positive directors' loan account exists it may be possible to structure the cover in a more tax-efficient manner.

Maintaining business continuity and the value of the business is one aspect – there is also the human aspect to consider. The directors or partners are likely to want to

Main issues facing a business that loses a key person:

- share ownership
- business continuity
- debt repayment
- creditor confidence
- bank confidence
- preserving value
- replacing the person with someone who has the equivalent skills
- loan repayment including directors' loans.

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offer emotional and financial help to the family of the deceased. One option is to protect the dependents. It is possible to write life cover for the directors' dependents, under a relevant life policy.

The above highlights some of the main issues that key person insurance can help resolve. The way the cover is structured will vary, depending on the circumstances and requirements of a particular business, its directors, shareholders/partners and their families. LighthouseCarrwood has the expertise to ensure that all aspects of a potential loss are considered and that the cover is structured for maximum benefit and tax efficiency for the business and the individuals.

It won't happen to me!

The likelihood of death or critical illness occurring within a business is higher than you may think: for a group of four people the chance that one of them will die or fall critically ill during their working lives is:

| | Death | Critical illness |
|---------|-------|------------------|
| Males | 29% | 68% |
| Females | 23% | 59% |

We would be pleased to offer your clients a review of their business protection arrangements free of charge. To take advantage of this and for further information please contact Mark Dallas, Managing Director, on 07899 981607 Mark.Dallas@lighthousegroup.plc.uk.