Handelsbanken
Wealth & Asset Management

Business protection

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Running a business can be both rewarding and challenging, but unforeseen events can cause disruption, or even put the stability of a business at risk. That's why businesses ensure buildings, machinery and other tangible assets are well insured. But what about their most valued asset – their people?

When a business relies on specific people (not only as owners, but also as experts in their field), what happens if that person becomes ill or passes away? How might creditors, suppliers and customers view such a loss, and would the business – and the employees who rely on it – survive the crisis?

This is where Business Protection comes in - insurance policies for your business and employees, providing peace of mind should the worst happen.

The following table provides a summary of the types of Business Protection policies and the cover they offer.

Cover type	Profit	Debt	Ownership	Employee
1. Business Loan Protection If the business loses a key person through death or long-term illness, the money paid by the policy can be used to clear loans or other debt. Without a cash injection, investors and creditors (like the bank) may call in debts as they're no longer confident the business can continue to pay back the debt.	No	Yes	No	No
2. Key Person Cover If a business loses a key person who influences company earnings, the policy gives the company a cash injection, helping to replace lost profits.	Yes	No	No	No
3. Shareholder/Partnership Protection If a partner or shareholder dies or is diagnosed with a critical illness, the proceeds help the remaining owners buy the affected individual's share of the business. Without protection, the surviving owners could lose control of the business, impacting its success.	Yes	No	Yes	No
4. Relevant Life Cover This is a tax-efficient life insurance policy that allows companies to offer death-in-service benefits to their staff.	No	No	No	Yes

Let's look at each in detail.

1. Business Loan Protection

Many businesses take out loans, for example, to start a company, purchase their commercial property, or to expand their current operation. Under the terms of the loan, the liability for repayment usually lies with the business owners, shareholders, partners or other key individuals. Should something happen to one of those individuals, preventing them from working, Business Loan Protection would enable the company to repay the outstanding debt.

This cover is purely to cover the repayment of any outstanding debt. When you take out Business Loan Protection, your cover should reflect the amount your business owes in borrowed money. This can ensure that if you claim for a pay-out, you have sufficient cover in place to repay your business loans.

A business can choose to cover its key employees with either Life Cover or Life with Critical Illness Cover. With Life Cover –a one-off payment of the agreed sum assured will be made on the death of the key person; with Life Cover with Critical Illness – a lump sum payment will be made on death or diagnosis of a specified critical illness of the key person.

Only for repayment of an outstanding loan/debt

Policy term to be in line with remaining term of debt

Level cover and decreasing cover are available

How does Business Loan Protection work?

Business Loan Protection can be taken out on what's called level cover or decreasing cover basis.

- **Level cover** - where both monthly payments and the cover amount stay the same for the whole term of the policy. This would be best for interest only loans, or recurring debt like an overdraft.
- **Decreasing cover** - with this policy the debt will reduce over time. Decreasing cover usually costs less than level cover, as the value of the debt being paid off gradually decreases over time, as does the cost of the cover.

The business will own the policy based on the life of the person(s) responsible for repaying the loan. This isn't always as straightforward as it seems as those liable could each be responsible for different amounts as per the terms and conditions of the loan.

Should the life-assured person die or suffer a critical illness (if that option has been selected) during the term of the policy, then the proceeds of the claim would be paid to the business. This would enable the business to settle the outstanding debt. In some cases the policy can be 'assigned' to the lender and the proceeds of a successful claim would be made directly to them.

Tax treatment

It is also important be aware of the tax treatment of Business Loan Protection. Where the insurance is initiated as collateral security for a loan, the premiums paid are not treated as a deductible expense from profits for corporation tax purposes and therefore tax relief is not given.

2. Key Person Cover

Businesses usually recognise the need to protect their tangible assets such as laptops, phones, buildings and so on, but can often be guilty of overlooking their most valuable asset – their people. A key person is someone whose death or illness would have a significant financial impact on the business and Key Person Cover provides a safeguard to your business against the loss of that individual.

Here are some examples of a key person:

Karen
Managing Director of AlwaysRight.com

Karen is a founder of AlwaysRight.com and creates the business strategy. She sets the vision for the company and drives the direction of the business. Without Karen there could be severe implications on the finances of the business.

Alan
Top sales guy at 'It's a Dog's Life'

Alan has been the leading sales person at 'It's a Dog's Life' for 10 years. Customers trust him and he holds key relationships with local suppliers. Alan's absence would quickly have an impact as it may be harder to attract and retain business and profits could drop.

Kevin
Technical Specialist at 'Up Up n Away!' Private aviation company

Kevin is the technical specialist on the mechanics of light aircraft used by 'Up Up n Away!' Without him – and a long lead time to find a suitable replacement – substantial business could be lost.

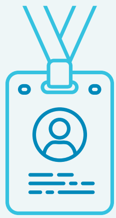
How does Key Person Cover work?

Key Person Cover is life insurance taken out by a business on the life of a crucial person in the business. It can also include critical illness cover. Policy proceeds are paid directly to the business to help replace the key person, cover any profit loss, and ultimately help to keep the business trading.

A business can choose to cover its key employees with either Life Cover or Life with Critical Illness Cover. With Life Cover –a one-off payment of the agreed sum assured will be made on the death of the key person; with Life Cover with Critical Illness – a lump sum payment will be made on death or diagnosis of a specified critical illness of the key person.

How much is needed depends on ...

How long it takes to find a **replacement** for the key person



How much to **recruit** and **retrain** a replacement?

What is the potential impact on **profits**?

The amount of cover will be based on each individual business needs and there are three options to choose from:

- **Level cover** – the pay-out and premiums remain the same throughout the term of the policy. This type of cover helps a business to remain in control of their costs, but won't keep up with inflation.
- **Decreasing cover** – the amount of cover goes down each year. This may appeal to a business that expects to see an increase in capital, for example if a long standing debt is being reduced.
- **Increasing cover** – the pay-out that could be received increases each year to keep up with inflation. Premiums are index-linked and increase annually. This level of cover may be attractive to a business that needs to build in protection against the increasing cost of living.

Tax treatment

The business will pay the premiums and own the policy meaning in the unfortunate event that the key individual dies or is diagnosed with a specified critical illness (if that cover is in place), then the benefit is paid direct to the business.

For the policy to qualify for tax relief the following three points must be satisfied:

- The sole relationship between the insuring party and the key person must be that of employee and employer. The employee should not be a significant shareholder in the business, the guidance on the definition of 'significant' is unclear but as a rule of thumb, a shareholding of less than 5% is deemed insignificant.
- The policy must solely be intended to compensate for loss of profits – for any other reason, such as to repay a loan, would mean it unlikely to qualify for tax relief.
- The policy must be an annual or short-term assurance which usually means five years.

This is a summary of potential taxation and will be different for each business.

3. Shareholder & Partnership Protection

Shareholder & Partnership Protection offers a safety net if a business owner dies. It also covers a diagnosis of a critical illness (like cancer). It means the remaining owners can keep control of their business, as it enables the surviving owners to purchase the deceased owner's share of the business from the deceased owner's estate and ensures that the deceased owner's dependants have a willing buyer and cash instead of a share of the business.

Why is there a need for Shareholder & Partnership Protection?

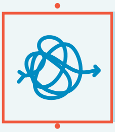
If a business doesn't plan for what would happen if one of the owners were to be critically ill or pass away, it leaves not only the deceased's family uncertain, but the remaining owners too. Here's an example below:

Debbie owns 51% of TableTop, a business creating furniture.

She becomes seriously ill, cannot work, but can still earn a salary and dividends.

Her business partner Kevin takes on the additional workload.

Debbie passes away and her family inherit her part of the business.



They do not want to be part of the business, but Kevin is not in a position to buy them out.

With Shareholder & Partnership Protection in place, the policy would provide a lump sum that enables Kevin to buy Debbie's family out of their share of the business, providing security to all parties.

How does Shareholder & Partnership Protection work?

Business partners and key business shareholders may buy protection with either Life Cover or Life with Critical Illness Cover.

In addition, a legal agreement is put into place at the start of the life and/or critical illness policy. This sets out what would happen if an owner were to be critically ill or pass away. In the above example, if Debbie were to be critically ill, the legal agreement would set out that she could decide to sell her part of the business to Kevin. To ensure she isn't forced out of the business, the legal agreement would ensure that selling her share is her choice. To give Kevin comfort that Debbie wouldn’t be out of work permanently and never sell her part of the business, a time limit could be agreed at which point Kevin could enforce his right to buy. This is called a single option agreement – i.e. the option to sell is in Debbie’s hands.

If Debbie passes away, the legal agreement would cover the lump sum going to Kevin, so he can buy the business from Debbie’s beneficiaries, should he wish to. This is called a cross-option agreement. With this in place, if Kevin wanted to buy Debbie’s share of the business, the beneficiaries would be required to sell and vice versa. A cross-option agreement offers peace of mind to the family left behind, who will have a willing buyer of shares they may no longer want, and remaining shareholders have the comfort of the option to purchase. The legal agreement also confirms how the business will be valued.

4. Relevant Life Cover

Relevant Life Cover is a life insurance plan which employers can take out to provide an individual death-in-service benefit for their employees. It forms an alternative way to provide death-in-service benefits for those employees who are not members of group life schemes.

Relevant Life Cover can therefore be particularly beneficial and cost effective for small businesses that do not have enough eligible employees to warrant a group life scheme. The policies can also be attractive for high-earning employees or directors who have substantial pension funds and don’t want their benefits to form part of their lifetime allowance, as well as for members of group life schemes who want to top-up their benefits.

How does Relevant Life Cover work?

Relevant Life Cover is applied for and paid for by the business on the life of the employee. It provides a lump sum benefit - payable either upon the death of, or the diagnosis of a terminal illness - in an employee during their employment (up to the age of 75).

The amount of cover is based on a multiple of salary which can vary by provider but is usually calculated by age groups. The following shows the maximum that could be covered.

For flexibility, these policies also offer a choice of level, decreasing or increasing cover.

Age	Maximum cover
16 - 39	30x total remuneration
40 - 49	20x total remuneration
50+	15x total remuneration

Level-term cover

Decreasing cover

Increasing cover

The policy can only be issued into a relevant life policy trust, which the employer will need to set up when they apply. The employee's family or dependants can be beneficiaries. The employer will always be a trustee and the trust will allow for the appointment of other trustees, such as a family member or an independent trustee. Should a terminal illness claim arise, funds will be made payable to the member.

Tax treatment

A Relevant Life policy provides tax efficiency for both the employer and employee. Premiums paid by the employer are usually viewed as an allowable business expense by HMRC and there are no benefit-in-kind implications for employees.

Premiums and any benefit paid are eligible for relief from income tax, corporation tax, and national insurance contributions, and (in most cases) are free from inheritance tax. In addition, benefits do not count towards the lifetime allowance for pension purposes.

The taxation of all policies is taken into consideration as part of our advice process.

Further information

For further information on our Business Protection service and the policies outlined in this brochure, please speak to your Client Director or get in touch with the Protection team:

ProtectionTeam.hwam@handelsbanken.co.uk

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