Business insurance strategies

Protect your assets

Insurance can be used to repay debts and protect assets used as security if you or another key person[1] in your business dies or is seriously injured.

How does the strategy work?

Most businesses use debt to start up and grow their operations. Examples include:

- loans sourced from a lending institution (eg a bank) that are secured by personal assets (such as the family home) or business assets (such as business real property)
- proprietor loan accounts[2], and
- significant trade creditors.

While few businesses could exist without entering into these types of arrangements, problems can arise if you (or another key person) are lost to the business temporarily or permanently.

Your business could have difficulty meeting its loan commitments. The lender could also have concerns regarding the business' cashflow and credit position and may require the outstanding loan to be repaid immediately.

You may even have to sell the personal or business assets used as security so the debts can be cleared.

One way to reduce these risks is to insure yourself and other key people in the event of death, total and permanent disability (TPD) and critical illness.

If any of these events should occur, the lump sum insurance payment can be used to:

- reduce or pay off the debts
- release any loan guarantee or security provided
- protect your personal and business assets, and
- ensure the business can continue as a viable operation.

Other key considerations

- It's important to update your insurance cover in line with the changing value of your debts, as failing to do this may lead to underinsurance.
- If you (or the entity through which your business is run) own an insurance policy taken out for the purpose of repaying a debt, the premiums paid by you (or the entity) will generally not be tax-deductible. You should get advice from a registered tax agent relevant to your circumstances.

Seek advice

A financial adviser can help you assess all the issues that need to be considered and determine whether asset protection insurance suits your needs and circumstances.

[1] For the purpose of this strategy, a key person must have an interest in the debt and will usually be an owner of the business.

[2] Proprietor loan accounts generally arise when a shareholder or director of a company lends money to the business.

Case study

Adam, aged 40, is married to Kylie, aged 35. They have a young family and own a home worth $600,000.

Adam wants to expand his dry-cleaning business and to do this he'll need to raise some capital. After assessing his options, he borrows $200,000 from a bank and, as part of the loan agreement, he signs a guarantee using the family home as security.

One of the conditions of the loan is that the debt must be repaid immediately if he dies or becomes totally and permanently disabled.

His financial adviser explains that should either of these events occur, the only way he'll be able to repay the loan is to sell either the business or the family home, and both these options would have significant drawbacks.

Selling the business assumes there'll be a willing buyer prepared to pay a reasonable price. Selling the family home can present similar challenges, compounded by Adam's family having to find somewhere else to live.

Adam could also face problems if he suffers a critical illness. In this scenario, he could struggle to meet the loan repayments – particularly if he takes a while to recover or is unable to return to work.

After assessing Adam's goals and financial situation, his adviser recommends he take out $200,000 in Life, TPD and Critical Illness insurance. If the unthinkable happens, he (or his estate) will receive the necessary cash to repay the loan and extinguish the guarantee.

Other business insurance needs

- Insurance can be used to protect your business revenue if you (or another key person) die, become disabled or suffer a critical illness. To find out more, ask your adviser for a copy of our **'Protect your business revenue'** flyer.
- You may also want to use personal insurances to protect your income if you are unable to work due to illness or injury. To find out more, ask your adviser for a copy of our **'Protect your income'** flyer.