Washington's Sculptor

An American history lesson on the beginnings of keyman insurance

by Michael D. White

On Feb. 22, our country celebrates and honors the birthday of President George Washington. "First in war, first in peace, and first in the hearts of his countrymen," Washington was also the object of a business enterprise that produced the first keyman life insurance policy in America.

In 1784, Frenchman Jean Antoine Houdon was commissioned to sculpt "for posterity a permanent likeness of the Father of the Country." But, Houdon, fearful of the danger of transatlantic travel and the risk that his family could be left without income should he die during his trip, insisted on a life insurance policy to guarantee payment to his family in that event.

At the request of Thomas Jefferson, then the U.S. ambassador to France, John Adams, U.S. ambassador to England, looked into the coverage and reported to Jefferson his meeting with several English insurers. He wrote: "But Dr. Price, who was present, undertook to enquire and inform me [about the policy].... You may write to the Dr. to get it done and he will reduce it if possible."

The doctor to whom Adams referred was Dr. Richard Price (1723-1791), a noted Protestant clergyman, mathematician and scientist who compiled the Northampton Table, the first scientific mortality table. The table became the basis for premium calculations at England's Equitable Life for the next century.

Dr. Price helped place this first keyman policy used to cover an employed person in America. With the cover secured, Houdon came in 1785 to the States where he rendered permanent the likeness of Washington for generations to come.

ICBA Insurance Seminars

This year Michael White will lead an ICBA insurance seminar, "How Community Banks Can Profit Selling Insurance."

The one-day seminar takes place March 19 in Dallas, May 15 in Cincinnati and Oct. 1 in Denver. It covers critical strategic issues, including assessing insurance opportunities, strategic planning, acquiring an agency and integrating insurance into your bank's operations.

For more information, call ICBA's Education Department at (800) 422-7285

Business-Related Insurance

Roughly 20 million small businesses-98 percent of all U.S. businesses-employ almost 60 percent of the work force. These businesses represent nearly half the nation's payroll and sales, and 50 percent of the Gross National Product.

Today small businesses have a number of important needs when it comes to their key personnel such as Houdon. These needs include recruiting, retaining and retiring employees. Business

life insurance can help meet these and other needs through split-dollar programs, keyman insurance, funding of buy-sell agreements and nonqualified deferred compensation plans.

Banks provide products and services that help small businesses maintain sufficient cash flows. Therefore, banks are well positioned, through financial planning and risk management, to offer their small business customers insurance that protects against lost revenue streams and assets from death, accident, sickness, fire or storms of employees.

A 1997 survey by the Arthur Andersen Center for Family Business and

Mass Mutual found that nearly one-fourth of older business owners had only "some" understanding of the amount of their estate tax due when they die. Nearly one-fourth did not have a primary investment adviser for pension assets, and almost one-third lacked such an adviser for personal assets. Bankers ranked second only to accountants as "most trusted business adviser," the most instrumental in succession and estate planning.

Approximately 90 percent of businesses are closely held, and most are family-owned. Yet, the majority do not have written and funded buy-sell agreements. Only 20 percent of small businesses have retirement plans. According to the U.S. Bureau of Labor Statistics, only 40 percent of full-time employees have long-term disability coverage, and only 64 percent have paid sick days or short-term disability protection.

According to the Life Insurance Market Research Association, small businesses and their employees are decidedly underinsured:

- 55 percent have no group health insurance;
- 62 percent have no accidental death and dismemberment insurance;
- 69 percent have no group life insurance;
- 70 percent have no prescription drug coverage;
- 77 percent have no group disability income insurance;
- 86 percent have no dental care coverage; and
- 91 percent have no vision care plan.

Key EmployeeValue

The loss of human life to loved ones, friends and business associates can never be replaced. But the death of a key employee, and the financial losses such a death brings to a business, can be defrayed and indemnified.

While most companies insure their tangible assets like inventory, equipment and real property, they often fail to insure their most valuable asset: the lives of their key employees who create profits. Life insurance is the only financial instrument that can enable a business to survive the financial impact of the sudden unexpected death of key employees.

Consider the following true stories of two companies that had two key employees die--one business was an electronics distributor, the other was a bank.

In December 1980, a fire broke out in the Stouffer's Inn in Westchester County, N.Y., killing 26 people. Among the fatalities were 13 high-ranking executives of Arrow Electronics Inc., then the nation's second largest electronics distributor.

Employee stock options, deferred compensation payments, survivor death benefits, additional accounting costs, hiring replacements and personnel relocation charges resulting from the deaths cost Arrow Electronics more than $5.5 million pre-tax, or approximately $3 million in net after-tax, expenses. As a result, Arrow Electronics' 1980 earnings fell from $5.5 million in the year before the disastrous hotel fire to $5.27 million, despite a substantial one-third increase in company revenues. Debt and losses mounted, and it took Arrow Electronics nearly a decade to re-establish its operating profitability.

In contrast, Professional Bancorp Inc. in Santa Monica, Calif., safeguarded its third-quarter 2000 net earnings of $1.4 million, despite the death of bank founder and former CEO, Joel Kovner. The bank protected its earnings with a $3.7 million death benefit payout for a keyman life insurance policy. The company's $1.4 million net earnings the year its founder died was a difference of $3.8 million when compared with the net loss of $2.4 million the year before.

Key Employee Life Insurance

Insuring key employees is especially important for smaller, closely held corporations, where the death of one employee on whom all business depends, could result in the company's bankruptcy.

Banks and their insurance agents can protect business clients from such disasters by insuring the increasing value of their clients' key employees. This can be accomplished by selling businesses a life insurance policy that makes the corporation the owner, premium payer and beneficiary of the policy.

Key employee life insurance may be the easiest and, perhaps, the most important insurance sale a bank ever makes. It has helped preserve the legacy of small business owners - including bankers, electronics executives and famous sculptors whose hands and minds have produced the great progress our nation has experienced in its 225 years of independence - just as it helped render permanent the likeness of him who led the army of patriots who produced that independence.

Michael D. White is chairman and CEO of Michael White Associates, LLC., a bank insurance consulting firm in Radnor, Pa. Reach him at mwa@BankInsurance.com

A version of this article first appeared in
Independent Banker
February 2001, V.51 N.2, pp. 94-95
*"**Washington's Sculptor**"*
BankInsurance.Com — Internet Version