# Insurance to the Rescue for Early-Stage Startup Risk?

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My whole career has revolved around financing entrepreneurial businesses. I have worked with thousands of companies, helping them in their quest for capital. My approach has always been to look at alternative techniques [as well as write about **out-of-the-box startup funding approaches** for *Wharton Magazine*]. One technique that has always seemed just out of my reach has been: mitigating the risk to the investor's original capital in an early-stage company.

I have been obsessed with mitigating this risk for years. I have come up with all kinds of solutions, but none of them have ever been practical enough for the investment community. I've suggested ways to set up a private Small

Business Administration financing program. I’ve helped to devise a way to insure against bankruptcy.

Well, folks, I think I have finally found how to do it.

The answer lies in a proprietary way to use so-called “key person” life insurance, structured to take advantage of an irrevocable asset protection trust. When properly put into place, it would protect investor capital from the high risks normally associated with early-stage companies.

I know what you are thinking: “Has Bruce turned into an insurance salesman?”

The key person insurance solution might sound confusing and convoluted, but it is real and backed by major insurance companies—and this approach will soon be available.

Have we finally found the holy grail of entrepreneurial investing? Let me tell you what it does for investors and companies looking for capital, and let you be the judge.

For investors, the key benefit is that they receive a return of 100 percent of their investment capital:

• Irrespective of how the company they invested in performs, even if it goes out of business.

• Despite what might happen to the key executives of the company.

• Even if creditors or courts try to come after the investment capital.

The key benefits to companies are:

• It takes away the final “no” from an investor, making it easier and quicker for the company to raise capital.

• It offers the company better financing terms because a major risk has been taken out of the investing equation.

• It protects the company from the loss or incapacity of key people.

Key person insurance can also:

• Work even in extremely volatile markets.

• Provide excess cash and death benefits to the company.

• Ensure that the company does not incur any debt.

OK, I could go on gushing, but you get the idea.

This concept provides investors the opportunity to realize venture capital-like returns with the peace of mind that their capital is protected.

The implications are immense. Anything that helps put more capital into the hands of qualified entrepreneurs will create more jobs and move this country forward. I am all for it.

Security crowdfunding is coming in January. This paradigm shift in access to capital will allow a whole new group of individuals to invest (not donate) their discretionary capital into entrepreneurial companies (thanks to the Jumpstart Our Business Startups, or JOBS, Act).

That is the good news. The bad news is the risk involved. How can we protect those investors from the risk they are about to take?

The Securities and Exchange Commission and other regulatory agencies have been working on the rules and regulations that will, to some extent, reduce risk through disclosure. But even with full disclosure, no one can predict which companies will be successful and which will not.

What if there was a way to protect all investors from the most dramatic, catastrophic type of failure—that is bankruptcy or the situation where a court takes over the company on behalf of its creditors and investors?

Just in time for the new wave of security crowdfunding investors, a way to protect investors from loss due to bankruptcy might emerge. A new type of insurance is being developed and may be coming on the market as early as the first quarter of 2013—to insure investors against bankruptcy. It will be like getting life insurance on a business. If a startup dies due to bankruptcy, the investors get their investment returned in full.

How can this be? Some very bright individuals have spent time and money figuring out how to insure against the loss of an investment in a business. They studied businesses in every industry going back to the 1920s, and they came up with a way to charge an insurance premium that defines the risk of the investment. In fact, they can rate any business' risk of bankruptcy and can determine the cost to the investors to insure their investment against loss.

A one-year premium can range from 2 to 20 percent of their investment. Underwriters might not choose to cover companies with ratings greater than 20 percent because the risk of loss would be considered so high.

What does this all mean to the new crowdfunding investors? It means that they will know through an independent insurance rating system how risky a prospective investment really is. Isn't that a wonderful invention for investors?

The next time that someone asks you to invest in a hot new company, you might be able to see, before you decide to invest or not, the company's chance of going out of business within the first year or possibly longer.

Keep in mind that not all companies will want to be rated or will want to offer this type of insurance to their investors. But the startups that do and have the cash flow to offer their investors this type of insurance will have a definite advantage in the new marketplace of security crowdfunding.

***Tags:***

- ***Bruce Blechman***, ***crowdfunding***, ***Insurance***, ***investment insurance***, ***JOBS Act***, ***Jumpstart Our Business Startups Act***, ***SEC***, ***Securities and Exchange Commission***, ***security crowdfunding***


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