KEY MAN INSURANCE

DEFINITION

Key man insurance, sometimes called key person or key employee insurance, is a form of business insurance that will protect a company in the case of an untimely death or disability of a senior member of the company. It consists of a life and/or disability insurance policy in which the company is paid in the event of the death or disability of a key person. Key person insurance provides the financial means to stabilize a company during the adjustment period after the loss. When a death or disability occurs, the company may lose critical management skills and may experience periods of falling sales and productivity. Additionally, significant costs may be incurred in identifying and training a person that will have the ability to replace the key person.

HOW THEY WORK

PARTIES INVOLVED

With key man insurance, the company secures the policy on the life of the key person. The company owns the policy, pays the premiums, and is the beneficiary in the event the key employee dies or is disabled. Premium payments made by the company are not tax deductible. However, in most cases, the proceeds received are tax free. Since the company is the beneficiary of the policy, key man insurance is designed to protect the company and not the employee. If a key employee dies or becomes disabled, the company can use the policy proceeds for any purpose.

KEY PERSON

In many companies, especially ones that are small to medium in size, success is dependent on a handful of individuals with specific skills and experience. These key employees are critical to the long term performance of the company. A key person is an individual directly associated with the company whose loss can potentially cause financial strain. The policy's term does not extend beyond the period of the key person's participation in the company.

LOSSES

If a key employee dies or becomes disabled, the company can use the policy proceeds for any purpose. However, they are meant to be, and generally are, used to cover expenses associated with ensuring business continuity. Policy proceeds may be used to offset profits lost from not having a key person's expertise or to recruit and train a replacement. The policy does not indemnify the actual losses incurred but instead compensates with a fixed monetary sum as specified on the insurance policy.