

Life Insurance For Key Employees

Who Is a Key Employee?

A key employee is someone whose knowledge and skills contribute significantly to your business income. Losing a key employee would most likely cause substantial negative financial consequences for your business. According to a survey of small businesses by the National Association of Insurance Commissioners, 71 percent of the firms surveyed said they were very dependent on one or two key people for their success. However, only 22 percent of respondents had key person life insurance in place.

What Is Key Employee Insurance?

Life or disability income insurance can compensate your business when certain key employees die or become disabled. These coverages cushion some of the adverse financial impact that results from losing a key employee's participation.

How Much Life Insurance Is Advisable?

There is no set formula for putting a dollar value on the financial impact of a key employee's death. Nevertheless, you need to come up with a figure as a guide to how much insurance coverage to buy. Some life insurance companies provide formulas for this which may or may not have a realistic relationship to the employee's worth to your business.

In some cases, a look at the employee's responsibilities can facilitate valuation. If, for example, the employee is responsible for a certain volume of sales, the loss is the profit derived from the person's sales, less the profit that could be expected from a replacement.

Also to be included is the expected cost of replacing the employee, including employment agency fees and moving expenses and possibly a higher salary for the replacement.

Who Owns the Life Insurance Policy?

Usually, your organization owns the policy, pays the premium and is the beneficiary. Alternatively, your business and a key employee may agree to split the premium payments, cash surrender and death benefit value.

The employee must agree to the company's purchase of this insurance. The insurer may also require a resolution from your board of directors stating the policy's purpose.

What Kind of Life Insurance Should I Buy?

Businesses usually use term insurance when the only purpose is to compensate for losses caused by the key employee's death. Policies that accumulate cash value are appropriate in some circumstances. Discuss which is better for your business with your life insurance agent.

What Is Key Employee Disability Income Insurance?

Key employee disability income insurance is less well known than key employee life insurance. Nevertheless, the risk of a key employee experiencing partial, total or permanent disability is actually much greater than the risk the person will die. Should a key employee suffer permanent total disability, the loss to your business will be just the same as if the person had died. Key employee disability income insurance protects the business from this loss exposure by paying you anywhere from 40 to 70 percent of the disabled employee's earned income.

If the disabled person is a partner or sole proprietor, a business overhead expense disability policy provides some protection. This pays, up to the policy limit, office expenses including rent, utilities, salaries and depreciation that continue when a partner or sole proprietor is disabled.

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