

KEYMAN INSURANCE

A keyman, is a person whose services contribute substantially to the success of the business. Generally, he is a person with special technical knowledge who can be replaced at a considerable cost of training. The services of a keyman have significant and unique affect on the profitability of a firm's operations. It implies therefore that immediately following his death, there will be a vacuum in the company with the result that the company incurs financial losses or even at times becomes unable to fulfill the commitments made by it. Thus, a keyman is:

- Any employee whose existence is critical to the profitability of the business.
- He / she in his / her capacity

- Key Person could be an employee / director of a company with technical background, experience entrepreneurial vision and / or market image whose death, will have a bearing on the profitability of the company.
- It is not necessary for a Key Person to hold the highest position.
- There can be more than one Key Person within a company of the requisite background, knowledge, experience etc.

Why Keyman Insurance?

- Compensation Of Financial Loss
 - Funds required to pass on the shares of the deceased

- Credit arrangements may be withdrawn.
 - Loss of sales / business momentum.
 - Project overruns due to delay caused.
- Bankers confidence could be adversely affected.
- Loss of customer goodwill – could affect future business.
- Loss of business expansion possibilities through the above.

BENEFITS UNDER KEYMAN INSURANCE

For the Organisation

- It keeps the company position stable in the market.
 - The company may also be able to obtain working capital at better rates because of the value attached to the name of the keyman.
 - The company can use as a collateral security for raising loans from the banks.
 - The company may also be able to take a loan on the basis of a policy at nominal rate of interest.
 - It may be used as an instrument for tax planning as it gives substantial income tax saving for the company.
 - The premium paid under Keyman insurance is a deductible expenditure under section 37 (1) of the income tax act.
 - The company is able to

"Businesses aren't made of factories and machines, the soul of the business is human". Today, business is not dependant on machines or factories or offices. People make great companies – not vice versa Like Dhirubhai Ambani to Reliance, Narayana Murthy to Infosys, Azim Premji to Wipro. A Business Enterprise insures its factory building, machinery, warehouse, vehicles, stocks, office, computers, goods in transit for the simple reason that the loss / damage of such critical assets may cause loss of business / profits and may lead the business enterprise to bankruptcy.

ity has skills or intellectual capital that are not easily replaceable on demand.

partner or director.

- Cost of recruiting and training a replacement.



create an asset for itself in the form of premiums paid and added bonus.

- It is a concealed asset, which is free from the danger of loss.
 - A special way of telling your key person that he is valuable.
 - It can be used as a golden handshake for the key person when he retires or can be used as a perk.
- For the Keyman
- The company may decide to assign the policy in favour of the KeyMan.
 - On assignment, the surrender value of the KeyMan policy is taxed in the hands of the KeyMan. The surrender value may be lower than the actual premiums paid and may provide a tax advantage to the KeyMan.
 - On assignment, the KeyMan would get the maturity benefit or the death benefit, which would be tax-free in the hands of the KeyMan.

QUANTUM OF KEYMAN INSURANCE

The Keyman is generally identified by his qualifications, experience, responsibilities, remuneration and his contribution to the growth of the company. The following factors would generally be taken into account while deciding the quantum.

- 1) The qualification of the Keyman.
 - 2) Experience vis-à-vis exposure in different capacities
 - 3) His service in the company and the previous record.
 - 4) Whether he is the only Keyman in the particular area or otherwise.
- It is very difficult to find

out in exact terms, the primary contribution of the Keyman. Different underwriters have different methods for arriving at the sum assured. One of the models available in the market is as below:

- a) For a large quoted public limited company the maximum S.A. allowed will be lower of the following:
 - (i) Five times the average net profit (after making provisions for depreciation and income tax)
 - (ii) Two to three times the gross profit (net profit + depreciation + income tax)
 - (iii) 10 times the annual compensation.

An example for calculation of sum assured

ABC Company Ltd. is a profit making Public Limited Company. The company wishes to take Keyman Insurance in the name of Mr Ram who is the MD of the company. The annual compensation package of Mr Ram is Rs 6 lakhs. The company had the following

Year	PBT	PAT
1998-99	20	12.3
1999-00	25	15.4
2000-01	30	18.5
Average	25	15.4
Twice AVG PBT	50	
5 Times AVG PAT	76.9	

profit figures:

- So the three parameters are:
- 10 times the Annual Compensation i.e. 10 X 6 lakhs = 60 lakhs
 - Twice the AVG PBT for the last 3 Years i.e. 2 X 25 lakhs = 50 lakhs
 - Five times the AVG PAT

for the last 3 years i.e. 5 X 15.4 lakhs = 77 lakhs
Least of the three is 50 lakhs. Therefore Max Keyman Insurance is 50 lakhs.

b) Maximum Sum Assured for Private Limited Companies or closely held Public

No. of Shareholders or employees	Max S.A.
< 10 but > 5	Two times of average of three years net profit.
Other cases	Three years total net profit.

Limited Companies:

c) Recently established companies where audited profit and loss accounts for the last three years are

Number of years for which audited accounts available	Max. S.A.
Two years	Two times average net profit.
One year	Equal to net profit.
< One year	Nil.

not available:

Is it Keyman or Keymen?
Can there be more than one Keyman for a company? Yes. How does one handle such a situation?

Let us say the maximum Keyman Insurance is found

to be one crore. There are two Keymen. Keyman A is earning Rs 10 lakhs and Keyman B is earning Rs 30 lakhs p a. Then the sum assured on Keyman A will be found by the formula. Compensation package of A
Total Compensation of A+B
A : Max Keyman insurance possible.



A. Sisir Kumar
The author is the Member of the Institute. He can be reached at virasi@sancharnet.in

.. Keyman A gets 10/40 X 100 lakhs = 25 lakhs and Keyman B gets 30/40 X 100 lakhs = 75 lakhs cover.

RESTRICTIONS ON THE KEYMAN INSURANCE

As per the present market conditions some of the restrictions in the issuance of Keyman insurance are as below:

Keyman insurance is not issued where:

- Keyman has a share of more than 51 per cent capital in the firm.
- His family has a share of more than 70 per cent capital in the firm. (Family of a Keyman includes key person, spouse, and minor children).
- The company is incurring losses consistently.
- The Keyman is illiterate.
- Keyman insurance cannot be granted to a partner in a partnership firm. (Some underwriters or is-

suing Keyman insurance to a partnership firm under special conditions.

- No riders allowed.
- Nomination not allowed.
- No Assignment allowed except if Keyman leaves the company.

Taxation Issues

- Premium paid for Keyman policy is deductible as business expense U/S 37(1) [circular 762]
- The proceeds – Maturity as well as death from the Keyman policy are not tax free U/S 10-10D
- The death/Maturity proceeds will be treated as income U/S 28(i) for the company
- If the policy is assigned to the Keyman the surrender value of the policy will be treated as profits in lieu of salary U/S 17(3)
- Post-assignment premium paid by Keyman will be en-

titled for rebate U/S 80C.

- Post-assignment maturity proceeds should be tax free in the hands of the Keyman.
- The Keyman can also buy out the policy by paying the amount equal to the surrender value to the company. The company shows this consideration as income in its books of accounts.
- The Keyman can show this amount as single premium paid for insurance and get section 80C benefits.
- Transfer of policy from one employer to another.
- Transfer of policy from one Keyman to another.

Whether any particular policy is issued under Keyman

Strictly speaking there is no one particular identified policy to be issued as a Keyman insurance policy. Each underwriting company has chosen more than one policy to be offered under the Keyman Insurance. However, recently the following notification has been issued by the IRDA vide their notification no. IRDA/LIFE/006/2005-06 dated 27th April 2005. "This Authority is aware of some of the aberrations that have taken place in the month of March 2005 in the matter of sale of Keyman Insurance.

We shall conduct a detailed examination of the policies marketed in March 2005 and shall come out with detailed guidelines on the sale of Keyman Insurance at the appropriate time. In the meantime, it has been decided that only Term Insurance Policy will henceforth be issued as "Keyman Insurance Cover". □

Summary of Benefits and Taxes

Situation	Benefits	Tax
If Keyman lives	On maturity the money would be paid to the company	This money would be taxable in their hands
Die	Sum assured paid to the company	The SA is taxable in the hands of the company
Quit/retirement	1. The company has the option of surrendering the policy	Surrender value becomes taxable
	2. Assigning the policy to the Keyman against payment of surrender value by the Keyman	The company has to pay on cash surrender value received by it. The Keyman can avail of all the tax benefits there after from the policy
	3. Assigning the policy to the Keyman without payment (consideration) of surrender value by the Keyman.	The company has to pay tax on cash surrender value and the Keyman will also have to pay the tax on the surrender value. The Keyman can avail of all the tax benefits there after from the policy.