



# Key Person Coverage: A Simple Concept with Underwriting Challenges

The hardest part in working with business owners is getting them to set aside time to talk about their life insurance. However, once the business owner agrees to meet with the financial professional, the next most difficult challenge may be determining the face amount of coverage and then getting the insurance carrier to issue the amount applied for. This is often the case when applying for key person coverage as demonstrated by the following two cases.

## Situation #1

A financial professional submitted an application with another life insurance brokerage general agency for a face amount of \$1.5 million on a key employee/minority owner earning approximately \$70,000. The proposed insured did not have any other business insurance. The application listed the business as the policy owner and beneficiary and key person coverage as the purpose for the insurance.

**Problem:** The carrier only agreed to issue \$350,000 of coverage. The carrier's offer was based on the typical guideline for determining key person coverage of 5 to 10 times the key person's income. The producer believed the carrier should base the face amount on the loss of 4 months of revenue – the estimated down time to find a replacement.

**Solution:** The financial representative was directed to a DBS associate with extensive experience working with carriers on difficult financial underwriting cases. The DBS associate informed the financial representative that the carrier likely used the low end of the typical guideline because of the key employee's relatively modest income.

The DBS associate inquired into factors that might be used to help justify the total face amount. During the inquiry DBS discovered that the location of the business made it difficult to find a replacement and the key employee's experience and skills did not exist in other employees of the business. Finally, \$500,000 of the coverage was going to be structured to provide a death benefit to the key employee's family. Based on the additional information, the DBS associate sent a note to several carriers explaining the situation.

**Result:** A different carrier agreed to issue the full-face amount requested.

## Situation #2

Proposed insured is majority owner of newly established business that develops apps for smartphones and tablets. Proposed beneficiary is an "investor" in the business. Insured is not receiving compensation for his services.

**Problem:** Carrier will not issue the amount requested. Typically, carriers will not offer key person or buy-sell coverage on a business in the first few years of operations because a majority of new business start-ups do not survive. Furthermore, carriers will not issue coverage to insure risk of investment loss.

**Solution:** The DBS advanced marketing resource reached out to the financial representative and made him aware of the difficulty in getting business cases approved where they involve a newly established business. Specifically, the DBS resource indicated that such cases usually require a detailed cover letter where you must "sell" the underwriter on the viability of the business. The content of the cover letter often needs to include a bio of the insured and business as well as the business marketing plans. In other words, the kind of financial information needed by a carrier underwriter to underwrite a new business life insurance case is often similar to the information required to get a business loan from a bank.

Gathering sufficient data to financially justify a new business start-up case is difficult, and in this case likely impossible. The DBS resource suggested an alternative solution. Specifically, she suggested that a carrier often finds it easier to approve personal insurance coverage for the family's benefit with an assignment to the investor.

**Result:** Client agreed to proceed using the personal insurance approach . . . the carrier approved the coverage.

Business life insurance cases tend to require more documentation than a typical life insurance case. Your dedicated DBS Case Design Associate can help you determine the type of documentation a carrier will likely request.

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