Relevant life policies versus Keyman insurance – explained

Contractors seeking to protect their business and family should understand that a Relevant Life Policy (RLP) and Keyman Insurance are not the same thing.

According to Contractor Financial's life and income protection insurance expert Mark McBurney, each protection insurance brings a range of different benefits, so contractors need to choose the right product for their needs.

"Both Relevant Life Policies and Keyman insurance are life insurance policies, but RLP's benefit the contractor's family whereas Keyman insurance benefits the contractor's business," explains McBurney.

McBurney also warns contractors who have existing Keyman policies that they may have been mis-sold the product: "Unless a contractor has an ambitious growth plan for their contracting business and has fellow directors or employs senior staff, a Keyman policy is not generally the right protection product for a single person contractor limited company."

What is Keyman insurance?

Men have a one in seven chance of dying during their working life, and for women it is a one in eleven chance. And senior employees who suffer serious illness such as a heart attack or stroke may not return for many months or years, if at all. Illness or untimely death of a business principal can place a huge financial burden on a small business.

"If a key individual within a business were to suddenly fall ill or suffer an untimely death, then Keyman insurance is there for the company to protect itself against the loss of that key employee," continues McBurney.

In McBurney's experience, what typically happens in small businesses is that if a director or partner falls ill, they still expect to draw an income from the business that their co-directors or partners are continuing to run.

At the same time, the business will most likely need to hire someone to replace the director, meaning it has to pay out two salaries. The business may also have other outgoings, such as loan repayments.

"The Keyman insurance would make a contribution to the cost of the director/partner's replacement until they are well enough to return to work. Some companies choose both Keyman insurance and critical illness for the individual too ill to work to help spread the costs."

How does Keyman insurance work?

A Keyman policy is designed to mitigate the financial impact on the business resulting from the loss of a key business principal or employee. As a result, any payouts are directly from the insurer to the business, and not the contractor or their family.

McBurney explains: "The insurance is not designed to replace the sales and profits that might be generated by the missing individual but it could contribute towards the training and salary of a replacement for a defined period of time. It could also cover other outgoings, such as loan interest, if the director were to pass away."

As with all protection insurance, a contractor would discuss their needs and risks with a financial adviser to identify what outgoings require protection. The policy and premiums would then be tailored accordingly, and as a legitimate business expense the premiums would benefit from corporation tax relief.

How a Relevant Life Policy is different from Keyman insurance

"In contrast, a Relevant Life Policy (RLP) is designed to benefit a contractor's family and ideally a contractor planning to grow their business would have an RLP and Keyman insurance working together," notes McBurney.

In the event of the contractor's death, the proceeds of the RLP will go to the estate of the person insured, or as McBurney would recommend, would be set up in trust and go to the contractor's beneficiaries tax efficiently.

"RLPs are set up and paid for by a contractor's limited company and are usually eligible for corporation tax relief. We would also recommend a critical illness policy, as RLPs only pay out when the insured person dies, not if they are too ill to work," adds McBurney.

Keyman insurance is not suitable for most contracting businesses

"A lot of people have the impression that Keyman insurance is some form of life insurance but in reality it is not. Keyman insurance is there to mitigate losses for the business, not to pay a lump sum to the contractor’s family.

“In the traditional contractor limited company set up, if something happens to the contractor then there is no business, so there would be no Keyman insurance pay out. Despite this, some brokers and insurers will still happily take a contractor’s premiums.


Mark McBurney

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Mark McBurney is an experienced financial adviser, with ten years' history in the mortgage market, now specialising in protection for contractors.

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“That’s why it is so important for contractors to review their cover annually. A review by a financial adviser would flag this instance of incorrect cover. The contractor wouldn’t be able to get their premiums back but they could ensure they have the right cover in place going forward should the worst happen.”

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