



BUSINESS SOLUTIONS

Protecting Your Business

An Owner's Guide to Key Person and Buy Sell Insurance

How to protect your company if you or a partner can no longer contribute, and how buy-sell agreements are commonly funded.



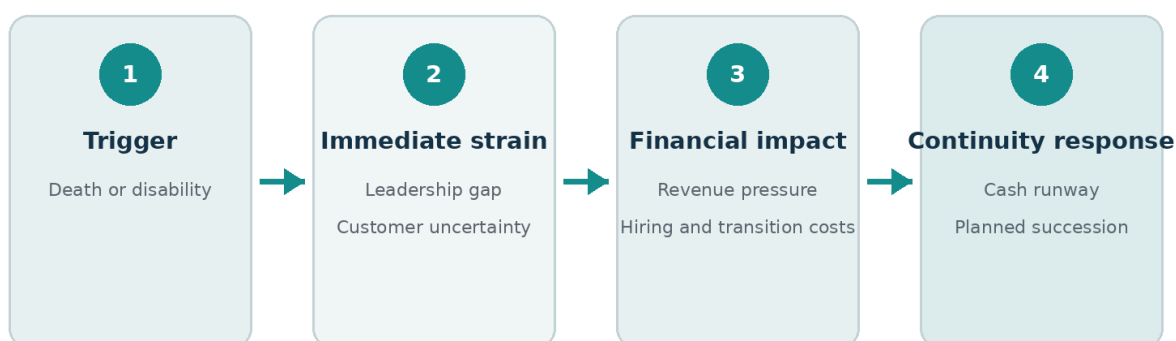
A practical planning guide for closely held businesses

The continuity problem to solve

A business can be profitable and still be vulnerable if too much value depends on one owner, rainmaker, technical expert, or relationship manager. Insurance can supply cash after a covered event, but it works best as one part of a written continuity and ownership-transfer plan.

The core idea. Key person coverage protects the company's economics. Buy sell coverage helps finance an ownership transfer required by a buy sell agreement. One policy may not appropriately serve both purposes because the owner, beneficiary, amount, and intended use can differ.

How a key person loss can reach the whole business



Insurance provides liquidity. The continuity plan determines how that liquidity is used.

Start with three questions

Question	What it reveals
Who creates concentrated value?	The people whose absence could materially affect revenue, operations, credit, relationships, or confidence.
What cash would be needed?	The liquidity required for transition, replacement, debt support, customer retention, or an ownership purchase.
Who should receive and control the money?	Whether proceeds belong with the business, the remaining owners, a trust, or another party under the agreement.

Key person insurance

Key person insurance is coverage a business owns on an individual whose death would create a measurable financial loss. The business generally pays the premiums and receives the death benefit. The purpose is to provide liquidity while the company stabilizes, replaces capabilities, and protects enterprise value.

What the proceeds may support

- Recruiting, signing incentives, compensation, and onboarding for a replacement.
- Temporary operating losses, customer retention efforts, and additional leadership capacity.
- Debt service, lender confidence, or obligations tied to the insured person.
- A measured wind-down if continuing the business is not economically practical.

A practical coverage sizing model

There is no universal multiple. Build the amount from the losses and costs the business could reasonably face, then test the result against affordability and underwriting.

Component	Planning prompt
Transition period	How many months of reduced revenue or margin should the business be able to absorb?
Replacement cost	What will recruiting, compensation, training, and overlap cost?
Obligations	Which loans, guarantees, leases, or commitments become harder to carry?
Relationship value	What could customer or supplier attrition cost during the transition?
Existing resources	What cash reserves, credit, insurance, and transferable team capacity already exist?

Illustrative approach. Coverage need can be framed as transition losses plus replacement and stabilization costs plus obligations, less reliable liquid resources. Treat the result as a planning estimate, not a valuation.

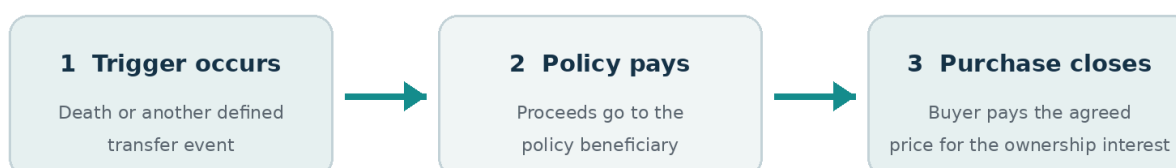
Policy design choices

Term insurance can provide lower-cost coverage for a defined period. Permanent policies may provide longer-duration coverage and potential cash value, but require careful review of guarantees, assumptions, charges, and long-term funding. Match the product to the expected duration and purpose rather than selecting on premium alone.

Buy sell agreements and insurance funding

A buy sell agreement is a contract that defines what happens to an owner's interest after specified events. Common triggers can include death, long-term disability, retirement, termination of employment, divorce, bankruptcy, or a voluntary offer to sell. The agreement creates the rights and obligations; insurance is one possible source of cash to perform them.

Typical buy sell funding flow



Agreement

Defines the trigger, buyer, valuation method, payment terms, and closing process.

Insurance

Supplies cash if the insured event occurs while coverage is in force. It does not create the obligation to buy.

Alignment matters: owner, insured, beneficiary, agreement terms, and policy amounts should tell the same story

Terms the agreement should coordinate

Provision	Why it matters
Trigger and timing	Defines when a purchase is required or permitted and when the closing must occur.
Buyer and seller	Identifies whether the business, the remaining owners, or another party must buy.
Valuation method	Determines price through a current fixed value, formula, appraisal process, or combination.
Payment terms	States how insurance proceeds, cash, notes, installments, and security are used.
Governance during transition	Addresses voting, management authority, information rights, and interim decisions.
Policy administration	Assigns responsibility for ownership, premiums, beneficiary designations, and periodic review.

Common funding structures

The best structure depends on entity type, number of owners, tax objectives, creditor concerns, administrative capacity, and the intended buyer. The following comparison is a starting point for discussion with counsel, a tax adviser, and an insurance professional.

Structure	Typical policy ownership	Typical purchase	Advantages	Watch points
Entity purchase	Business owns policies on owners	Business redeems the departing owner's interest	Fewer policies; centralized administration	Entity-level tax and basis effects; creditor exposure; corporate-law limits
Cross purchase	Each owner owns policies on the other owners	Remaining owners purchase the interest	Purchase basis may increase for buyers; proceeds go directly to buyers	Policy count grows quickly; unequal ages and premiums; administration
Trust or special-purpose arrangement	Trust or designated vehicle owns policies	Structure directs funds and purchase duties	May simplify administration for several owners	Additional legal complexity, trustee duties, and tax review
Wait and see	Ownership path is determined at the trigger	Entity and or owners buy under a stated sequence	Preserves flexibility	Must be drafted precisely; policy ownership and access to cash need alignment

How many policies can be required

In a simple entity-purchase arrangement, the business may own one policy on each insured owner. In a traditional cross-purchase arrangement, each owner may own a policy on every other owner. With three owners, that can mean six policies; with four owners, twelve. Administrative alternatives can reduce policy count, but they should be designed by qualified advisers.

Funding methods beyond life insurance

Method	Best fit	Main limitation
Cash reserves	Predictable transfers with ample liquidity	Cash may be unavailable when needed and has an opportunity cost.
Installment note or borrowing	Business can support payments over time or qualify for credit	Seller or estate bears collection risk; financing may be costly or unavailable after disruption.
Insurance	Death or long-term disability liquidity while coverage is in force	Underwriting, premiums, definitions, exclusions, benefit caps, and policy performance must be managed.

Disability and the owner who cannot work

Death is clear; disability is not. A partner may be unable to perform key duties yet remain an owner with voting, distribution, and information rights. A strong plan separates four questions: who runs the business, how income continues, when an ownership purchase is triggered, and how the purchase is funded.

Coordinate four layers

Layer	Purpose	Key alignment point
Operating plan	Transfers authority and critical responsibilities	Who can sign, approve spending, access systems, and communicate with customers?
Disability income coverage	Replaces some personal earned income	Benefit definition and waiting period should fit the owner's personal plan.
Business overhead expense coverage	Helps pay eligible operating expenses	Confirm covered expenses, benefit period, and who is insured.
Disability buyout coverage	Helps fund purchase of the disabled owner's interest	Agreement trigger, policy definition, elimination period, and valuation must match.

Draft the trigger before choosing the funding

- Define disability objectively, including whether the test is based on the owner's own occupation, any occupation, or specified material duties.
- State the waiting period and whether intermittent periods can be combined.
- Clarify who determines disability and what medical information may be required.
- Specify whether the purchase is mandatory, optional, or staged, and what happens if insurance pays less than the purchase price.
- Address recovery before and after closing, including any repurchase rights or ongoing employment status.

Practical caution. Do not assume a life-insurance-funded agreement also solves disability. Death benefits and disability buyout benefits respond to different events and are underwritten differently.

Implementation roadmap

Treat the agreement, valuation, and insurance as one coordinated project. The following sequence reduces the risk of buying coverage that does not match the legal obligation.

Step	Owner action	Deliverable
1	Map key people, critical duties, relationships, and financial dependencies.	Key person risk inventory
2	Choose transfer triggers, intended buyers, governance rules, and payment approach.	Agreement design brief
3	Establish a defensible valuation method and update process.	Current valuation or signed value certificate
4	Model liquidity needs under death and disability scenarios.	Funding gap analysis
5	Compare entity purchase, cross purchase, trust, and hybrid structures.	Ownership and beneficiary map
6	Obtain underwriting indications and policy illustrations before finalizing amounts.	Coverage and premium proposal
7	Execute the agreement, policies, consents, and administrative records in the correct order.	Coordinated closing file
8	Review annually and after major business or ownership changes.	Documented review record

Annual review checklist

- Confirm owners, insureds, policy owners, beneficiaries, premium payers, and contact details.
- Compare policy death benefits and projected performance with the current purchase obligation.
- Update the business valuation and any signed value certificate required by the agreement.
- Test disability definitions, waiting periods, and purchase timing across the agreement and policies.
- Review loans, collateral assignments, beneficiary changes, conversions, and policy replacements.
- Confirm notices, consents, tax reporting, corporate approvals, and record retention with advisers.
- Revisit the plan after a new owner, acquisition, major debt, rapid growth, divorce, retirement plan, or health change.

Questions to bring to your advisory team

Ask	Decision it supports
What exact financial loss are we insuring?	Separates business continuity needs from ownership-purchase needs.
Who is obligated to buy, and who should receive proceeds?	Aligns the contract with policy ownership and beneficiary designations.
How is the purchase price determined at the trigger date?	Reduces disputes and reveals the funding gap.
What happens if proceeds are more or less than the price?	Clarifies surplus, shortfall, installment, and security provisions.
How do entity type and state law affect the structure?	Surfaces tax, corporate-law, creditor, and basis considerations.
Which policy values and premiums are guaranteed?	Distinguishes contractual guarantees from illustrated assumptions.
What records and annual filings are required?	Supports notice, consent, reporting, and policy administration.

Important federal compliance point

Employer-owned life insurance can be subject to Internal Revenue Code section 101(j) and reporting under Form 8925. The IRS instructions describe written notice and consent requirements that generally must be completed before policy issuance, along with annual reporting for covered contracts. Have tax and legal advisers confirm whether the rules apply and ensure the sequence and records are correct before coverage is issued.

Selected resources

- **IRS Form 8925 and instructions for employer-owned life insurance:** https://www.irs.gov/pub/irs-access/f8925_accessible.pdf
- **IRS Notice 2009-48 on section 101(j) questions and answers:** <https://www.irs.gov/pub/irs-drop/n-09-48.pdf>
- **NAIC Life Insurance Buyer's Guide:** <https://content.naic.org/sites/default/files/publication-lig-lp-consumer-life.pdf>

Scope of this guide

This guide is general educational information, not legal, tax, accounting, investment, or insurance advice. Policy terms, underwriting, tax results, and governing law vary. Work with qualified advisers who can review your entity, ownership agreement, valuation, finances, state law, and proposed policies before you act.

Next step. Schedule a working session with the owners and advisers. Bring the current ownership documents, cap table, valuation, debt agreements, existing policies, and a list of duties and relationships that depend on each key person.



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