Advanced Planning

Compare Buy-Sell v. Key Person Life Insurance

FORTRESS BROKERAGE

It is common to begin a conversation with a client that asks about key man insurance only to identify after having the discussion that the case is actually for the Buy-Sell concept. Let's break down the difference between the two types of sales.

What is a Buy-Sell Insurance Case?

The buy/sell life insurance concept involves business owners using life insurance policies to address financial issues that could arise if one of the owners were to pass away (or become disabled). Here's how it works:

1. Ownership Agreement: Business owners craft a formal agreement called a Buy/sell agreement,which outlines what happens to the business if one of them dies or becomes incapacitated. The agreement provides instruction for what will occur with the owner's share of the business, at death.
   Example: The buy/sell agreement is a contract that would establish that at the death of Owner A, Owner B will be obligated to purchase Owner A's shares of the inheritor (usually their spouse or children). This ensures that the business can continue to operate and run smoothly.
2. Life Insurance Policies: Business owners will purchase life insurance policies on one another (or in an entity buy-sell, the business will purchase life insurance policies on each owner) so that in the event a death does occur, the tax-free death benefit is available to buy out the decedent's share of the company.

What is a Key Man Insurance Case?

Key Man life insurance is a type of insurance policy that a business purchases on the life of a key employee or employees whose skills, knowledge, or leadership are essential to the company's success and profitability. Here's how it works:

1. Identifying Key Individuals: The business identifies employees who play a crucial role in the company's operations, revenue generation, or strategic direction. These individuals could be executives, top salespeople, technical experts, or anyone whose absence would significantly impact the company.
2. Ownership: The business purchases a life insurance policy on the key employee's life, with the company being the policy owner, premium payer, and beneficiary. This means that if the key employee were to pass away, the company would receive the insurance payout.
3. Purpose of the Policy: The primary purpose of key person life insurance is to provide financial protection to the company in the event of the key employee's death. The insurance payout can help the company cover expenses such as recruiting and training a replacement, compensating for lost revenue or profits during the transition period, or paying off debts or loans that the key employee was involved with.
4. Policy Terms and Coverage: The coverage amount and policy terms are typically determined based on the key employee's importance to the company, their expected contributions to future profits, and the potential financial impact of their loss.