USING PERMANENT INSURANCE TO COVER BUY-SELL TRIGGERS

Buy-Sell Agreements - Are Your Clients Truly Covered?

It's common to see term insurance used to fund buy-sell agreements. Term insurance can provide benefits in the event of an unexpected death of a business owner or key employee, for a relatively low cost. What about the other events that can trigger a buy-sell event? What happens if your client becomes disabled, chronically ill, or retires? Does term insurance provide solutions or help your client financially prepare for the other buy-sell triggers?

You have already uncovered that your client needs insurance. Use a cash accumulation policy to provide for, cover, or help mitigate some of the expenses of other buy-sell triggering events.

Common Buy-Sell Triggers and Potential Insurance Solutions

Buy-Sell Triggers	Term Insurance	Permanent Insurance
Death	Death Benefit (DB)	Death Benefit
Disability	No	Cash Value (CV)
Chronic illness/LTC rider	Accelerate DB	Accelerate DB or CV
Retirement	No	Cash Value
Divorce	No	Cash Value
Transfer of business interest	No	Cash Value
Bankruptcy	No	Cash Value
Criminal conviction	No	Cash Value
Loss of professional license	No	Cash Value
Early resignation	No	Cash Value

As shown above, term insurance only covers the business owner in the event of unexpected death. A cash accumulation life insurance policy can help cover or mitigate some of the other buy-sell triggers.

Now let's take a look at how your clients can financially prepare for the exit of the business when their business partners retire.

Exiting the Business - Providing Methods for Buy-Sell

Client information: Male; Age 45; Preferred Non-Smoker; 39.6% Tax Bracket; $1,000,000 business interest:

Method	Total Cost	Cost Per Dollar	At Death	Buy-Out at Retirement
Cash method	$1,000,000	$1.00	$1,000,000	$1,000,000
Sale to outside owner	$0	$0	$0	$0
Installment method ($100,000 for 10 years at 5% interest	$1,275,000	$1.28	Payment(s) remaining	Payment(s) remaining
Loan method (10 year loan at 8%)	$1,490,295	$1.49	Loan balance	Loan balance
Sinking fund ($36,051 annually at 5%, 3.02% after tax)	$720,020	$0.72	Fund balance	$1,000,000
Term insurance	$23,580	N/A	$1,000,000	$0
Insured method, IUL 5% return, increasing DB $35,000 annual premuim 20 years	$700,000	$0.70	Death Benefit	$2,258,638 (Death Benefit is $534,189 after distribution)

Different Methods for Funding Buy-Sell

- **Cash method:** The client will need to come up with $1,000,000 of cash out of personal savings to buy out the retiring owner. The cost per dollar is $1.
- **Sale to an outside owner:** The client will need to go out and find a new business partner to purchase the business, if one is available and has the funds to make the purchase. Will the new business owner have the same values and visions for the company as the current owner(s)?
- **Installment method:** The client will provide an income stream of $100,000 a year plus interest, to the departing owner in order to purchase the business interest. This cost is $1.28 on the dollar.
- **Loan method:** The client will need to go out and apply for a business loan in order to buy the business partner's share of the business. Assuming a 10-year loan at 8% loan interest rate, the cost is $1.49 on the dollar.
- **Sinking fund:** The client will need to put away $36,051 annually into an investment that earns a minimum of 5% interest each year. If the business owner is in the highest tax bracket of 39.6%, the after tax rate of return on the investment is 3.02%. The cost per dollar is $.72. The amount available at death is the fund balance. Will it be enough?
- **Term insurance:** This is the most inexpensive option to cover the business owner in the event of death. The business owner will have spent $24,480 in 20 years for death benefit protection.
- **Insured method:** This method starts with a $1,000,000 cash accumulation index universal life policy, then maximum funding for 20 years with increasing death benefit in order to achieve $1,000,000 of cash value at the retiring owner's age of 65. The cost per dollar is $.70 — that is a 30% discount on the purchase price of the business owner's price.

What Else Can a Cash Accumulation Insurance Policy Do?

1. ***Transfer the policy to the exiting business owner.*** The business owner can supplement retirement income potentially tax-free by taking withdraws to basis and loans thereafter.

2. ***Get cost recovery.*** If the client cannot afford to max fund the policy, the cash accumulation policy can be used for cost recovery of the premiums. If you cannot tax deduct the premiums, the next best thing is cost recovery.

3. ***Accumulate cash values (tax-deferred) in a permanent life insurance policy.*** The policy cash values can be used as collateral for loans or a source for emergency funds.

4. ***Negotiate a better underwriting offer.*** It may be possible to negotiate a better underwriting offer on a permanent policy than a term sale.

5. ***Get a Long Term Care or Chronic illness rider.*** Most permanent insurance policies offer an LTC or Chronic Illness rider. In the event the exiting business owner becomes chronically ill or is in need of LTC, the owner of the policy can accelerate the death benefit to buy out the business interest.

6. ***Get creditor protection.*** Some state statutes protect cash values from the claims of creditors. A sinking fund does not have any creditor protection.

7. ***Take advantage of a term conversion.*** If you already have a term buy-sell on your clients, perhaps it is time for a term conversion. A term conversion will allow you to convert your policy to a permanent plan of insurance without medical underwriting.

Is It Time to Review Your Clients' Buy-Sell Needs?

Many business owners use their cash to grow their business and may not have the cash on hand for permanent insurance. An inexpensive term policy can help protect their business in the event of an unexpected death. If the business does have cash on hand, it may be best to purchase a cash accumulating life insurance policy to protect it from other buy-sell triggers. If the business can afford to purchase a permanent life insurance policy, the cash value in the policy and added riders may mitigate the effects of the other buy-sell triggers.

For more information on buy-sell triggers, please contact your Tellus Advanced Sales Director or your Tellus Account Manager.

[1]Policy riders are available at an additional cost and may not be available for all products. Terms and conditions may apply.