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Did YOU know?

Buy/Sell Agreements – It takes a TEAM and a PLAN!

Written by Paul J. Phelan, CFP

Every few weeks I am asked to review an existing Buy/Sell agreement and the partners want to know if they have enough life insurance. My response is usually something like, "Probably, but are you protected if something other than death happens to you or your partners?" For reasons unknown to me over the course of my career in insurance and specifically in Executive Benefits, Buy/Sell conversations always revolve around life insurance. That has always struck me as strange because odds are their Buy/Sell agreement will be invoked *due to a disability, not death.*

The following example characterizes what I run into all too frequently. A firm with three owners has a Buy/Sell agreement. It is well-funded with life insurance, which the partners dutifully review and update every five years. One of the owners suffers a severe heart attack. Fortunately, it does not kill him, but he is left incapacitated and unable work in the business. He truly believes (and his doctor confirmed) there is 50% chance that with the right rehab he'll be back to work in a year. The two other owners are unconvinced and are faced with the following three questions:

1. When do they make the call that their fellow partner can't come back to work, despite his good intentions?
2. How do they pay him for his share of the business out of current cash flow or credit?
3. Will this obligation debilitate the business?

When they started the Buy/Sell process they asked the wrong questions. Approaching the process from a risk management perspective could have led to different results.

In order to effectively assess and address the financial risks associated with a Buy/Sell Agreement, I suggest embracing an approach similar to the following plan.

1. First hold a meeting with the business owners and their advisors, including their CPA, lawyer and financial/insurance professional. The purpose of this meeting is for owners to state/ discuss their intentions, review business valuations and financials, and create a set of next steps that lead to their lawyer drafting a buy/sell agreement.
2. The attorney will consult with all of the parties to be assured each person fully understands the impact of the dissolution language chosen.
3. The financial/insurance professional will present options for managing the risk of dissolution through:
    - A. Risk transfer – Insurance, both life and disability.
    - B. Risk retention – Assist the CPA in developing a plan to pay out an owner in the event of dissolution occurring.
    - C. Risk avoidance – An example is establishing a wellness program for the company which will reduce the risk factors of death or disabling conditions of not only the owners but employees.

Buy/Sell planning is a bigger discussion than, "Do I have enough life insurance?"

It should involve a team and a plan.

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