

# Insurance Agency Perpetuation Planning

## ***Defining Perpetuation and Business Succession - Best Practices for Insurance Agencies***

STOP, just for a moment, and answer a serious question: ***If you had been hit by a bus last night, what would have happened to the business of your insurance agency?***

- If you aren't sure, you need to do some **Perpetuation Planning**
- If you imagined uncertainty, even chaos, for your family and your employees, you need to do some **Business Succession Planning**.
- If you realized that there would be an immediate and possibly substantial loss in the **insurance agency's value**, you need to do some planning.
- If you have planned for such a contingency (or you just don't care) you need to read no further.

## ***Insurance Agency Perpetuation Plans***

Advisors, consultants and your peers call your response to this question “**Perpetuation Planning**.” In its simplicity, this is misleading. What you need to plan is how and for whom to **preserve your insurance agency's value** when a “triggering event” happens. And one *will happen to you*.

Think about it. We sell insurance every day “*in case*” things happen to our clients and friends. But one, and possibly more than one, “triggering event” – disability, death, retirement, WILL HAPPEN TO YOU. Why not take a few moments and begin to think about the effect on your insurance agency and those that depend on its survival.

## ***Getting Started on Perpetuation and Business Succession Planning –***

Getting started on a realistic plan for your insurance agency succession and perpetuation is so easy that you can begin planning while drinking your morning coffee.

Had you and that bus collided last evening, what do you really want to have happen to the value represented by your insurance agency? What is important for your family to be able to carry on the family business? What would happen if you had to put your insurance agency up for sale? Take a single sheet of paper and answer the following questions, briefly, explicitly and, most importantly, “selfishly.”

- In the event of my death, it is important that ----
- In the event I became disabled, it is important that ----
- When I retire, in \_\_\_\_ years, it is important that ----

Obviously, your answers will change over time as the agency grows and prospers, as your family situation changes and as you age. However, these progressions only mandate that your “perpetuation plan” cannot be cast in stone and must be reviewed and updated at frequent intervals over time.

So, tomorrow morning over coffee, start writing down your personal “Wish List” for the future of your insurance agency. Only when you understand what you *really* want regarding your agency and the value it represents can you begin to develop an appropriate perpetuation plan. And if your plan is to be successful, then you must be “hard nosed” and “selfish,” (OK, self interested) about what you want for your insurance business should death, disability and retirement happen.

### ***Key Issues for the Perpetuation and Succession Planning Process:***

Now that you have your plan objectives, it might be useful to know a couple of basic principles about “perpetuation and succession” planning that I have learned over the years. I have numbered them all “1” because they are of equal importance in the planning process.

- 1) **“Terms” are more important than “Price” or your Insurance Agency’s “Valuation.”** The most accurate, fair and agreed upon valuation/price will fail if the terms of your “plan” or transaction are not reasonable and comprehensive.
  - **Reasonable** - in terms of payment amounts and payment period for if you ask for too much, too soon you are assuring default.
  - **Comprehensive** - in terms of the controls, limitations and obligations that are imposed on the transferees. These people are not stepping into your shoes; they are becoming debtors.
  
- 1) **Family Business Succession Planning:** “Internal” transactions almost always result in the lowest values. Transferring the insurance agency ownership or control to family members and / or employees are the more difficult to negotiate if one is seeking optimum values. Both family members or employees expect to be treated “better than others” and employees will always suggest that their contribution has been important to the agency’s success and thus should be taken into consideration (even though, it is hoped, that they have been fairly paid for their efforts)
  
- 1) **Good Perpetuation Planning Incorporates a Succession Plan:** Your Perpetuation Plan is the equivalent of an “all-events” Succession Plan. Your perpetuation plan must, at all times, be consistent with other agreements and documents, such as your Will and Estate Plan. Otherwise your perpetuation plan will cause confusion rather than be of value to yourself, your heirs and employees and possibly others.

### ***Perpetuating Factors and Best Practices***

To successfully implement your plan you are going to have to deal with several important issues. Among the more important are the following.

#### **Valuation of Your Insurance Agency**

Quality insurance agency valuations are expensive. Furthermore, a full-blown valuation at this stage in your planning process, while it may have its uses, is likely an unnecessary expenditure. For most agency owners at the beginning of the process there are two options:

- First, simply be practical - estimate your value. Keep in mind that 99% of all agencies are worth more than one times “commissions” and less than two times “commissions” – which should not suggest to you that the average agency is worth one-and-a-half times “anything.” “Good” agencies are worth more. “Poor” agencies less.
- Second, see if someone *with valuation experience* will give you a good estimate based on thorough analysis but without doing a full written report. Avoiding a full blown written report should substantially reduce the cost.

Regardless of the option you choose having a *reasonably accurate* valuation is a necessary starting point. Without one it is difficult to plan your funding requirements or anticipate discussions with possible transferees.

### **Transfer Business Ownership of the Insurance Agency**

Perpetuation / Succession planning will almost certainly involve the transfer of ownership of your insurance agency. In this regard there are three primary options: i) Family members; ii) Employees; or, iii) Other agencies. Each has its advantages and drawbacks thus a few brief comments may be useful.

### **Perpetuating the Family Business:**

While it might be great to have the third generation own and run the insurance agency, if your son or daughter aren't already in the agency, enjoying it and want insurance as a career, planning a transfer to them in the event of death or disability is unreasonable at best and absurd at worst. Situations where the family member simply doesn't want to be in the business or is incapable of running it will only disappoint everyone. Owners who endeavor to force their fantasies on a family member are only looking for disappointment. Still worse, such fantasies result in sharply diminished employee morale and increased turnover among the better members of the staff.

### **Business Succession to Employees:**

Occasionally, only very occasionally in my experience, is this choice realistic. Sure, you have one or more deserving, respected employees. However, if your effective Office Manager can't produce new business then the agency will likely falter. If your best producer can't manage the office staff you've created a weakness. If you are thinking of going this route, caution is recommended.

### **Making Plans to Sell your Insurance Agency Externally**

Given the size and location of your insurance agency, it may be prudent to explore “partnering” a mutual perpetuation solution. While the planned transfer of ownership

and control to another insurance agency may not be appealing initially, it can have several advantages. First, it is the likely result if you haven't done any planning so far better to plan this result "on your own terms."

### **Funding for a Pre-Planned, Third Party Perpetuation Transaction:**

The choice of funding vehicle and sources will be dictated by many things. Obviously, if the results of your run-in with that bus last evening were death or disability, then clearly the existence of adequate life or disability insurance would have been a perfect choice. Purchased by the corporation on a key man basis they could be structured to gain tax advantages while providing the agency with funds to contribute toward the objectives of your plan. On the subject of insurance, Business Overhead Expense insurance is often worth the expense as a part of your planning.

Over the years I have been successful in getting occasional direct help from an agency's leading markets – especially where the insurance company's book of business is large and historically profitable. More often, companies have been willing to provide third party guarantees, either directly or through a bond, to banks that would assume the burden of collection – particularly in the event of delinquency. In these instances a quality valuation is imperative as is something more than a Compiled financial statement from your accountant. Your lawyer should be able to help you convince either the insurance company and / or the lender that they will have additional security by perfecting a security interest on the agency's expirations.

Over the years, many agents have found that structuring a transaction, conditioned on a triggering event" with another insurance agency makes sense. Whether it is a "two-way" agreement between agencies of similar characteristics in the same market or a one-way agreement with a larger agency a pre-planned, third party transaction will often ease the transition and result in the [best business valuation](#).

### ***Professional Advisors and Consulates for Perpetuation Planning***

Unless you are an insurance agency that is large enough to be staffed with experienced, credentialed professionals you will require professional valuation advice along the line. But, the first step is to build YOUR simple perpetuation and business succession "wish list."

Understand, however, even a "simple" plan is likely to involve a number of complex issues and agreements. Thus, business "Perpetuation and Succession" planning will involve dealing with one or more of your accountants, lawyers and even "experts." When the time comes to retain someone, take the time to get the right person. Don't simply turn to someone with whom you have been working over the years or who says "I can do that."

A couple of suggestions for selecting and using advisors for your perpetuation planning.

- Don't select "expertise" based primarily on his/her hourly rate. Very often, the right advisor understands the problem and its solution based on experience and his "hours"

will be few. Less experienced counsel must often spend time “researching” thorny issues, not always to arrive at the correct answer, thus his hours will add up.

- Once you are ready to retain professional help, you may find it practical and often time and money saving, to sit down with all of your advisors at the same time. In this way, the details for implementing your plan can be worked out so that all agree, not only what is to be done but who will do it. This will minimize, if not eliminate, overlapping efforts and expense.
- Don't ignore the involvement of your lead markets. Many companies offer expertise in these areas. Even if their assistance is not available, their awareness of your plan may enhance your relationship and in the case of those looking for an external solution they may well be of considerable help.

### ***Plan for Your Business Continuity***

If you don't have the time or the inclination to develop even a simple plan for the perpetuation of your business and its successful succession, then understand this. A plan of some sort for the end of your insurance business already exists. You may not like it, or how it deals with you, your family or your preferred employees, but it will do so. And, in the absence of your wishes the results can devastate your insurance agency and its value. So, get started in the morning over your coffee – it is that easy.

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