Helping health insurance brokers **Protect, Grow** & **Sell** their commissions

COMMISSION CHRONICLES

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Advanced Planning

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Using Financials is an Area of Opportunity to *Sell, Buy or Grow*

Financial Liquidity, Organic Growth, and Rule of 20

A working knowledge of financials is helpful when seeking to Sell or Buy commissions and also to Grow your book. As mentioned, EBITDA is a common method to measure a company's overall financial performance and used as an alternative to net income. For health insurance commissions, EBITDA may have less importance on profitability and when placing a value on the agency or business. Since EBITDA is so common having an understanding is necessary.

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As mentioned, EBITDA is a common method to measure a company's overall financial performance and used as an alternative to net income. For health insurance commissions, EBITDA may have less importance on profitability and when placing a value on the agency or business. Since EBITDA is so common having an understanding is necessary. Based on research the average EBITDA for agencies under $1.25M in annual revenue is 27%. EBITDA is Earnings Before Taxes, Interest, Depreciation, and Amortization and is expressed by taking these expenses from earnings or gross revenue and calculating the percent gross revenue.

Large Agency Buyers hunt for well-run agencies as they see upside potential centered on lead systems, retention programs and technology that can be transferred. Smaller agencies also look at more than commission income and often want to acquire business that mirrors their current book of business. All Buyers want to retain key employees and look for documented success in the performance between revenue performance numbers and employees.

Organic growth is a key measure that captures new "year-over-year" revenue generated from new business. Buyers look for agencies with systems in place that have consistently generated leads and referrals. To proactively identify organic growth use the process below. Organic growth offers an excellent way to evaluate the effectiveness of growth in an agency's revenue which is why Buyers look at this as a key measurement.

To calculate organic growth, use the annual gross revenue from the previous year and divide by new revenue achieved at the end of the year. For example, Agency ABC has $500,000 in annual revenue for the most recent year. ABC adds $50,000 in new revenue the next year. ABC's one-year organic growth total is 10%.

Further, if we assume ABC agency has an EBITDA of 24% we know the agency is performing well. To evaluate ABC's growth even deeper we can use the Rule of 20. Rule of 20 scoring reduces EBITDA in half (12% in our example) and adds the percent for organic growth (10% in our example) to arrive at a Rule of 20 Score. In our example we arrive at a score of 22% (12% + 10%) which compares favorably to agency standards of like sized agencies. A score of 22% is above the industry average mark of 18% for agencies with $1.25MM in annual revenue or less.

Any Rule of 20 score above the average shows the return on investment is higher than average and signals to a Buyer that additional funds invested should provide a profitable return. The Rule of 20 score for Agency ABC at 22% shows the owner's decisions on marketing, employees, and other expenses have provided a healthy profit. An educated Buyer will understand that an agency with these above standard marks is well run and the Seller can often attract more Buyers and therefore create a better deal.

Performance standards such as EBITDA, Organic growth and the Rule of 20, make up financial methods to value a book of business.

Sellers who want to sell someday or merge with a friendly agency can apply these performance standards to build value in their agency. Brokers with 5 to 10 years to plan, can work on their business and improve these scores. Developing a plan focused on the longer term is a goal that will take time but is well worth the effort since above standard performance leads to higher a valuation. The higher the valuation the better the terms of sale, and more the owner(s) is paid.

What Is In a Written *Commission Protection Agreement*

A written Commission Protection Plan or agreement is needed when you find a Successor broker you would like to work with. Verbal agreements are not suggested.
Brokers have found the following key attributes need to be addressed with Successor candidates and can help you narrow down from your top three brokers or agencies to your final selection.
The points below involve a two-way negotiation process. Once terms are negotiated, all of the key points can then be added in the final draft. The points include:

- ✓ Retaining 100% of your commissions paid to you until you decide to sell and move to Inactive status. Anything else is a non-starter.
- ✓ 100% of your commissions protected in all life events, especially death and disability.
- ✓ 100% control of when you decide to transfer your commissions.
- ✓ Commission protection points addressed legally in your successor agreement that continues commissions paid to you as the broker when a life event occurs while you are alive and defines the payout terms when inactive as well as who is paid upon your death.
- ✓ The key pre-planning step that drives the agreement includes: Purchase Price and Payout Period. Set the Purchase Price as a percent of revenue; and set the payout amount over a defined time period.

- ✓ Commission protection points addressed legally in your successor agreement that continues commissions paid to you as the broker when a life event occurs while you are alive and defines the payout terms when inactive as well as who is paid upon your death.
- ✓ The key pre-planning step that drives the agreement includes: Purchase Price and Payout Period. Set the Purchase Price as a percent of revenue; and set the payout amount over a defined time period.

- ✓ An LLC is popular but does NOT provide comprehensive commission protection for all lines of commissions. In nearly all cases upon the sale or transfer of commissions from one broker to another, the commissions are transferred/assigned to the Successor or "Buyer". Once a sale or transfer is completed the result is an LLC shell which is often closed down.
An LLC or S-Corp can provide asset protection but in many cases is not recognized by insurance carriers as the agent of record. In these cases a Successor needs to be a human who is licensed and certified with each carrier commissions are paid to a broker. Comprehensive commission protection and transfer therefore requires a Successor broker in the majority of cases with insurance carriers.

- ✓ Pre-planned carrier specific commission transfer paperwork directing commissions to your Successor that is updated annually

Look for flexibility and affordability in your planning options. Then, lock in specifics with your final written agreement. The best practice is a *Commission Protection Plan* that includes both a Successor and purchase agreement.

Since the Successor's role is to serve as a Successor in any life event including retirement or death, we add a purchase agreement into what we call a complete Commission Protection Plan. This way commissions are protected, while a broker is active or inactive, with inactivity caused by retirement or disability or death. This type of agreement works extremely well when an active broker chooses to retire as they have a pre-determined purchase price and a Buyer ready.

Your written Commission Protection Plan is the legal document that outlines the terms you and your Successor will follow at some point in the future.

The broker you select as your Successor is the ideal person who has gained your trust through actions or a track record demonstrating the qualities you prefer. You make this selection based on their strengths such as insurance and business experience, track record as a professional, their age and future plans, client similarities, client service approach, and the support and management systems they use. A written agreement is needed to define how commissions will be paid when you slow down, when you retire and in the event of your death.

Many brokers are now aware they can pre-arrange for a transfer of commissions which protects commissions in a Life Event. Our agreements include the paperwork to transfer commissions to the Successor at some point in the future. That point is determined by the active broker while alive and upon death by the ***Commission Protection Plan*** we use.

MORE GROWTH IDEAS

We are often asked about other ways to grow commissions outside of the traditional methods. We suggest the following 4 areas as must consider:

Medicare is a growing market and compensation is stable.

To participate in this solid and growing market, look to partner with a Medicare broker, hire a Medicare broker, or get into this market through a Field Marketing Organization (FMO). The fact is MAPD and Med Supplement commissions have not gone through a reduction like small group and other individual lines. Medicare (for now) appears solid and Medicare commissions are expected to remain solid as well. For several years, annual increases in Medicare commissions have helped attract more brokers to this Boomer-fed, growing market. The strength of this market, combined with changes in the group market, has motivated brokers to sell their group book to focus on Medicare later in their career. With most of the work focused on the annual election period, brokers can pace themselves during the year and push hard the last four months of the year to retain clients and add new ones too. Service issues are often managed effectively by the carriers so educating those aging into Medicare and renewing clients, mostly during the fourth quarter, is the focus for brokers doing only Medicare business.

Buyers consider Medicare revenue as solid and valuable. Since most Medicare commissions are transferable, they are valued highly by many Buyers.
If a Buyer is only group-focused, Medicare revenue can either be retained with limited effort or sold to another Buyer looking for Medicare commissions.

Acquire Revenues by tapping into older brokers moving to retire:

Brokers can look to acquire smaller books of business ($50,000 to $150,000) to gradually reach revenue milestones like $250,000, $500,000 or $1,000,000. When considering this type of growth, brokers need to develop a plan to absorb the new clients. Acquisition of commissions can be a cost-effective way to reach revenue milestones and can be paired with traditional marketing to add clients. Acquisition is often an excellent way to add valuable employees who have experience in the industry and currently work for the Seller.

The key to this growth is how to balance revenue and expenses as there is usually a payout period committed to the Seller. Transitioning clients is always critical in an acquisition and the Seller's employees can be equally valuable when considering client retention.

Get Younger for several reasons.

A key aspect to future growth potential of an agency includes adding younger agents. Younger brokers are needed to both help absorb client growth and to replace retiring brokers. Younger brokers often are paid less than older brokers, they usually have capacity to add new clients and older brokers who have a "locked in" base compensation amount can be less motivated to add new clients. Younger brokers can become future inside Buyers who are likely able to work longer and execute a long-term plan. Sellers see the employee mix as a valuable consideration especially in the case when implementing a succession plan with key employees as inside Buyers. For outside Buyers, they often see added value in acquiring a multi-generational team blended into their growing agency. As a result, a solid and young employee base is another key component of added value in the eyes of a Buyer. Most Buyers see a younger workforce as highly valuable which gives the Seller significant leverage in negotiations. Consider training programs and internships to attract the growing pool of recent college graduates looking for all of the advantages a career in health insurance provides. Young professionals like the customer service focus, education based enrollment process, sales incentives linked to performance and remote work opportunities.

The goal is to grow and build the value of the agency.
Higher revenues will attract more Buyers and lead to a higher sales price.

Adopt Technology that helps build value.

Technology will allow for increased specialization, better employee training and development, and improvements in quality management. All of these areas help improve an agency's value and performance. Brokers who can respond to the changing needs of clients will see the growing threats and opportunities offered by technology as solutions for growing and servicing their clients. Technology is your friend and will help keep pace with the service aspects of the health benefits industry and ward off competitors. Sellers benefit from adaptation to technology as Buyers see value in technology.

Finally, Always Complete a ***Commission Protection Plan.***

Personal planning to address the important topic of commission protection is a must. Find someone experienced to help with this important task. We are confident our commission protection plans lead the industry and we welcome input from brokers and their trusted advisors on our planning documents. Our team is available to collaborate with other advisors or lead the planning process.

Planning is one of the most important leadership skills brokers can apply when looking to grow. For brokers who want to grow "now" they can apply several techniques to double or triple revenue before they ever consider selling or merging. With planning, brokers can identify key performance methods to impact growth and improve performance.

CASE STUDY #2

FINDING, SELECTING AND CONTRACTING WITH YOUR IDEAL SUCCESSOR

Best Practice Successor Guidelines:

Joan D. has a successful agency but her commissions are 100% at risk. We worked with Jane to identify, select and contract with a Successor.

What does a Successor do? A Successor has a responsibility to back you up when you need it most, in any life event. They need to agree in writing to pay you or your loved ones for the amounts outlined in your successor agreement. Your Successor should be able to step into your shoes at any time and protect your commissions based on the terms you and your Successor mutually agreed on.
Jane was looking for someone who had similar clients and a management style she felt comfortable with. She thought her staff would be able to step in but after spending time with an executive coach Jane was able to compare inside buyers with outside buyers. Jane, after careful consideration and an objective analysis process, ruled out an employee buyout. Jane then embarked on a journey to find a Successor.

Jane used our Successor Considerations:

- Personality fit for you and your clients,
- In 100% alignment with your personal and estate planning needs,
- Experienced with service and support of your client's needs,
- Youthful, enthusiastic, energetic and excited about health insurance,
- Has the capacity to handle your clients now and throughout the time you remain active,
- Has a team in place with at least two certified and licensed health insurance professionals (depends on the size of their current book and you book),
- Track record of success,
- Capable to handle renewals and retention,
- Willing to work with you and sign your successor agreement,
- Accepts the responsibility of their role as Successor as defined in your agreement including paying you or your survivors the agreed upon amount,
- Has all of the transfer and assignment documents required of all the carriers you receive commissions from, and
- Has a system to include your clients in a database and update annually

If you have over 500 Medicare clients, over 35 small groups, or a mix of the two in your book. As part of the agreement, your Successor should commit to either hiring your personnel or adding a support person.

In a written *Commission Protection Plan*, one Successor agent or agency is selected. The ideal Successor will have gained your trust through actions or a track record demonstrating the qualities you prefer. Jane met with her colleagues and asked if they had ideas on any brokers she could speak with about succession planning. After meeting with a few referrals she narrowed down to a few she felt would be a fit.

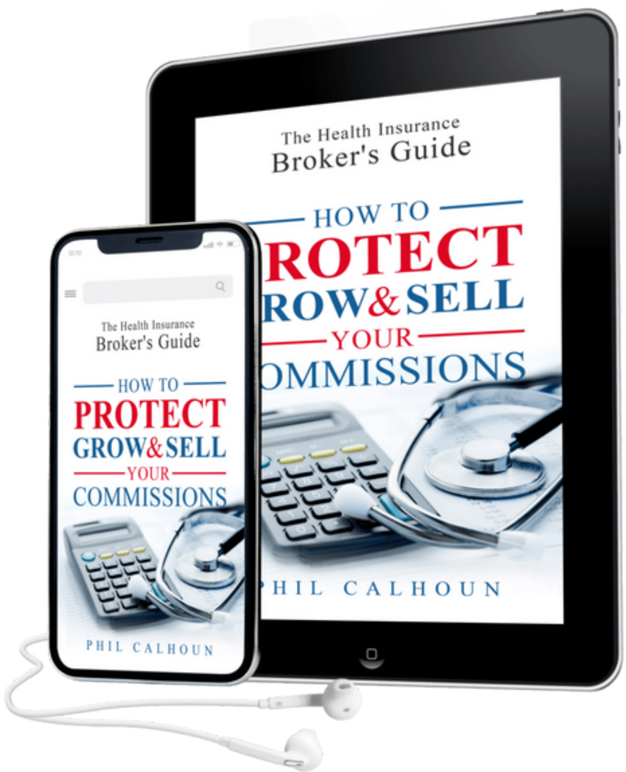
Jane used the TIP SHEET to sort over the Successor options. With the final three she began to do a further evaluation of her top three candidates. We helped Jane move from her top three Successor candidates using her personal preferences balanced with business logic. Jane asked why three and we explained it is a best practice to have three options in order to allow for drop outs in the midst of moving through the agreement process.

Jane employed a value ranking system for each item listed on the TIP SHEET, using 1 as the lowest value and 10 the highest for each candidate. This helped her separate candidates based on the qualities on the TIP SHEET she felt to be the most important. Jane ranked experience, track record as a professional and their age and future plans, client similarities, client service and support practices, management systems, and how commissions will be paid when she slows down, when she retires and in the event of her death. The final scores for each candidate helped Jane provide a comparison of the final candidates. She gained a deeper perspective as she worked with the candidates on her key items. Mostly she found this process revealing as she knew the negotiation phase would become difficult when expectations and performance issues are discussed.

Next, Jane needed to share her written agreement with each Successor candidate. Since a commission protection plan is often also a buyout agreement, this step is vitally important to Jane and her loved ones. We provided Jane with our Commission Protection agreement and she worked with our tax and legal team to customize the details for her needs.
Jane shared her Commission Protection agreement in confidence with her top candidates. As she walked through the points in the agreement she found which candidate was most willing to agree to the most critical conditions. Jane worked hard to keep the focus on the goal which is to protect her commissions and arrive at the best purchase and buyout deal possible. We also assisted Jane with the deal points discussion and worked on her must have and most hoped for list of points including dollar amounts.

Jane selected an agency with similar staffing and clients as well as experience in merging clients and transferring commissions into their agency. With a high level of confidence in the Successor she selected and a fair purchase price and buyout terms documented in the Commission Protection agreement, Jane is very pleased. Today Jane has a Successor in place so her commissions are 100% protected in all life events.

ARE *YOUR* COMMISSIONS 100% PROTECTED?



"***The Health Insurance Broker's Guide How to Protect, Grow, and Sell Commissions***," by ***Phil Calhoun***, MBA, contains many insights and secrets gained over 30 years in the field.

Discover how a ***Commission Protection Plan*** can help *you* protect *your* hard-earned income.
This book has three significant values:

1.***Protect:*** The important message is to identify a Successor to may achieve 100% commission protection and avoid losing all your hard-earned commissions.
2.***Grow:*** "***The Health Insurance Broker's Guide***" outlines 15 strategies for retaining clients, gaining recommendations from a variety of sources, becoming a Successor for other brokers, and earning commissions.
3.***Sell:*** The time it takes to sell a book of business can range from one to five years, and when a broker takes the time to prepare, the average increase in value is 20% to 33%.

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