The sale and servicing of an ongoing Insurance Practice

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Hypothesis:
An insurance or financial services practice has a greater value to the agent / advisor who started it and to their family than it has to a potential purchaser who wants to pay to buy the practice outright.

- Many agents would like to retire from full-time active practice.

This session will explore the value of a continuing practice to the vendor in comparison with the value that could be obtained as the result of an outright sale of the practice.

It will suggest various ways to accomplish a transfer of value to a purchaser with no money being paid by the purchaser to the vendor and with the clients continuing to receive full service.

According to a 2009 CARP (Canadian Association of Retired People) study of boomers (the next retirement generation) 80% of us expect to work at least part-time during some of our retirement years.

- Are you really ready to retire?

- Have you thought about the things that your practice pays for that you will have to pay for yourself when you retire?

Perks that are now paid for by your practice likely include: automobile expenses, business lunches, club memberships, travel points accumulation, a computer, Internet access, cellular telephone and mobile data, health care coverage, a Health Spending Account, Income Splitting and others. This makes a difference to your net income.

- Do you want to maintain those things when you retire?
- How will you pay for them?

When you retire you will likely have to change your lifestyle.

- What will the impact be on your daily life?

The idea of retiring and handing off our clients to someone else is difficult to accept. During our careers we spend most of our time and energy developing our practices and building our businesses. We work with our clients and develop strong relationships with them and we often don't want to lose those hard won relationships.

Most agents and advisors are getting older (no real surprise here).
Most of us have put off thinking about retirement.
Our renewals and trailers are now substantial and continue to grow. The longer we wait the higher our renewal income becomes.

Advocis tells us that, in 2010, the average age of a financial advisor in Canada is 54. Many advisors are considering semi-retirement and starting to plan for their practice succession. There are several different transition strategies they can look at using.

Succession plans depend on:
- our product focus;
- the length of time that we are in practice;
- the size of our book of business; and
- the number and seniority of our staff.

We all have one thing in common: The advisor selling his practice wants the highest price and the buyer wants to pay the lowest price.

There is no one formula when it comes to the best way to sell a practice. You will want to know what works for others to help you to decide what may be best for you.
It's rare for agents and advisors to have written succession and retirement plans, which is strange because as advisors we help our clients to put their succession and retirement plans in place. We talk with our clients about the need to prepare for retirement BUT while we are doing this we often forget, that we need to prepare for our own retirement.

We are pretty good at planning for our possible disability or premature death. We can generally save for retirement. BUT we have to plan for more.

Advisors don't generally seek outside advice from their accountants and lawyers and few of us hire business consultants. We often do our own financial planning but, like most who do-it-themself, we find it difficult to be objective.

As advisors we often fail to ask the opinions of those people who can help us to avoid overlooking the obvious. I know many agents and advisors who have suffered a long-term disability before the age of 60. Some had enough disability insurance, but many others did not. For them disability meant early and only partially funded retirement. They were forced to make decisions regarding the sale of their practice when they were in the worst possible position to do so.

We have to plan for our own needs as well as those of our clients. As with all plans, this must be done in advance.

Some advisors plan on never retiring.

When asked when I would stop selling insurance, I used to answer: " three years after I die".

What will happen to my practice during those three years? What happens after that?

Some advisors feel that: if they bring up the idea of succession planning, their clients might assume that they're considering retiring soon or that aren't serious about taking care of their clients' needs. Sooner or later your clients will start to ask questions about your future plans. Your ability to answer these questions honestly will help you to reassure your clients. It may also help you to protect the value of your practice in case you are disabled or die before you're ready to retire.

As a professional you have a responsibility to ensure that you have a viable succession plan in place so that your clients' financial affairs continue to be managed when something happens to you or when you retire.

At a bare minimum, some advisors put a reciprocal agreement in place with another advisor to safeguard their clients, but this does not always maximize the value of their practice.

To help protect the value of your practice start by thinking about your assistant.

- Has their compensation been commensurate with the work that they do and that will need to be done?
- Is their workload reasonable?

Your assistant will play a key role in any transition and minimizing the change for clients helps to maximize client retention.

Client retention increases the value of a book of business. This is even more true for a practice with a good renewal stream and large renewal block than for one with FYC only or that is fee-for-service.

It happens all too often. A financial advisor becomes seriously ill, disabled or even dies unexpectedly.

When this happens, one of the most valuable assets that they own - his or her client book - is left uncared for and the client base and value begin to erode. The beneficiaries and /or executors are left scrambling to sell the book with little or no understanding of its value. With very little upfront planning, advisors can easily avoid this sort of problem.

There are many ways to structure the purchase of an advisor's practice.

- The purchaser may request the purchase price be subject to a revenue or asset retention test for the first year of ownership.

But clients might decide to move their business to a different advisor and this would result in lower revenue levels than planned for by the purchaser. This is a common concern among purchasers and can be easily managed if you properly communicate your Continuity Agreement to your clients, particularly to your best clients. Clients will be reassured knowing that you've protected them, and your practice, with a succession plan.

- Most agreements are based on a calculation based on the revenue that is actually generated for the practice by the existing book of business.

- Most agreements should give direction for the release of gross annual revenue figures for the past three years to the purchaser. The purchaser then uses the average of the practice income in last three years to calculate the final purchase price.

There are many ways to structure the purchase of a practice. One example is:

1. 1.25 to 2.5 X annual gross revenue; with
2. 0 to 50% of the purchase price as a down payment; and
3. the balance paid in equal instalments over 3 to 10 years with no interest and with payments made quarterly.

BUT this arrangement would require a Retention Clause, reducing the value of the practice if revenues fall below the target amount. It also means that, for practices with large renewal income streams, the purchaser is using the revenue from the practice to pay out the interest of the vendor.

I recently read a report that contends that all but 7% of the country's financial services firms won't extract significant value from their practices when their owners retire because most do not have a sustainable profit model.

Even those that are able to create what the report called "enterprise value" (defined as: what a buyer would be willing to pay for a firm) it won't do what they need to.

The report stated that:
"A careful analysis of the industry suggests that only about 200 to 400 (practice owners) either have, or possess, the potential to build material enterprise value and we believe only a fraction of those will ultimately succeed in doing so".

The report suggests that we offer value to our clients and communities in many ways but suggests that we are "starry-eyed greybeards" who are "almost delusional about the worth of" our practices. The report suggests that the overwhelming majority of firm owners cling to the same fantasy.

It goes on to say that in this shared dream, we are able to run our firms any way that we want to. However, at the exact point in time when want to retire, a strategic acquirer, perhaps "a large, dumb public company, will appear out of nowhere.

In this dream the acquirer's management will be both unsophisticated and desperate to buy a practice for substantial consideration with few conditions attached." Do you have a large, dumb public company in mind?

The report went on to state that "Legacy" transactions (where owners gradually sell stakes to successor generations and which are the most common avenue for sales) are "the most difficult to complete and involve many potential trade-offs".

So, is there an alternative to the "Legacy" transaction that allows for the sale of a successful practice with a good renewal income stream and that maximizes the value of the practice for the retiring practitioner or their estate?

Enterprise value is often subjective.

Fee-based, or hybrid, firms are particularly low in enterprise value because their revenue model relies on new fee income or on continuing and increasing product sales. The practitioners might be highly skilled but their knowledge and experience are hard to replicate by their successors, according to the report.

The report isn't much nicer when discussing fee-only firms, saying that "a typical registered investment adviser that manages less than $300 million in assets and produces less than $3 million in annual revenue isn't profitable" for an acquirer to purchase".

Many financial advisers assume that selling their practices to family member or to a trusted junior advisers inevitably results in a smooth and easy transaction. It generally doesn't. Like any complex transaction, selling your life's work, even to someone who you know very well, is difficult. Emotions can often result in disputes, and the clashes can be disastrous to the survival of the practice, the relationship and to the value of the practice.

As business owners we generally overvalue our practices. We think about all of the time, sweat equity and emotional energy that we have invested in them.

Buyers only see all of the work that lies ahead.

We need to think about:

- the kind of post-sale relationship that we expect;
- whether we will make a clean break?

- Do we, as the seller, want an extended role in the administration and operation of the practice?
- Do we want to continue to work with our clients as much as we would like?
- Do we want an office to go to and continuation of the perks that we now have?

It takes time to uncover everyone's needs and motivations and to work out details. Most practices that have substantial renewal income streams are incorporated and the practice is licensed. The Practice owns the renewal income and they are paid to the corporate entity, often because of tax planning.

To maximize the ongoing value of a high renewal stream of income there are just two prerequisites:

1. Maintain the renewal income above a certain, minimum, level; and
2. Continue to have a minimum level of new business in the practice every year;

In order to achieve these two goals a practice will need:

1. Good client service and administration; and
2. Someone who is licensed to deal with existing clients' new or continuing needs for service and information and with new clients who are referred to the practice.

Continuing client service and administration can be provided by an administrator who knows the clients and their files and who has a relationship with the companies that provide the clients' financial products. Only a licensed agent or registered advisor can deal with the clients' new or changing needs.

In order to achieve these two goals a corporate practice will need a way to continue to operate as a licensed / registered entity (to receive continuing commission income and trailer fees) with Errors and Omissions insurance coverage.

The practice will also have to create an arrangement with one (or more) licensed agent / registered advisor who is willing and able to deal with clients' ongoing needs for additional protection and investment advice as well as the needs of new clients who are referred to the practice by existing clients and centres of influence.

Commissions can be split between the ongoing practice and the new advisors / agent providing advice and counsel to clients of the practice.

The practice can arrange for renewal commissions to be split so that the new agent / advisor receives 25% of the ongoing renewal income as a standby fee for servicing of clients when advice about existing products is required. The splitting of commissions can be done at source (company / MGA / dealer) rather than within the practice. All new commissions generated by the new agent / advisor, from the existing clients of the practice, could be split 50 / 50. Any new clients referred to the practice could be split with 70% going to the new agent / advisor and 30% to the practice.

These two sources of new commission income should satisfy the ongoing contractual requirement that the practice produce new commission income in order to justify the ongoing book bonuses and grid requirements in order to maximize ongoing income.

Commissions on any clients that the new agent / advisor finds on her / his own are 100% theirs.

A Continuity Agreement is an agreement that can be set up to allow another financial advisor the authority to step in to service existing clients of the practice and even to buy the client book in the event of your unexpected illness or premature death.

A properly drafted Continuity Agreement should be stored with your will.
This will allow your executor immediate access to the details of the arrangement.

Any plan is better than no plan. Do not procrastinate. The first step in any succession plan is to investigate your options.

Protect your loved ones from financial loss and plan for the unexpected.