

Agency Networks Aid Agency Net Worth

BY THOMAS M. BRANIFF, JD, CPCU

Are you considering joining an "agency network" (sometimes referred to as a "cluster")? As with any important decision, there are advantages and disadvantages to be considered. The purpose of this article is to outline a process to assist you in making that decision.

For more than 15 years, our firm has been involved in planning and creating numerous agency networks, drafting network operating agreements, and providing advice to agencies considering network participation. We also provide advice to independent agencies that are members of networks, and have assisted agencies in getting out of this type of arrangement.

For the purposes of this article, we define an insurance "agency network"

or "cluster" as any two or more autonomous insurance agencies sharing certain resources and/or working in a cooperative fashion under a formal organizational structure in order to gain certain financial, influential, and/or economic benefits, without sacrificing the integrity of individual agency identity or the ownership of the business generated through their individual efforts.

Characteristics of Agency Networks

Our experience has been that true agency networks include at least the following characteristics:

- Member agencies retain their individual identity and business structures.
- A core entity is created to manage the affairs of the group.
- Ownership of all business placed through the network remains with the originating agency.
- A formal contractual relationship exists between and among the participating agencies, specifying the duties and responsibilities of each member to the network, and the network to the members, as well as the compensation structure.
- A formal management system exists that involves members overseeing the decision-making process regarding the activities of the network.
- There are no penalties or buy-out provisions if a member elects to withdraw from the network.

Benefits of Joining a Network

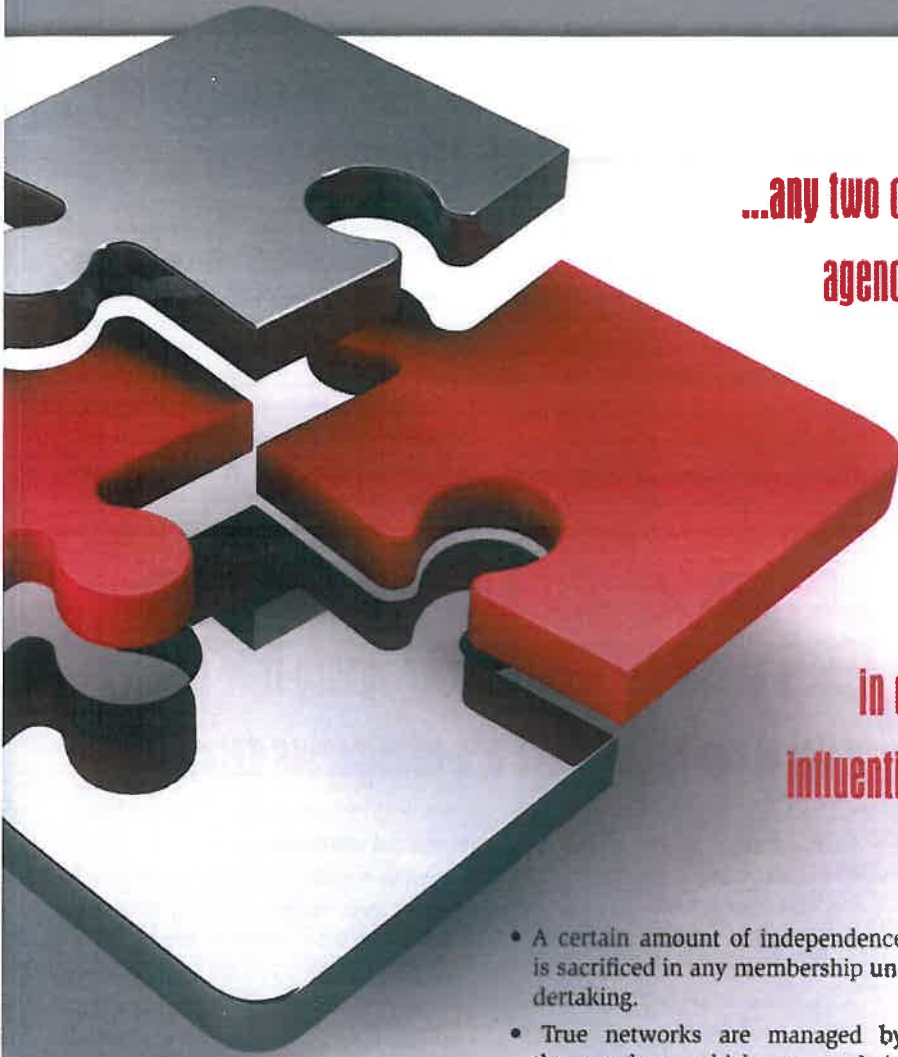
There can be numerous benefits to joining an agency network, especially for small to medium size agencies. These include:

- Increased access to competitive markets
- Preferred commission schedules
- Increased clout with carriers due to aggregation of the network's production
- More favorable profit sharing and production growth contracts
- Networking with peers to assist one another as trusted advisors
- Increased profitability resulting in increased agency value

LEARN MORE, EARN MORE

If you'd like to learn more about topics such as measuring agency performance, mergers and acquisitions, and valuation issues, attend a Ruble Agency Management Practices Seminar. You can also participate in discussions and learn about agency performance and making comparisons to peer group averages by attending a CIC Agency Management Institute. And *Maximizing Agency Value II* is an excellent guide for buying, merging, and selling agencies, while the popular *Growth and Performance Standards* (GPS) study contains performance benchmarks for measuring agency performance and making comparisons. Published by The National Alliance Research Academy, these books are available for sale at www.TheNationalAlliance.com/bookstore.





...any two or more autonomous insurance agencies sharing certain resources and/or working in a cooperative fashion under a formal organizational structure in order to gain certain financial, influential, and/or economic benefits...

The benefits listed above are relatively easy for a quality agency network to achieve. A network can provide other potential benefits, depending on the complexities of each agency's ownership, differences in the character of business handled by members, and the degree of fear over loss of independence. These benefits include:

- Perpetuation planning, including buy-out provisions in the event of death/disability
- Centralization of accounting and other backroom functions
- Uniformity of management operating systems
- Group E&O coverage

Potential Drawbacks to Joining a Network

Joining an agency network can also have drawbacks. Some problems we have encountered include:

- A certain amount of independence is sacrificed in any membership undertaking.
- True networks are managed by the members, which can result in lengthy delays in decision making.
- A portion of the members may wish to pursue a benefit or program that other members may not wish to implement (e.g., forming a premium finance company, developing specialized programs, etc.).
- A single member's poor underwriting practices or otherwise bad loss experience can spoil the entire network's profit sharing bonus.
- By necessity, another layer of accounting is required to track the commissions and other revenues generated by the group.

Factors Critical to a Network's Success

Some of the factors or characteristics of successful agency networks include:

- A well thought-out organizational structure and a formal operating

agreement that are prepared by a qualified attorney. Preferably, the attorney should be familiar with the operations of an insurance agency, as well as agency network issues. Some of the provisions to be included are:

- Membership requirements/qualifications
- Management structure/decision making process
- Financial commitments of members
- Mutual covenants
- Termination/withdrawal provisions
- Agreed upon rights and responsibilities regarding income/expenses/bonuses
- Reliable accounting/data management of the network's records
- Consistent and professional communication among members regarding opportunities/problems
- Mutual respect, compatibility, and compliance among members

Continued on page 6.

Agency Networks Aid Agency Net Worth

...continued from page 5.

Due Diligence In Selecting a Network

One of the first steps in determining if joining an agency network is right for your agency is to develop a list of the reasons you are considering doing so, as well as the benefits you expect to receive, both now and for the long term. It is also important to focus on the managerial and administrative functions you do not wish to surrender. You should obtain information regarding:

- Current member agencies, including branch locations
- Premium volume and loss ratio information
- Insurance providers represented
- Profile of the book of business (e.g., is it concentrated in any industry; does it focus on commercial or personal, etc?)
- Copy of the operating agreement
- Your agency's representation on the network's board of directors
- Decision-making process
- Compensation and expense sharing system

Essential Provisions of a Network Operating Agreement

The following is a list of some key issues that should be addressed in the

operating agreement among the members of an agency network:

- Duties and responsibilities:
 - Individual member agencies' responsibilities regarding servicing, billing, and collecting and paying account currents, etc.
- Termination provisions:
 - Termination for breach of operating agreement
 - Right to withdrawal with appropriate notice
 - Notice period in the event of termination/withdrawal
- Mutual covenants:
 - Confidentiality of individual members' information, both during the term and after termination
 - Non-solicitation/non-piracy among members, both during the term and for at least 24 months thereafter
 - Non-solicitation/hiring of another member's employees
 - Restriction of member agencies "brokering" with (or for) non-members agencies
 - Restriction of member agencies joining any other agency network
- Transfer of member agency ownership:
 - Prior notification to the network if a change in an agency's ownership or management control is anticipated
 - Approval process for continuing as a member if ownership or management control of an agency changes
- Establishment of procedures relative to the handling of profit sharing and contingency bonuses, including the formula to be used in computing distributions
- Adherence to all company agreements held by the operating entity
- Timely payment of insurance company balances
- Maintenance of minimum E&O coverage limits, and naming the operating entity as an additional insured
- Observation of all operating rules and procedures

One of the first steps in determining if joining an agency network is right for your agency is to develop a list of the reasons you are considering doing so...

ABOUT THE AUTHOR: THOMAS M. BRANIFF, JD, CPCU

Thomas Braniff is an attorney and insurance consultant in Houston, Texas, who provides management, regulatory, and legal assistance to the insurance industry, as well as others faced with insurance-related problems or opportunities. He is also a member of the adjunct faculty in the Insurance & Risk Management degree program at the University of Houston—Downtown. Tom is a member of the American Association of Insurance Management Consultants (AAIMCo), and a Research Associate of The National Alliance Research Academy. More information about Mr. Braniff can be found at: www.texins.net or www.braniff-law.com.



Other Collaboration Agreements

Other options include "franchisor" or "aggregator" organizations. Un-

like agency networks, these agreements generally involve an override or profit element for the individual or entity that controls participation in the group. Such organizations provide some of the benefits of a network, but do not provide the mutual support among member entities and an equal voice in the management of the group, which are characteristics of true networks. Franchisors or aggregators do however represent a valid alternative to relieving some of the market pressures independent agents experience. Many of the decision criteria discussed in this article with respect to joining a network would also apply to becoming involved with a franchisor or aggregator.

Though "brokering" relationships between agents may involve collaboration, they do not qualify as agency networks. These arrangements involve a voluntary sharing of commissions for business placed by an agent that does not hold a particular insurance company appointment, through an agent who does have an appointment with that company. Laws and regulations vary from state-to-state with respect to the legality of "brokering," and the notification the two agents must provide to the policyholders. This type of arrangement is often times unknown to the insurance carrier and is generally governed by informal understandings between the two agents. This method is frequently seen when market capacity crises emerge, and agents have little or no options for meeting the immediate coverage needs of their customers.

Conclusion

The purpose of this article is to present a broad overview of some of the primary issues and questions to be answered when an agency is considering membership in an agency network. To some degree, every agency network is unique. Membership in a network involves benefits, restrictions, and responsibilities. It is important that all parties fully understand these in advance. ■



The Academy Merges with Higher Education

In recent months and years, The National Alliance Research Academy has cultivated unique relationships with universities that offer coursework pertaining to the insurance and risk management industry. By working with these universities, The Academy helps to develop more substantial insurance and risk management programs while working to ensure continued success in attracting and training new talent. In addition, The Academy conducts cooperative research with these higher education institutions to help educate and inform current insurance and risk management professionals.

As a part of these relationships, The Academy offers aspiring professionals the opportunity to use university insurance and risk management coursework to obtain credit toward their Certified Insurance Counselor (CIC) or Certified Risk Manager (CRM) designations. Students who successfully complete the approved university coursework receive credit for one part of either the CIC or CRM designation. Participating students are then given the opportunity to receive credit for an additional part of the CIC or CRM programs by studying and using their knowledge to complete a proctored exam. Upon passing the approved coursework and exam, students will have earned credit for two of the five required courses leading to the corresponding designation.

At this point, successful students will also obtain one of two new designations offered by The National Alliance—the University Associate Certified Insurance Counselor (UACIC) or the University Associate Certified Risk Manager (UACRM) designation. These designations give recognition for hard work and represent a distinct advantage for those students entering the insurance and risk management workforce.

Participating universities:

Appalachian State University	University of Mississippi
Ball State University	University of North Carolina—Charlotte
Baylor University	Olivet College
University of Central Arkansas	University of South Carolina
East Carolina University	University of Southern Maine
Florida State University	
University of Georgia	
University of Houston—Downtown	

Join us in our efforts to attract new talent into the industry and support these dedicated students by contributing to the Jerry Montgomery Memorial Fund, which funds scholarships for the UACIC and UACRM programs. For more information, email William J. Hold at wjhold@scic.com or call 800-633-2165, ext. 3325.