



Evolving Options for Independent Insurance Agent & Broker Distribution

Aggregators, Alliances, Franchises & Networks



Disclaimer

This paper includes only general information and comments, and is not intended to provide specific advice about individual legal, business or other questions. It was prepared solely for use as a guide, is not a substitute for independent evaluation of any business opportunity, business structure or contract, and is not a recommendation of any form of business or that any contract be signed or rejected. If specific legal or other expert advice is required or desired, the services of an appropriate, competent professional, such as an attorney, should be sought.

Table of Contents

About This Guidebook	3
History, Background and Evolution	4
Stakeholder Goals	5
Aggregation Models Defined	8
Strengths, Weaknesses, Opportunities, Threats	13
Business Considerations	20
Trends	28
Acknowledgements	30

About This Guidebook

Commissioned by IIABA's Council for Best Practices, this guidebook is intended to be an objective look at how existing and evolving alternative distribution models are affecting the future of the Independent Agency System for all the stakeholders—carriers, agents, brokers and consumers.

This material:

- Provides a brief history of agency aggregation and alternative distribution models and how these concepts have evolved during the past 25 years.
- Defines various aggregator models which are taking different paths than models used by consolidators or acquirers.
- Reviews various aggregation models and provide highlights of each model
- Analyzes the strengths, weaknesses, opportunities and threats to and of aggregators.
- Offers business suggestions to independent agents and brokers considering working with entities that operate under such models.
- Provides a framework for the evolution of these entities.

The guidebook is intended to be a starting point for what may be ongoing analyses and forecasts. IIABA periodically will update the material, and provide additional resources and research on the evolution of agency aggregation models, as circumstances warrant.

History & Background & Evolution

The concept of agency aggregation has been around for nearly three decades. Adopted by some enterprising insurance agencies as an organizational structure to provide greater negotiating strength, hone efficiencies, and generate economies of scale, this model was considered to be one that would allow agency owners to attain their goal of sustained growth while remaining independent entities. As the models evolved, the industry gave the groupings names, such as clusters, huddles or networks. In recent years, the terminology has evolved to the more encompassing term, agency aggregators.

Agency aggregators probably date back to the mid-to-late 1970s. As they grew, they were increasingly accepted by insurance carriers as they affected a great deal of distribution and premium volume. Starting in the 1980s, the early aggregators found ways to expand their offerings into new states. New structures were born and some existing aggregators created aggregators within themselves. For carriers, aggregators reduced the number of contracts needed with independent entities operating under the umbrella of or as part of aggregators while increasing the number of distribution points. The pressure for agents to get larger—or get out—created an environment that fostered this growth of new agency groupings. Clusters began to take shape and evolve to offer new paradigms for insurance distribution.

The Independent Agency System has worked well over its long tenure. The consumer has benefited from choice, competitive pricing, and a local advocate. Insurers, however, must navigate a distribution force and process over which they have limited control. That is one reason that some have branched into alternative ways of distribution, such as direct response and affinity group marketing.

There sometimes are conflicts between insurance distribution and risk bearing with respect to their objectives. The capital resides on the risk-bearing side of the business—and it's necessarily the process-driven side. It is a daunting task to keep all the policies correct, making sure they get issued and billed properly. Some insurers have felt the bitter pang of insolvency because they could not complete these tasks with the necessary promptness, accuracy, and cost-efficiency.

It is no secret that the insurance industry historically has been product and process focused—which some may view as being at the expense of being sufficiently customer focused. And from this dichotomy between the goals of consumers and risk bearers arises the opportunity and need for and value of a facilitator, such as an independent agent.

As in other industries, the pressures of globalization are mounting on the insurance business. The dynamics of the industry are changing, and restructuring of distribution is one of those changes. Some carriers have elected to avoid working with “clusters” of agencies, citing a loss of underwriting control. Then, they faced criticism for having too many agency contracts, while at the same time not enough distribution points. Conversely, now faced with limited and contracting markets, legislative reforms affecting compensation, and other challenging business conditions, agencies all over the country are considering how they will meet their business needs.

Stakeholder Goals

As we analyze distribution changes and particularly the aggregator and network models, we need to consider the stakeholders in an insurance transaction. These include insurers, reinsurers, regulators, and agents and brokers (distributors), as well as consumers.

Insurer's View

Some insurance companies require higher volume from the agencies it appoints to produce business, and have raised the incentive compensation bar as well. This creates both entry and operational barriers for all the parties involved.

Insurers originally thought that “clusters” of agencies—typically smaller firms—would offer less distribution expertise and quality. Carriers now indicate that this situation has become less concerning, as the management of the clusters typically use a more rigorous selection process than in the past and manage marketing and underwriting more prudently.

Carriers now realize that smaller agencies—even those with premium volume of \$300,000 to \$500,000—often can sometimes generate greater profit on a smaller volume than larger entities.

Many insurers are striving toward a larger volume per agency contract as a way of achieving cost reduction. They also are looking to increase the number of distribution points to access a potentially more profitable market share. This may help some increase premium volume without a corresponding marginal increase in expense dollars in relation to gross written premiums. One national carrier has reported that its top five aggregators collectively represent more than 6,000 agencies.

Distribution's View

Some agents and brokers are embracing the aggregator model. The reasons may be many, including things such as:

1. Increased market access since participants, as a group, may better satisfy the growing production requirements of carriers, rather than being restricted to a few carriers due to minimum premium volume.
2. Insulation from the risk of losing an appointment due to the loss of individual books of business.
3. Enhanced opportunities to work with carriers to meet unique and special coverage needs of insureds.
4. Increased revenue opportunities as the group moves up the compensation scale that may be available as business produced is more profitable.
5. Opportunities for incentive compensation to be enhanced based on profitable performance of the business produced by the group.
6. Reduced impact of individual losses on the profitability of business produced when measured against business by the entire group rather than just agency.

The aggregator model also offers agency members the possibility—with increased access to capital as a group—to form their own risk-bearing entities. Distribution-owned captives and

insurers could become more common, increasing the competitive advantage of many of these aggregators in the marketplace. Insurance products and pricing structures also will change as products are designed to meet consumers' needs.

However, some aggregators will likely learn difficult challenges as their size and the stakes increase. Some forays into captives could prove financially disastrous, due to the large volumes of risk if there are excessive and/or substantial claims. If results sour over time, these volumes will put large blocks of business at risk rather than a smaller, and possibly more manageable block. These risk-bearing entities will face the same difficult lessons many existing risk-bearers already have learned.

Aggregators may enjoy increased underwriting opportunities due to the aggregation of volumes. This will have multiple positive and negative effects on the books of business and the profitability of the entities. They may increase the stability of earnings for their books, and increase their ability to attract and retain talent who seek career opportunities that are outstanding.

Underwriters employed by carriers may evolve to be housed in the platform of the distributor but dedicated to that entity. That would allow producers to member's enhanced access that can facilitate enhanced service to insureds, to the benefit of all.

Reinsurer's View

Reinsurance companies may enjoy increased stability in their control and earnings realized from carrier dealing with aggregators. Better underwriting control and lower costs may result from business produced through aggregations. Reinsurers may experience improved predictability and profitability due to the ability to gain buy-in by aggregator members. Thus, they may see better underwriting and loss control as the agents continue to focus on the profitability of their books of business. Reinsurance could now be dictating selection of risk issues that could not have been done in the past.

Regulator's View

With the rating agencies as a backbone, insurance industry regulators appear to be in favor of the aggregator models as they to help insurers target markets as well as manage profitability and loss results. The rating agencies exert underwriting control through reinsurers with the use of such tools as credit scoring, multi-variant rating, and exposure control exclusions, for example to improve the perceived selection of insureds. Moreover, the ratings firms constantly are focusing on expense reduction in the consumer protection rating model.

Agents, however, must be wary of attempts to excessively refine the rating process. As rating is refined, it will become more regressive. Excessive rate reduction for "select" insureds will result in a larger segment of the "less than perfect" insureds paying a disproportionate share of aggregate premiums necessary to make the mechanism function properly.

Insurance is evolving to the point where risk is no longer shared across the industry, but is simply shared with the other participants in selected risk-bearing entities. This has many positive effects from a solvency standpoint, but it also has negative impacts on markets and availability and turns the risk-sharing mechanism into a complete selection game rather than a contribution game. The continual refinement and micro-classification of risk may "spoil" some markets. Aggregators could exacerbate this process.

The entrance of other financial entities into the business of insurance distribution and risk bearing has caused federal regulators to consider increased control over the industry. Federal regulation will likely favor fewer distribution points to regulate. The aggregator model can simplify the regulation of distribution.

Aggregation Models Defined

Aggregation models were largely introduced as a way for agencies that could not generate sufficient volume for their carriers to continue in business. Some have evolved into comprehensive management structures for groups of agents. Aggregators differ from consolidators, and are described below, in very general terms:

Consolidators - Consolidators purchase agencies to increase their own size, and the independent ownership disappears. Consolidators either employ the former agency owner or the former owner retires or leaves the new entity.

Aggregators - Aggregators are organizations that combine production volume of more than one agency; but may leave the agencies and their ownership in place; with varying terms on how profits and responsibilities are divided among them.

Today there are hundreds of aggregators representing a wide range of business arrangements—groups of just a few small agencies all the way up to large networks with thousands of individual entities. A larger percentage of agencies in the under \$1 million or \$2 million annual revenue range are likely to be involved in some form of aggregated arrangement, whether it be formal or informal, as evidenced by the 2006 Future One Agency Universe Study, with 19% of respondents noting their involvement at some level.

Since the terminology to describe aggregators is not perfect or always consistent within the industry, and as aggregators have evolved, aggregators that leave the agency ownership in place appear to fall into four general groups:

1. Agency franchise operations
2. Market access cooperatives
3. Agency platform operations
4. Managed agency organizations

Following these descriptions, there is a chart that provides an overview of the business highlights of each group.

Agency Franchise Operations (AFOs)

Agency franchise operations (AFOs) offer a franchise arrangement and share revenue, while providing market access. This is a compensation-based model rather than an upstream holding company concept.

Some AFOs provide start-up financing. Some have various ownership models involved in franchising. This appears as more of a wholesaler model than a volume aggregator. Some operations require a large participation investment.

AFO Highlights

- Fee structure
- Compensation-based model
- Incubator
- Market access

- No upstream ownership
- No downstream ownership
- Start-up financing
- Growth financing

Market Access Cooperatives (MACs)

Market access cooperatives, or MACs, are the original agency “clusters” where agencies in the cluster retained ownership of their businesses, and thus their name, identity, location and assets. Individual agency volume is aggregated through a master code at each insurer. The MAC may or may not share some ownership of each agency’s book of business.

In some MACs, the holding company is owned by some or all of the agent participants, and in some MACs, the holding company is owned by a particular grouping of the participants. Other MACs require that the holding entity own a share of the each participating agency; or an economic interest in the business written by each agency.

MAC structures can vary. One model is built on the theory that the upstream entity is a vehicle for it to thrive more effectively while helping other small agents thrive (“altruistic” model). Other upstream firms are set up on a more traditional business model and are designed to be profit-seeking entities themselves (“capitalistic” model).

MACs generally take a percentage of the downstream agency revenue and a percentage share of any incentive compensation it receives. The volumes of all participating agencies are aggregated, but insurers’ contract with the individual agents. The agencies are insulated from individual premium volume requirements of carriers through the aggregated volumes. The downstream agency fear of cancellation diminishes due to the larger volume and the importance of the relationships to the insurers.

MAC Highlights

- Upstream holding company
- Volume is aggregated
- No or limited shared ownership
- Enhanced agency contracts
- Enhanced performance-based commission
- Enhanced income stability
- Group volume commitments

Agency Platform Operations (APOs)

Agency platform operations, or APOs, have taken the aggregator model to the next step. APOs provide the benefits of the services already discussed for AFOs and MACs plus further agency structure benefits. They set up large automation platforms for agents.

In APOs, the agency-company contracts are with an upstream entity—and perhaps even the commercial lines processing and service are provided through the upstream entity. The automation provided is centralized accounting and backup through redundant systems.

In APOs, incentive compensation is aggregated for all participating agencies. Some APOs attract larger agents as they are providing enhanced services to participants and are thus adding considerable value for several aspects of the organization.

Expense savings are enhanced for participants, and while fees to be in APOs are higher than for some other structures, the array of services can include a host of offerings not available via some other aggregators.

APO Highlights

- Common automation platform
- Centralized commercial lines
- Centralized underwriting and accounting
- Aggregated performance-based commission
- Larger agencies typically participate

Managed Agency Organizations (MAOs)

Managed agency organizations (MAOs) attract large numbers of agents and provide a common management structure for all agent members.

Members usually share the ownership of the upstream entity and manage the organization that oversees their agency books of business. MAOs capitalize on the economies of scale that larger distribution entities are attempting to achieve.

MAOs exert a higher level of organization and management control than is present in other aggregation models. Management is shared through a cooperative effort and there are more human resources and expertise available through the MAO to all its participants. There are tighter restrictions on participation, but agents retain individual ownership of their respective entities.

MAOs also can provide incubator opportunities for new agencies. The model is more collaborative and addresses the traditional weakness of agencies by banding together for shared resources and skills.

MAO Highlights

- Newer concept
- Possible future trend
- Management control centralized
- Tighter restrictions on participation
- Individual ownership rights
- Common ownership rights
- Revenue sharing

Aggregation Models Defined (At a Glance)

Key

AFO = Agency franchise operations
MAC = Market access cooperatives
APO = Agency platform operations
MAO = Managed agency organizations

TECHNOLOGY	AFO	MAC	APO	MAO
Common automation platform		X	X	

COMPENSATION	AFO	MAC	APO	MAO
Aggregated incentive compensation			X	
Compensation-based model	X			
Enhanced income stability		X		
Enhanced performance-based commission		X		
Revenue sharing				X

BUSINESS PRACTICES	AFO	MAC	APO	MAO
Centralized underwriting and accounting			X	
Enhanced agency contracts		X		
Group volume commitments		X		
Incubator	X			
Larger agencies typically participate			X	
Management control centralized				X
Newer concept				X
Possible future trend				X
Tighter restrictions on participation				X

FINANCIAL IMPLICATIONS	AFO	MAC	APO	MAO
Fee Structure	X		X	
Growth financing	X			
Start-up financing	X	X		

OWNERSHIP STRUCTURES

	AFO	MAC	APO	MAO
Common ownership rights				X
Individual ownership rights				X
No downstream ownership	X			
No or limited sharing ownership		X		
No upstream ownership	X			
Upstream holding company		X		
Volume is aggregated		X	X	

CARRIER ACCESS

	AFO	MAC	APO	MAO
Centralized commercial lines			X	
Market access	X			X

Strengths, Weaknesses, Opportunities, Threats

More than two decades ago, many industry stakeholders feared the evolving aggregator and network models. Some still do. But in some cases, initial fears have turned out to be *strengths*. The models leverage shared market access, enhanced individual insurer revenue, economies of scale, enhanced agency revenue opportunities, enhanced incentive compensation, profitability and growth, reduced number of agency contracts, and more distribution points.

On the other hand, agency ownership usually is diluted or otherwise affected with aggregator models. Separation from the aggregator arrangement may be difficult—it is the number-one challenge reported by industry experts and agents involved with aggregators. There may be disadvantages to the individual balance sheet and income statement, but those disadvantages may be offset by increased volumes.

Agents must evaluate aggregator contracts carefully, and it is important to seek quality advice from appropriate professionals.

SWOT Chart

The following chart can be utilized in the evaluation and analysis of the various aggregator models. This SWOT analysis focuses on the internal and external environments, examining strengths and weaknesses in the internal environment and opportunities and threats in the external environment. Each of the SWOTs are considered to be applicable to all defined aggregator models. (See **Aggregation Models Defined** for more information)

STRENGTHS

Carriers
<i>Potentially lower-cost distribution in marketing and underwriting employees, compliance, technology, and other expenses due to fewer agency contracts and more distribution points.</i>
<i>Potentially more centralized control of underwriting, claims and other processes. The insurer likely can promote a more consistent, uniform stream of communication and message, as well as an increased ability to brand their company within the groups of agencies.</i>
<i>Potentially maximized resources and increased profitability. In some cases, aggregators take the agency management and prospecting tasks away from the carrier, acting in effect as an arm of the company. Some aggregators do a good job of holding their agencies to volume commitments, loss ratios and book retention.</i>
<i>Access to marketing territories the carrier otherwise wouldn't have; and ability to more quickly ramp up production in a state.</i>
Distribution: Agents, Brokers & Aggregators
<i>For agents, immediate access to more markets, with volume requirements and other appointment criteria no longer an impediment. These firms include smaller agencies, newer or start-up producers with a track record having worked for another agency and established agencies seeking to retain a particular large account in their area. For start-up agencies, there may be no other option for writing "main street" business.</i>
<i>Once established, smaller agencies can grow more quickly with immediate market access than if they were on their own.</i>
<i>Producers have more time to sell rather than dealing with market issues.</i>
<i>Increased leverage with carriers results from the larger premium volume within the aggregator's book.</i>
<i>Contract protection is more certain with the increased stability of loss ratios through larger volumes and through the sheer numbers the group is generating. An insurer is more reluctant stop doing business with a single agency within the group.</i>
<i>Aggregators can enjoy more access to preferred office space, equipment, talent and specialized customer services due to the economies to scale of the larger books.</i>

Increased profitability should result from larger books as they can withstand the impact of shock losses or loss anomalies.

Aggregators can provide more professional, long-term management and stability—even increasing perpetuation options for individual owners. This may slow some of the exodus of “sell outs” of individual firms and encourage agents to stay in the game through generations.

Some aggregators appear as bigger players in the marketplace—leveraging branding and distribution points—than the individual member agencies otherwise would have. The perception could allow them to compete with bigger distributors.

WEAKNESSES

Carriers

With an intermediary between the local agent and the carrier, the so-called “franchise value” of the carrier can be reduced. This concern most often is cited by regional companies.

Carriers who maintain direct relationships with agencies that also operate within an aggregator model may actually see higher costs, as they pay higher compensation for the business produced via the aggregator. In some cases, carriers spend more staff time than they would like (or that they even realize) out in the field with the smaller agencies in the larger group.

Shared management, while offering strengths, may have inherent weaknesses as different people and management styles may or may not complement one another. The insurer may have a more difficult time dealing with multiple personalities and styles.

The aggregator may have an unclear line of communications and authority, creating a challenge for the carrier. The insurer may have less control—and while it may perceive it has a better model with which to work, the increased levels of authority may make communication and control more difficult. Loss experience and agency/carrier relationships may suffer.

Consistently under-performing agencies can be perpetuated in an aggregated entity. Losses and flat or declining growth or retentions coming home to roost at the carrier expense, and that of all other participants.

The growing aggregators present management and potential lost opportunity issues. Some carriers say their employees lack a true understanding of the number of type of aggregators with whom they work—and the total volume coming in the door. While home office, distribution and marketing representatives often have a clear understanding of the aggregator, others may not. Franchise value can suffer. There can be confusion, for instance, over appointments, compensation and rules of engagement with agents between those responsible for the field and those in national accounts.

There may be less direct agent contact for an insurer. As the aggregators evolve there may be less interaction with the actual producers of the business. The information from the producers may be highly filtered and underwriters may understand less of the actual risk.

As the distribution entities aggregate volumes they may enjoy increased leverage against the insurer. Carriers ultimately may not have their exclusive way.

Carriers may be forced to increase compensation. This may be beneficial for everyone in the long run, but initially may be viewed as negative by carriers. Some aggregators with large volumes already have made arrangements for increased performance-based commission agreements and cut into the underwriting spread.

Distribution: Agents, Brokers & Aggregators

Agents may find themselves with weaker, or no, relationships to actual underwriters. If the group lacks sufficient volume to warrant an enhanced relationship, agents may lack a direct relationship with underwriters. In some cases, this may make it more difficult to place risks. Without relationships, pricing and placement may suffer at the complete control of underwriting management.

Activity by other agents in the aggregator group could lead to business being misplaced or incorrectly rated, resulting in diminished underwriting results. If the results were to deteriorate sufficiently, this could result in a large block of business being put in jeopardy of coverage with no fault on the part of most of the members of an aggregator.

Individual agencies with a strong loss history for a couple of years may have been eligible to receive attractive additional compensation if they were on their own. That additional compensation may be not forthcoming in the aggregator group.

The aggregation could become more vulnerable to personal relationships with management. This calls to mind some major property-casualty program failures, for example.

Individual entities share the revenue stream with other partners. If the partners fail to manage revenue well there could be waste over which the individual agent has little control. This could be detrimental to the balance sheet of individual agencies.

In the wrong aggregator group, agents could feel neglected and without control, lacking the support they expected from the aggregator after they initially signed on. There also could be an inequity in the total commission the agency originally thought it would receive.

For individual agencies, the future can be mortgaged. Aggregators can de-facto "own" member agencies' futures with prohibitive exit plans, poor buy-sell provisions, partial/full renewal ownership, agency merger prohibitions, rights of first refusal, and other provisions that can impede agency perpetuation. (Some agents in aggregators may wish they simply had merged with or acquired another agency to reach critical mass. Due diligence is a must.)

With each aggregator agency contract unique, and confusion abounding, agents must invest time and money to truly understand what they are about to do.

Technology and Internet advancements will pressure the aggregator models. The reasons for which some aggregators started may be less valid in the future. Some carriers are making direct appointments with smaller agents, claiming lower costs of appointment and ongoing contact.

Carriers
<i>Risk bearers could reduce expenses when working with an aggregator. Size does matter in the distribution insurance. The carrier can reduce the number of agency contracts they have in place, while increasing the number of distribution points.</i>
<i>Carriers can capitalize on economies of scale—such as centralized services—by reducing the number of agency contracts.</i>
<i>Carriers can choose to focus on aggregators that provide more long term, value-added services to agents, such as sales and back-office support.</i>
<i>Carriers should enjoy increased contract protection from agencies. It will be very expensive for an agency to move from a carrier when several million dollars of premium is at stake. As long as insurers can keep away from the “flip a switch and change carriers” automation system, the insurers should enjoy a better competitive advantage due to increased volume per agency contract.</i>
<i>If insurers embrace a more serious consumer-focused mentality, they will become extremely valuable to clusters and individual agents. They can enjoy increased market share and market power if they are truly delivering a viable product.</i>
Distribution: Agents, Brokers & Aggregators
<i>Distributors should enjoy more support from carriers and should be able to negotiate preferred status with them. The agents should enjoy increased contract enhancement and contract security from the aggregated volumes.</i>
<i>Distribution could enjoy increased product availability. When distributing for an entity for which one is providing millions of dollars of business, one assumes it would take something devastating to impede the relationship.</i>
<i>Distributors can access custom performance-based commission arrangements and preferred status for rollover of books of business. Companies may be willing to allow distribution to cut into the underwriting spread and make more money on more profitable books of business.</i>
<i>The increased volumes and higher profitability may lead to agents putting skin in the game and partnering with existing companies to bear risk. The agents may become investors in their carriers and may form captives to bear risk. Agent-owned captives and agent-initiated carriers may become more common.</i>

THREATS

Carriers
<i>Carriers face increased vulnerability to larger books of business. With the restructuring of business and the use of reinsurance, risk bearers take more risk and live by the sword more often due to the threat of deteriorating experience being handed to a reinsurer. This increased risk appetite is exacerbated when individual books of business are larger. Carriers are putting more eggs into fewer baskets.</i>

<i>Distribution will leverage the volumes they enjoy with individual carriers. Partnerships potentially could become acrimonious.</i>
<i>Underwriting control could deteriorate because of the insertion of another layer of distribution. This layer will increase the odds of one leveraging against another and make either party more vulnerable to the other.</i>
<i>With compensation arrangements, carriers might focus on growth at the expense of loss ratios—a long-term recipe for disaster for both agents and insurers.</i>
<i>The performance-based commission equation threatens the risk-bearing entity. Insurers will be forced to share more profits and may do so without the forethought to share profits judiciously. An example of this is the workers compensation dividend programs and the loss development that occurs later on the books.</i>
<i>The attractiveness of volume alone can be fool's gold. Premium volume in the aggregator model for its own sake can overshadow the fact that the individual agencies aren't growing, for example. Or if the underwriting fundamentals aren't in place the aggregation can hide issues</i>
<i>A carrier ranked highly in an agency before might be a smaller player as part of the aggregator.</i>
<i>Carriers need to manage their appetites. With aggregators applying pressure, underwriters could make the wrong call on a bigger book of business.</i>
Distribution: Agents, Brokers & Aggregators
<i>Accumulating volumes with fewer carriers actually may yield less control. The distributor may not have a lot of choice but to go along with the carrier demands as they are so vulnerable with so much business.</i>
<i>The larger the books of business, the more desensitized everyone can be to consumer needs. Larger entities can get to the point they cannot know all their customers and the risk bearers may forget from whence they came and treat the clients with a greater level of indifference.</i>
<i>Individual agents may have less opportunity to communicate with carriers and thus may have less influence in client satisfaction. The conflict of objectives between all parties may become greater due to new layers between the parties.</i>
<i>Larger aggregated books may lead to more negative broad brush treatment of all the parties involved. The increasing number of transactions favors it becoming more institutionalized. One of the strengths of independence has been individual attention, but this may be difficult to achieve with larger numbers. Some big distributors are vulnerable in relation to the one-on-one treatment offered by small agents. Consumers often dislike the treatment meted out by larger entities.</i>
<i>Potentially diminishing value over time. Aggregators that focus simply on aggregating volume—at the expense of sales focus, call centers, back-office technology, marketing and underwriting support, and other services to member agents—ultimately could struggle.</i>

With compensation arrangements, carriers might focus on growth at the expense of loss ratios—a long-term recipe for disaster for both agents and insurers.

Online markets offer alternatives. The ability for individual agents to access small commercial and other commodity products in an online, comparative-rating environment—combined with carriers getting smarter and more efficient with smaller agency appointments markets—could pressure aggregators.

Evolving options in direct appointments. New technology such as Web conferences offer efficient ways for carriers (particular the regionals) to build direct relationships with smaller agents, negating the need for aggregators. Even national carriers may choose to reach out to more agents directly.

Excess and surplus lines markets are expanding—even in a soft market. Many of these markets offer what standard carriers offer without volume requirements, with more underwriting flexibility, and in some cases at higher commission rates.

Potentially negative impact on independence. Agencies can de-facto lose their independent status when they join a group, working with a select few carriers under shared ownership and loss ratio.

Business Considerations

In the end, the Independent Agency System is just that: independent. Growth choices abound for new and existing agencies of all sizes. If your agency is considering an alternative business structure—such as by merging with another entity or joining an aggregator, network or franchise organization—it is important that your decision be informed. Remember that sound business decisions are based on factors like:

- The values and perceptions of the decision-maker;
- Carefully considered alternatives and options;
- Your basic “gut reactions”;
- Expert guidance by qualified, appropriate professionals;
- Periodic reassessments of the decision and its effects.

The following list provides some basic questions to consider when contemplating entering into any type of aggregation model. The answers to these questions will vary by aggregator model, agency, and circumstance, and there will be many business decisions to be made as part of any assessment about proceeding with such an arrangement. And, since each situation varies, there will be other questions and issues not listed here that are important and will require your thoughtful consideration.

Common Considerations for Agencies Contemplating An Aggregator Relationship

1. Management
 - a. Who is managing the aggregator?
 - b. Does the management philosophy align with yours?
 - c. How much involvement or assistance will you receive from your new partners and how much do you desire?
 - d. How independent do you want to remain, and how independent will you be able to be in your agency operations?
2. Insurance Carriers
 - a. Do their markets fit your geographic footprint?
 - b. What additional markets do you want to access? What additional opportunities do they present?
 - c. What relationships would you be required to give up?
 - d. What do the aggregator's carrier relationships look like?
 - e. Is there stability with the carriers the aggregator has chosen? (Or are there book rolls, for example, that occur frequently?)
3. Financial Considerations
 - a. Does the aggregator have a deferred interest in the value of your book or your agency?
 - b. Does the aggregator's participation impact your ability to retire or perpetuate your agency?
 - c. How will your incentive compensation be impacted by participation in the group?
4. Ownership of expirations
 - a. Who owns all or part of your book?
 - b. How does that ownership align with any contracts you may have with producers, managers or owners?
 - c. What is the impact on business already written as well as future business?
 - d. Is ownership of your book left intact but your actual realization of value compromised in some other way, such as the aggregator having a stated "economic interest" if you sell or leave the aggregator?
5. Exit strategy
 - a. Is there a plan for termination of the agreement?
 - b. How does the deal impact future mergers and acquisition that may come your way?
 - c. How expensive is termination if you elect to pursue it, and how long will it take?
 - d. How are your existing markets affected at termination of the aggregator agreement?
 - e. Can you retain access to the markets you acquired through the aggregator if you or the aggregator elects to terminate?
 - f. What has been the experience of others who have terminated?
 - g. Is there a "first refusal" clause that may impair agency sale opportunities or value?
 - h. What happens to incentive compensation on termination before the end of the year?

6. Perpetuation
 - a. Does the agreement provide mandatory or optional perpetuation plans?
 - b. Does it affect your plans for internal or external perpetuation?
 - c. Does the aggregator have any rights at the time of sale or perpetuation of your agency?
 - d. Is there a “first refusal” clause?
7. E&O considerations
 - a. Do you carry your own errors and omissions coverage or is E&O carried on a group basis?
 - b. How will your agency as well as producers be protected—in coverage, pricing and loss experience—when you are part of a larger group of agencies?
 - c. Are you protected from potential liability of other agencies participating in the aggregator model?
8. Volume and quality commitments
 - a. What are your volume commitments to carriers now, and under the aggregator deal?
 - b. How will your loss ratios be impacted, currently and long term?
 - c. Will you be penalized by the group if you have a higher-than-normal loss ratio with a carrier?
 - d. If so, are you rewarded if you have an excellent loss ratio?
9. Compensation
 - a. What will your firm ultimately receive in compensation, after commission splits and any other fees required to be paid?
 - b. How does that relate to what you would get on your own? Can you sustain your business without it?
 - c. What other support is provided, such as technology assistance, marketing support, and sales assistance?
10. Growth potential
 - a. Will the aggregator model provide your firm more rapid growth?
 - b. Do you have alternatives to growing, even if some present slower growth options? (Options could include independence, independence, online markets, wholesale/surplus lines markets, merger, etc.)
11. Customer service
 - a. How will the aggregator arrangement impact client service?
 - b. How will it impact your image in the community?
12. Brand
 - a. Will you continue to operate under the current name of your agency?
 - b. Are there any restrictions on your participation in Trusted Choice?
 - c. In what ways, if any, can you leverage the model to your commercial benefit in promoting your agency?
 - d. Can the aggregator use your name (and that of your agency) to promote itself and attract others?

13. Employees

- a. How will the deal affect staff morale?
- b. Will your sales folks fit the profile of what the aggregator seeks?
- c. Will your education initiatives be impacted?
- d. How will compensation, policies and procedures change?

14. Services

- a. What services do you get for any fees you pay?
- b. Are you required to use aggregator services or is that ever optional?

15. Other Terms

- a. Are the “boilerplate” contract terms satisfactory? This can include a wide array of issues, such as dispute resolution, confidential treatment of proprietary information, notice clauses, governing law, indemnifications, procedures for amendments, assignment rights, etc.
- b. Are all rights and responsibilities clearly stated in the contract?
- c. Are you free to talk with others participating in the model for information about their experience?

16. Objectivity

- a. Overall, are you doing this for the right reason(s)?
- b. Are you being objective? Are you doing it for subjective reasons (e.g., it simply “feels good”)? Or is your decision objective and supported by some professional advice?

Next, you may want to use the Sample Decision Checklist, which utilizes a variety of issues that may play a role in your initial decision.

Note there are “Pros” and “Cons”—and a scale of 1 to 10 to weight each selection. Add up the weighted scores (your 1-10 rating for each Pro and Con) to help you better understand all the attendant risks and benefits allowing you to make the best decision that offers a solid chance for success.

Sample Decision Checklist

Business Issues	PRO	CON	Importance Rating 1-10
Increased Access to Markets You Can Use			
Decreased Expenses/Overhead			
Increased Revenue: a) Base commission b) Incentive compensation			
Improved Customer Service			
Impact on Customer Perception/Image in Community			
Technology Improvements & Assistance			
Impact on Automation Cost & Support			
Increase Profitability			
Production/Sales Assistance			
Staffing Assistance & Management			
Brand in Marketplace			
Agreement on Joint Expectations			
Fair Dispute Resolution Process			
Owner Personalities			
Management Structure			
Amicable Negotiations			
Legal Issues			
Easy to Understand Contract (Is it fair and negotiable?)			
Ownership of Expirations			
Handling of Existing Company Contracts			
Legal Structure of New Entity			

Future Sale of Agency (First Right of Refusal?)			
Financial Issues			
Start-up Costs			
Incentive Compensation Impact			
Commission Sharing			
Marketing Costs			
Tax Implications of Joining (Short & Long Term)			
Long-Term Financial Ramifications for You/Your Family			
Other Considerations			
<i>[Add in your own thoughts]</i>			

Professional Advisors

Once you've completed your list of pros and cons, you can address your concerns and take a multi-faceted approach with your research and evaluation. It is highly recommended that you seek guidance and assistance from qualified, professional advisors including:

Legal Assistance

- Contract review
- Business negotiations
- Agency/Company contracts
- Business entity formation
- Human resource concerns
- Confidentiality Agreements
- Non-piracy/Non-compete

Financial Advisors

- Tax Implications
- Review of Entity Financial Data
- Creation of Business Plan
- Assistance with securing financing

Agency Consultants/Merger and Acquisition Specialists

- Review of Deal Points
- Appraisal of Agency Values

Carrier Partners

- Reputation of the aggregator
- Impact on existing direct appointment, if any
- Changes in contractual terms of agency contract
- Access to product
- Assistance with securing financing

Other Agencies

- Experience with aggregator
- Issues/problems experienced, if any
- Pros and cons
- Brainstorming

Agent Associations/Resources

- Big "I" Virtual University
- IIABA Best Practices studies
- InsurBanc
- Big "I" Markets
- State or local association networking

Items to Request for Evaluation

As part of your due diligence, you also will want to seek information from your contact at the aggregator, including:

1. History of organization
2. Mission statement
3. Operating and Strategic Plans
4. Business plans, financial projections and pro forma
5. Audited financial statements for last three to five years
6. Tax returns for the last three to five years
7. Details of tax issues (if any)
8. Accounts receivable and accounts payable for past 3-5 years
9. Profile of book of business for past 3-5 years, including loss ratios, list of carriers/markets/lines of business
10. Buy/Sell agreements and business succession plans
11. Technology plans and overview of agency management system(s)
12. Non-competes and other staff agreements
13. Human resource manuals
14. Disaster plans
15. Marketing plans
16. Policies and procedures
17. Details of administrative actions by state authorities (if any)
18. Details of legal proceedings by other parties (if any)
19. E&O claim history

Trends

Like the Independent Agency System itself has done since its founding in the 1800s, the various aggregator models will continue to evolve.

Some possibilities for the future include:

1. *There may be more aggregation and economies of scale within the industry.* Aggregators may become the “black box,” reducing the number agency contracts while expanding the number of distribution points.
2. *Distribution could “super size” as a combined force.* Distribution entities may exert more control on the process due to their increasing size. Independent agent distribution will become increasingly effective at competing with larger distribution structures and approaches.
3. *Wholesalers could increase both in number and volume as they may become part of the aggregators themselves.*
4. *There may be increased customer focus on both agents and insureds by risk bearers and better and more varied products and services may often result.*
5. *Reinsurers and the ratings agencies could exert more control on risk-bearing entities to reduce segments of markets, creating opportunities for larger clusters to innovate.* Insurers also may find ways to capitalize on ignored segments of the market. The aggregators would have the power to support these forays into risk bearing; some may be successful and some may not—an age-old issue in the insurance marketplace.
6. *Increased federal regulation, if adopted, could favor more compliance and increase the level of institutionalization of insurance—thus playing to the aggregator model in yet another way.* Increased levels of compliance could encourage more consolidation to allow for easier regulation.
7. *Aggregators may become more sophisticated, blurring the lines between risk bearing and distribution.* This may require larger entities to capitalize on changes. This could lead to more joint ventures and larger entities in distribution, leading in turn to smaller risk bearers entering niche markets for insurance and riskier ventures in the marketplace. Some risk bearers may then turn into truly risk-bearing entities by outsourcing underwriting and placement.
8. *Large, direct distribution entities could continue to attempt to erode the market share of independent distributors.* It will be interesting to see how (and if) consumers accept the approach of these entities over the advocacy and customization independent agents offer.
9. *Distribution may remain a local enterprise—through independent agents, and direct writers with an agent in every town where it is economically viable.* Companies could work to carve out a segment of the market for themselves through excellent service models and the ability to handle mass transactions. With the right investments of capital, independent and local distribution could win with improved service, technology and skills enhancement.
10. *New types of distribution entities could be enabled, such as incubators for start-up firms that become part of a larger distribution scheme.* On the other end of the market, new publicly traded brokerage operations may spring forth to compete on the larger risks.
11. *Excess and surplus lines markets could continue to grow and evolve, providing alternatives to an aggregator model for independent agents.* The Internet is allowing agents to easily search these markets.

12. *Private equity may continue to get into insurance distribution.* Aggregator models may continue to thrive and evolve in response to increased competition and reduced margins.
13. *Aggregation of volumes and expertise may continue to expand as the benefits become clearer.* Various names and systems may evoke new models and schemes. Clusters, franchises, huddles, back-room clusters, and carrier motivated and agent-motivated models may emerge. Agent networks and online markets could proliferate.
14. *Market cycles may impact aggregators.* Carriers may be more or less willing to feed the aggregators depending on the underwriting cycle.

These potential changes present both challenges and opportunities for independent agencies and brokers, but the one constant is that smart firms will continue to have new opportunities. Those who choose to innovate will change the rules in distribution and create opportunities for agents to work together in new and creative ways.

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