The Bank, the Board and Insurance: Turn Around or Divest

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Over one thousand banks in the United States report insurance brokerage revenue. While the leading banks in insurance are committed to expanding their brokerage platform, many others debate the future of the insurance offering.

Why are some banks questioning their insurance investment? To answer the question, it is important to understand the problem. The trickle of bank insurance agency investment began when the Barnett case created a narrow opportunity. Instead of a complete prohibition, Barnett allowed banks to sell insurance in towns of with less than 5,000 people. Banks eager to sell insurance to their customers scrambled to have a branch in a rural town. In 1999, the Gramm-Leach-Bliley Act opened the market completely.

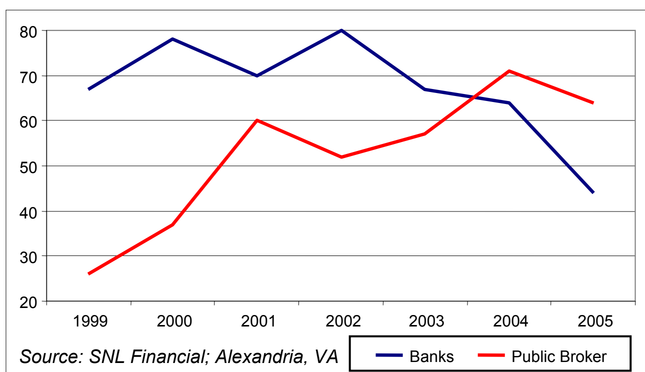
Despite the initial financial services rush to buy and offer an insurance solution, the illustration below shows that bank-insurance deal activity has been steadily declining in the last few years.

One reason for the slow down in bank-insurance activity resides in the fact that questions are now arising in bank boardrooms, as some early entrants have not met expectations for insurance. Unfortunately, in many cases, those strategic and financial expectations were never quantified and articulated.

Understanding Bank Insurance Goals

Leading banks typically entered the insurance business for one of four reasons:

- To expand fee income to diversify the bank's reliance on interest rate margin risk
- To enhance institutional earnings per share
- To capture client wallet share
- To expand the bank's trusted advisor position with bank clientele



Leading banks maintain an acute understanding of why they got into the business and track progress toward their goals. They targeted accretive bank earnings performance, fee income enhancement and the expansion of the bank's consultative trusted advisor position.

Conceding the fact that cross-sell activity has not yet driven wallet share (the best performing banks are generating only 2% to 4% of prior year's insurance commissions via bank referrals), these leading banks look at cross-selling more as a long-term opportunity versus immediate results. Insurance has served as a sound financial investment for the bank, realizes some of the strongest financial and operational performance of any distribution segment, has been gradually integrated into bank culture, and retains the commitment of bank executives.

As bank executives and boards question what the future holds for an underperforming insurance operation, two viable options appear - an executable turnaround strategy or divestiture. In the first, executive oversight and internal discipline remain at the forefront. The hardest part resides in "recommitting" bank time, money and resources to fixing the problem. More than anything else, this recommitment is what separates leading banks from those that are failing. In the second alternative, the decision must be made to cut losses, dress up the existing operation and sell to the highest bidder.

Turning Around the Insurance Operation

Acquiring an agency is only the first part of a transaction. The real measures of success reside in post-closing performance. The most efficient mechanism for driving revenue and earnings within the acquired insurance platform is to enforce sales discipline. While it is easy to target individual underperformance, the institution must also be held accountable.

Sales Discipline

Sales discipline is a by-product of the sales culture of the agency. Leading banks are realizing the highest organic growth rates of any distribution segment, not because of cross-sell penetration, but because they purchased best of breed agencies with pre-existing sales cultures.

In the average bank owned agency, approximately 80% of producers write less than $75,000 in new commissions during a given year. The challenge is developing a total agency sales culture whereby the entire insurance operation is focused on both new business production and account retention. The following disciplines can improve the agency's results:

- Set new business production goals equal to 20% of each producers' existing book of business
- Monitor and track new business production goals, with the results posted in the office
- Establish cross-sell teams with referral requirements
- Adjust the producer compensation plan to instill a drive for new business. Service staff should be responsible for handling renewal accounts.
- Establish minimum revenue account thresholds, under which producers will not get paid a renewal commission
- Mandate that producers annually transfer the bottom 20% of their accounts to a service center or small business unit. If that 20% of accounts actually consume 80% of the producer's time, you need to reallocate resources.
- Create an incentive program for service staff, which encourages and rewards them for helping the organization realize production and retention targets

Total Comm./ Fees Growth	2005 Public Brokers (1)	2005 Bank-Owned Agencies (2)	2005 Large Independent Agencies (3)
Total Growth	11.3%	9.8%	7.6%
Organic Growth	-0.5%	8.1%	7.0%

(1) Source: Select Public Broker Information, MarshBerry
(2) Source: Public Information, MarshBerry **B**ank **A**gency **N**etwor**K** (BANK)
(3) Source: MarshBerry Independent Insurance Agency Clientele

Buying a True Foundation Agency

Leading banks paid handsomely for the best insurance operations in a given market territory paying up to 8.0X EBITDA. These same banks report that 88% of foundation insurance agency (or initial) acquisitions and 71% of subsequent insurance acquisitions have attained the base level of profitability expected at closing. Most other banks cannot make the same claim because the initial agency purchase price was not financially justified, or even worse, may have been the wrong investment altogether. Below are a few of the characteristics that the leading banks are targeting for such high performing acquisitions:

1. Scalable Size
2. Pro Forma EBITDA of 25% +
3. Double Digit Historical Revenue Growth
4. Strong Leadership/Diverse Management Team
5. Producer Age Dispersion
6. Excellent Reputation in Community
7. Capital for Reinvestment in Systems and People
8. Strong Carrier Relationships
9. Efficient Use of Technology - Small Business Units/Service Centers
10. Professionalism/Corporate Governance

As banks continue to evaluate the financial performance of the current insurance platform, executives must proactively reassess the operation originally purchased. If the base insurance platform does not have such attributes, yet the bank is dedicated to insurance distribution, additional capital may need to be deployed in acquiring a true foundation agency that can drive future success.

Divesting the Insurance Operation

Bank executives and boards may decide to divest the insurance platform. If such a strategy is being employed, the bank should fully understand the potential market buyers and expected sales price, within their specific market.

Because soft market conditions are compressing organic growth, public brokers, bank-owned agencies and independents alike are in the market to buy. This demand side appetite has dictated continued aggressive sales pricing for insurance sellers. However, sophisticated financial buyers also recognize a declining asset and will price accordingly. Additionally, most buyers are not in the turn-around business. Remember, the foundation for buyer value and deal structure is rooted in past performance. Any synergies or leverage a buyer may bring to the operation is considered a buyer benefit and that benefit is not typically shared with the seller through increased compensation.

On average, divesting banks may realize anywhere from $.50 to $1.00 on the dollar when selling an underperforming insurance operation. Once the decision is made to sell, it is beneficial to make cosmetic changes include instituting proper staffing levels, which include terminating underperforming producers, non-essential staff, and consolidating offices. Depending on the size of the insurance platform, banks may need to scrutinize the cost-benefit analysis of selling immediately or making changes first.

Summary

While leading banks are committed to driving continued insurance growth, underperformers are starting to question the insurance investment. Bank-insurance executives need to understand bank goals for insurance, current performance and future direction before properly addressing strategic alternatives.

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