



TOOLS

To build agency revenue, profits and value

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Continuation of an
eight-part series on
Perpetuation Planning

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Producers - The Key to Perpetuation and Growth (Continued)

Developing your producer compensation plan

A key question to ask before developing a producer compensation plan is how do my "other" (non compensation) producer-related costs for the agency compare to those of other agencies? For example:

- Benefits costs (life, health, dental, short & long term disability insurance, 401k, etc.)
 - Most agencies spend between 7% and 10% of their net revenues for benefits.
- T&E expense and/or car allowance etc.
 - About 38% of all agencies require producers to pay their own T&E expenses; the rest reimburse producers for actual expenses or pay a monthly allowance. That allowance averages around \$200 for agencies with revenues under \$2 million.
- Sales Support costs
 - Most agencies with revenues under \$2 million do not offer extensive lead generation support (telemarketing, direct mail, appointment scheduling, etc.) for their producers.
- Vested ownership in producer's book, deferred compensation based on value of the producer's book, etc.
 - Only 28% of agencies with revenues below \$2 million give producers the opportunity to obtain some kind of equity.

If your agency's total "other" producer related costs are higher than those of most agencies, you probably cannot afford to also pay the most generous level of producer compensation without sacrificing agency profit.

Another key question to ask is how complex do I want my producer compensation plan to be? The plan that rewards all the desired behaviors might need so many different variables that it would be a nightmare to administer. We recommend that you develop a plan that everyone can understand and that can be easily administered.



Sample Producer Compensation Plan

Here is a sample plan that you can use or modify to fit the individual situation in your agency:

Line of Business	New	Renewal *
CL	45%	25%
PL	45%	15%
EB & Life	55%	35%
Any account transferred from another producer	N/A	15%

**Except for very small CL and EB accounts which earn 15% on renewal;*

Assumptions:

- The agency owns all of the business produced or serviced by the producer.
- Each agency defines “small” accounts for CL or Benefits at the revenue size level that they feel represents the size of accounts that can be serviced by CSRs with little or no involvement of the producer (after the initial sale).

The proposed commission percentages chosen for the sample plan are somewhat lower than the averages that producers countrywide are paid (as a percentage of the total books they handle) for producers that focus on one major business line. However, they are somewhat higher than the averages that producers countrywide are paid (as a percentage of the total books they handle) for multi-line producers. **Countrywide, the average percentages that agencies pay producers are: 38% for commercial lines producers; 34% for personal lines producers; 60% for life & benefits producers; 27% for multi line producers; and 16% for accounts transferred from another producer.**

If you feel that you need to pay more or less than the proposed levels, you can customize the proposed plan to fit your individual situation.

Transition Planning

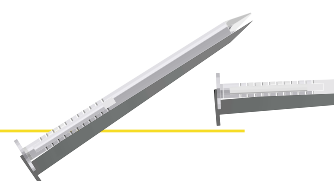
When putting in place a new producer compensation plan, a key issue is how to manage the transition from the existing plan to the desired one in a way that enables

retention of existing producers. Every situation is different, but the key is to soften any unfavorable impact so you do not lose your good producers. One way to do this is to grandfather the old compensation arrangement for long-time producers and to put the new plan in place for all experienced producers you newly hire. Another way is to put the new plan in place for existing producers but to give them a transition period (possibly two years) during which time you gradually move them from the current plan to the new one. This can be accomplished by placing them on a draw and guaranteeing them a certain minimum compensation level during each of the transition years.

Producers New to the Agency

The sample plan we have provided applies only to existing experienced producers. Producers who are new to the agency must be compensated differently for the initial months of their employment, to give them time to develop their books of business. After that time they should be placed on the new plan.

Most agencies pay their new producers a salary for the first three to six months and then switch to a draw against commissions. The draw typically ranges from around \$2,500 to \$3,500 per month. The draw continues as long as the producer is meeting the minimum production required in the validation schedule that they designed prior to employing the producer. Often, agencies forgive any shortfall developed between the draw taken and the commissions earned, as long as the producer is on target according to the validation schedule.



Good salespeople who are new to sales in the lines the agency sells or new to the industry itself typically take about 30 months to develop a book sufficient to support their compensation. For this reason it often makes sense to shift some “house” accounts to them to develop, thus helping them to shorten the ramp-up period. House accounts are typically accounts transferred from the owner, which give him or her more time to sell, or accounts transferred from a former producer who has left the agency.

Good experienced producers who are simply new to the agency typically take about 15 to 18 months to develop a book sufficient to support their compensation. Even with this latter group, it often makes sense to shift some “house” accounts to them to develop in order to shorten the ramp-up period

How to include a producer in your perpetuation plan

In an earlier issue on “Internal Perpetuation” we discussed the most commonly taken steps to transfer ownership to a producer. They are:

- Step 1:** Put some ownership in the hands of the key producer who is the perpetuation candidate.
- Step 2:** Engage in a shareholder agreement with that producer/ shareholder;
- Step 3:** Observe the performance of that minority shareholder/producer for a period of time;
- Step 4:** Sell the balance of the agency to that shareholder.

Step 1 is often easier to take if the producer is a family member or a loyal, long term employee. In such cases, the owner may want to immediately make the producer a minority shareholder by doing one of the following:

- Enable the producer to make a cash purchase of a minority interest in the agency, through a promissory note to the owner; or
- Grant a stock bonus or ownership bonus to the producer based on performance.

However, sometimes the owner wants to enable the producer to earn equity but would like to mentor the producer for a while longer before actually offering ownership. In such cases, the owner can take an interim

action prior to taking step 1 above. Interim actions that enable a producer to accumulate personal assets which in the future might be used to fund the purchase of a minority interest (but do not dilute the principal’s present ownership) include establishing arrangements such as:

- Vesting (providing the producer with up to a 50% vested interest in the equity value of the business he or she personally produced);
- Satellite corporations (creating a separate “paper” company owned 50% by the agency and 50% by the producer and having it own the producer’s personally produced business);
- Deferred compensation (wherein awards are earned based on the producer’s attainment of certain performance levels);
- Phantom stock (wherein units corresponding to shares in the agency, but not representing stock ownership, are earned based on the producer’s attainment of certain performance levels).

Enabling a key producer to accumulate personal assets in return for contributing to agency growth can motivate the producer and lead the way towards internal perpetuation.

Note: Countrywide data provided in this newsletter was obtained from various industry sources including Business Management Group’s most recent Owner, Executive and Producer Compensation Survey and IIABA’s Best Practices Study.

If you have questions, or would like to discuss your situation regarding perpetuation, please call your Iroquois Regional Manager.

Reminder - Iroquois practices neither law nor accounting and is not undertaking to provide any legal, accounting or tax advice herein. The following is intended solely for use by the Iroquois member agent as a guide for the member’s discussion with his or her attorney and financial advisors.

