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Bank Regulatory Law

Insurance Sales by Banks Purchasing an Insurance Agency

INTRODUCTION

Effective July 1, 1999, Florida repealed its anti-affiliation statute thereby permitting affiliations between banks and thrifts (collectively, "financial institutions").¹ At the same time, Florida enacted a law designed to avoid customer confusion, to protect customer information and to prevent the use of financial institutions over the purchase of insurance policies by their customers.² These new laws created uncertainties that previously barred or inhibited the sale of insurance products by financial institutions. Though federally chartered institutions, such as national banks, have the benefit of the repeal of the statute, they must still comply with federal law. For example, national banks must still maintain an insured deposit account of 5,000 or fewer persons.³

The profitability of insurance sales by banks is already well documented. In his presentation at a 1999 seminar on Insurance Sales by Banks, co-sponsored by the Florida Bankers Association and McCaffrey Owens, of the accounting and consulting firm of McGladrey & Pullen, reported that 70% of bank branches were profitable or very profitable, that increased bank profitability through insurance sales of 5% to 10% and that 77% of bankers will take the opportunity to sell insurance to loan customers⁴. Mr. Owen also stated that **year 2000, 15% of all bank revenues will come from insurance sales.**⁵ For Florida bank profitability, insurance sales offer a new, dramatic opportunity.

Several speakers at the 1999 FBA/M&R seminar recommended that banks seek entry into the insurance market by acquiring an existing insurance agency, rather than attempting to build their own agency from scratch. They emphasized the ease of entry through acquisition of a seasoned, operating agency which will have the knowledge of applicable insurance laws and regulations, a book of business, ready products, a long-term relationships with vendor insurance companies. While acquisition of an existing insurance agency offers these advantages, banks should proceed with caution before signing on the dotted line.

GETTING STARTED

Because of the variety of insurance products available as well as different potential sales arrangements, management needs to evaluate and identify the role of insurance sales in the bank's overall future strategy. At the FBA/M&R seminar on Insurance Sales by Banks, speaker John Pottridge, President and CEO of P

suggested that banks compile an Assessment Checklist. Questions to be addressed include whether the bank has analyzed its customer base to determine the type of insurance products its customers need, insurance products that work best with the bank's own products and services and insurance products its customers are likely to purchase through an insurance alliance.

Before embarking on an acquisition program or even speaking to a potential target, a bank should assemble a working team of key personnel and assign the team the responsibility of overseeing the project and making periodic reports on its progress. It is best to keep the working group small and prohibit the members from discussing the project with any other employees or others, except on a strict "need to know" basis.

The first task at hand for the internal working group should be to learn as much (and as quickly) as possible about the insurance industry. While there are some similarities between banking and insurance, the differences between the two industries are great. Equally important, the working group needs to understand the factors that make an insurance agency profitable and well run and the factors that predict a poorly performing agency.

Much of the insurance industry is made up of small, independent agencies with a strong sales culture. The owners who own and run these agencies are not accustomed to the highly regulated nature of the bank industry. The working group recognizes that, in all likelihood, any potential target will have a corporate culture very different from that of the bank and, as such, the working group needs to be prepared to accommodate this difference if it is to succeed.

The bank should identify and retain outside professionals to the extent needed to complement the internal team. Among possible outside professionals to be considered are lawyers, accountants, a valuation expert, and a business broker.

PRELIMINARY AGREEMENTS AND DUE DILIGENCE REVIEW

As in any acquisition, whether of another financial institution or of an insurance agency, an acquisition agreement is recommended. Recommended procedures for the acquisition, beginning with a confidentiality agreement between the bank and the target, are as follows. If desirable, the parties should execute a letter of intent, identifying those provisions of the letter of intent that will be binding and those provisions that will not be binding. In the instance of an insurance agency, a letter of intent is helpful in carefully identifying the scope of the acquisition, i.e. is it a stock purchase or is it the purchase of assets, what assets are to be included. If possible, the letter of intent should also include language that prohibits the agency from negotiating with other possible purchasers (*i.e.*, from "shopping" the offer) while negotiations are ongoing. www.moneylaw.com, the web site of McCaffrey & Raimi, contains detailed discussions on confidentiality agreements and letters of intent.

According to a number of people in the insurance industry, as well as bankers in the know, many insurance agencies expect much for insurance agencies. Whether this is true or not, there may be an expectation on the part of the insurance agency that, when dealing with a bank, it will be offered an unrealistically high purchase price. Caution is advised with such expectations is to conduct an effective due diligence review of the agency to identify its strengths and weaknesses, including determining the agency's historic levels of income. Due diligence reviews should be conducted by a combination of the internal team, the lawyers and the accountants.

In his presentation at the FBA/M&R seminar, Paul Allen, of the accounting firm of Hacker, Johnson & Associates, mentioned a number of key items to be examined in the due diligence review, including determining the agency's structure and the agency's true financial condition. Other items to be reviewed are the agency's assets, carriers, customer relationships, personnel, and equipment. Because the sale of insurance is regulated by the state insurance commissioner, the public records of the commissioner should be consulted for any necessary information.

due diligence review should seek to determine if any fraud has been committed, such as the creation of policies.

Armed with the results of the due diligence review, a valuation of the agency's worth should be determined. In the valuation, the bank should estimate the potential income to be earned through the agency and, the potential return on its investment.

ACQUISITION AGREEMENT

Normally the acquisition agreement will be drafted by lawyers. Included in the agreement should be set forth the nature of the acquisition contemplated, (*i.e.*, a stock purchase or a purchase of assets). The agreement should also set forth each party's representations and warranties, the terms for the sale of the agency business prior to the closing (*e.g.*, that the agency will be operated in the normal course of business and that extraordinary transactions will be entered into without the prior knowledge and consent of the bank). The contract is signed and the closing date) and conditions precedent to closing (*e.g.*, that no material adverse change will occur prior to the closing date). The normal agreement will also contain protections against breach or wrongful termination of the agreement.

Retaining key personnel of the insurance agency should be a priority and an acquiring bank should consider "golden handcuffs" such as stock options, incentive bonuses or separate employment agreements. The bank should consider different techniques for preserving and rewarding the sales culture of the insurance agency, which includes preserving the normal commission arrangements, even when it means that, in a good year, an insurance salesman may make more than the president of the bank. Also, consideration should be given to non-compete clauses for key insurance agency employees either in the takeover agreement or in separate agreements. If non-compete clauses are not included, key personnel will be free to leave the company and take their client base with them, thus leaving the takeover bank without the benefit of its bargain. More terms to be included in an acquisition agreement can be found at www.moneylaw.com/mergers.

CONCLUSION

In an interview reported on August 10, 1999 in the *Wall Street Journal*, Sanford I. Weill, chairman of Citigroup, the product of merger of Travelers and Citicorp, gave some tips on making a good deal. In response to the question "What advice would you give to all CEOs in every deal?", Mr. Weill said: "Assuming that the deal makes sense, the homework, and the financials, the strategy and concept made sense, I would tell him to treat the people in the other company with respect. ... I would tell the person he or she should make decisions slower. ... When you slow down the decision-making process, such as who's going to do what, they tend to end up leaving, and you end up with a lot of mediocre performers. ... And pray to God that you don't do so that you are not hounded by the press and forced to say something premature. Because deal done in a newspaper."

1. Fla. Stat. 626.988 (1974) repealed effective July 1, 1999.
2. See Cardwell, J. Thomas, Bank Sales of Insurance, Florida Banking, August 1999.
3. See Scope of Insurance Sale Activities by National Banks at www.moneylaw.com/articles, the Raimi.
4. Survey jointly sponsored by the American Bankers Association and the Independent Insurance Association of America, 1996.

5. A.M. Best Research, 1997.

6. Creating an insurance agency from scratch is a viable option as explained at the FBA/M&R seminar by Tom McGoffin, Executive Vice President, and David Mulder, Senior Vice President, of Riverside National Heatwole of Fidelity Insurance. This route into insurance sales may be more involved and more costly than outright acquisition of an existing insurance agency; nonetheless, this route may offer its own advantages and ability to shape and form the desired agency.

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