Make a long-term plan for your business

Jeff Botosan, executive vice president of HUB Financial Inc. and HUB Capital Inc., says he doesn't believe in the idea of there being a good or bad time to buy or sell a block of business. Instead, what advisors should do is invest some time in long-term planning.

"You have to have a long term plan for your business and gear your actions accordingly. I think now more than ever, with the instability in credit markets, you have to be more selective about where you're going to allocate your resources. Right now there are great opportunities out there, but there have never been a shortage of great opportunities," he said.

The current stock market environment also means that advisors with investment business have likely seen their clientele's assets decline significantly. If an advisor decides to sell during this market, they should look for a special arrangement with the seller that takes into consideration the longer term value of the investment block, he advises. "The market conditions we have experienced over the last two quarters have been nothing short of extraordinary. It would be unrealistic for a buyer to set a price based on what has occurred during the past six months."

Mutual needs

For a successful sale, buyers and sellers should make sure their mutual needs are met, he adds. "For this to be accomplished, each side should be willing to accept a degree of risk. I would suggest setting a component of the price based on the value generated after the sale has been finalized, perhaps one, or even two years down the road." (See also p.19 for more on the subject)

Are sales of business blocks slowing because advisors are hesitant to abandon their clients during a downturn?

Downturn or no downturn, Mr. Botosan says he has not seen much in the way of sales from advisor to advisor. Due to the aging of the advisor channel, HUB had previously anticipated that there would be a wave of such sales coming.


Jeff Botosan

About two years ago, to accommodate such sales, HUB set up a financing arrangement to facilitate transactions. There are some conditions that apply, relating to the percentage of the advisor's business done with HUB and the length of the relationship.

Since offering this financing arrangement, HUB has only investigated two financing opportunities, and completed one financing – far, far fewer than they were expecting. "Sales from advisor to advisor just aren't happening, or at least we are not seeing them," observes Mr. Botosan.

But he doesn't believe the current downturn accounts for the lack of advisor to advisor sales. It's simply that older advisors are not interested in selling. "I believe the majority of advisors are working into retirement."

Two camps

He sees these advisors falling into two camps. The first group are slowing down. "The advisors in this group are your average advisor. They enjoy what they do and make a decent living at it. They've slowed down as their residuals have built up (enough) to ensure that they can remain comfortable in retirement. They are still servicing their clients; they just aren't doing the prospecting that they had done earlier in their careers."

The second group of these aging advisors, however, are still prospecting and picking up the opportunities left by their

(Cont'd on page 18)

LEGEND FOR BUSINESS VALUE INDEX TABLES

↑$$$	Extremely valuable
↑$$	Valuable
↑$	Rather valuable
↓$	Less valuable
↓$$	Even less valuable
↓$$$	Far less valuable
☆	Factors to consider

VALUE ATTRIBUTED TO THE SIZE OF LIFE INSURANCE IN-FORCE (ACCORDING TO RENEWAL COMMISSIONS AND ECONOMIC VALUE)

Renewal commission factor	Size of in-force
5 X	In-force of $1 million and more
4 X	In-force between $500,000 and $999,999
3 X	Under $500,000

Source: Nessa Capital

COMPENSATION FROM LIFE INSURANCE CLIENTELE

↑$$$	Renewal commissions for policy life
↑$$$	High renewal commissions
↑$$$	Additional bonuses payable in future (retention, service, etc.)
↑$$	Commissions protected by contract with insurer
☆ Tip	Some firms assign a uniform base value to each client for which no renewal commission is payable (often $30 to $35 per client)
☆ Tip	When appraising the clientele, some companies take into account estimated gross revenue for the next few years and all take into account gross revenue produced by the clientele in the years preceding the sale

BASIC COMPONENTS FOR VALUATION OF LIFE INSURANCE BUSINESS

↑$$$	Duration of renewal commissions (see Compensation from life insurance clientele)
↑$$	Retention rate
↑$	In-force premiums (for premiums paid by the clients only)
☆ Tip	In-force size significance is related to the duration of renewal commissions left on policies in the business block, multiplied by the retention rate.

LIFE INSURANCE TRANSACTIONS

↑$$$ or ↓$	Seller offers temporary support to ease the transition. Sometimes works for the buyer.
↑$$$	Seller contacts all the clients, in writing or verbally, to inform them of the transaction and introduce them to the buyer
↑$$	Business concentrated with a small number of suppliers
↑$$	Program to ease the transfer, including financing for the buyer
↑$	Seller and buyer have same business and service philosophy
↑$	Seller incorporated: lighter tax burden and fewer potential legal problems
↓$$	Firm with no computer systems or administrative assistant
↓$$$	Seller has a bad reputation with the clients
↓$$$	Lingering debt, administrative charges and commission recalls

peers who are slowing down. This group is comprised of the "consummate sales person" explains Mr. Botosan. "They love their clients, being on the go… and most importantly the closing of the sale. Many in this group will continue to make sales until the day they die."

Working into retirement

But does the fact that many advisors are working into retirement resolve the industry's problem of lack of recruitment? "No, the concern is still there. Age and mortality eventually catch up with all of us."

One of Mr. Botosan's responsibilities at HUB is to oversee acquisitions. Part of this role involves transferring advisors' business blocks from one managing general agency to another for life business (including segregated funds), or one investment dealer to another. On the life side, he has seen an increase in these types of transfers in recent months, especially with larger transactions.

"Advisors see the value of having their business all in one place. As well, there is value that is inherent in permanence as carriers will continue to evaluate their relationships with their distribution partners and weed out those relationships that are not profitable for them in the long term."

With regard to mutual funds, advisors are less willing to change dealers due to the current stock market situation. Transferring a block of mutual fund business to a new dealer is more onerous than transferring a life insurance block. Mutual fund rules require an advisor to contact each client individually before changing dealers. "Due the transfer rules in place, advisors are less willing to change distributors during a downturn as it isn't something they want to go see their clients about. During these times, advisor efforts are better spent tending to their individual client needs."

Donna Glasgow

Erratum

In last month's edition, some important information concerning the Vital-Cheque product by GCI Insurance Services was inadvertently omitted from the group critical illness insurance comparative table. We apologize for the error. Below is the product as it should have appeared.

COMPANY	GCI INSURANCE SERVICES
Product name	VitalCheque
Available throughout Canada?	Yes
Group size ranges	10 employees & over
Coverage amounts for children / dependents	N/A
Coverage amounts for spouse	\$25,000 - \$100,000
Coverage amounts for employees	10 to 49 Lives = \$10,000 and \$50,000 (any amount between) 50 & over Lives = \$10,000 and \$100,000 (any amount between)
Continuance and conversion options	Guaranteed conversion to limited plan equal to face amount or \$25,000., whichever is less. Optional conversion of full plan for any amount from \$25,000. to \$100,000.
Compulsory or optional participation	Mandatory plan requires at least 90% participation of eligible employees. Optional plan requires a minimum of 5 lives or 100 lives if an association.
Covered Conditions	Cancer, Heart attack, Stroke, Alzheimer's disease, Blindness, Coma, Coronary artery bypass, Deafness, Kidney failure on dialysis, Major burns, Major organ transplant surgery, Multiple sclerosis, Paralysis, Parkinson's disease, Benign brain tumour, HIV infection (Occupational), Loss of limbs, Loss of speech, Major organ transplant surgery waiting list, Motor neuron disease, Aortic surgery, Heart valve replacement, Loss of independence, Specific cancers: colon stage A, chronic lymphocytic leukemia, Hodgkin's disease stage 1, invasive basal carcinoma, melanoma. Also: Aplastic Anemia.

LIFE INSURANCE PRODUCTS	
↑\$ ↑\$ ↑\$	Renewal commissions are high and of unlimited duration: disability insurance; health and accident insurance
↑\$ ↑\$ ↑\$	Segregated funds
↑\$ ↑\$	Convertible term with several conversion products
↑\$ ↑\$	Level cost universal life with high excess premium
↑\$	Whole life with redemption value that insured can withdraw without terminating the policy
↑\$	Product whose premium is paid monthly by pre-authorized bank withdrawals
↓\$ ↓\$	Whole life with little or unavailable redemption value
↓\$ ↓\$	Non-renewable term or exorbitant renewal premium
↓\$ ↓\$	Non-convertible term
↓\$ ↓\$ ↓\$	Book with large proportion of products whose renewal commissions will soon expire
↓\$ ↓\$ ↓\$	Yearly renewable cost of insurance universal life, minimum premium and high performance projections

LIFE INSURANCE CLIENTELE	
↑\$ ↑\$ ↑\$	Average age of clientele from 40s to early 50s (critical illness insurance niche)
↑\$ ↑\$ ↑\$	Advisors with computerized client files, which supply a complete detailed list of the clientele, along with targeted business opportunities
↑\$ ↑\$	Cross selling potential (e.g. buyer has a life clientele and the seller an investment funds clientele)
↑\$ ↑\$	Active seller with new clients in the book
↑\$ ↑\$	Targeted clientele (niche with potential growth, e.g. business owners)
↑\$	Clients demonstrated loyalty by buying more than one product from seller (good for retention rate but less good for future sales opportunities)
↑\$ or ↓\$	Clients dissatisfied with products (can harm retention ratio but can give the opportunity of meeting clients)
↓\$	Clients scattered across different regions
↓\$ ↓\$	Low income clientele
↓\$ ↓\$	Poor advisor-client relations
↓\$ ↓\$ ↓\$	Files in a mess, information generally incomplete
☆ Tip	Book containing several recent clients is worth more than a clientele to whom the advisor has not sold anything for a few years

OTHER FACTORS TO ANALYZE	
Quality database on client files	Ideal database contains complete financial and qualitative strategic information to help the buyer integrate and quickly serve the clientele acquired. Also easily transferable electronically.
Transaction framework	What are the company's environment, team and reputation? What are its clients' habits? What are its commercial partners and agreements? Will you keep the assistant, associates, brand name, etc.?
Complementary portfolio	The more the clientele is concentrated in a line of business, e.g. life insurance, the more attractive it is for a potential buyer concentrated in another line of business (e.g. mutual funds)
Clientele distribution	Is the clientele scattered?
Supply and demand	Do market conditions favour the buyer or seller? In which sector, region and market segment will the sale take place?
New business potential in coming years	Better potential development opportunities (future sales) of the clientele will attract a larger number of interested buyers, even from different networks and competing companies.
Quality of clientele	Average value per account not too high (especially with a small number of clients) or too low.

CLIENTELE DIVERSIFICATION	
↑\$ ↑\$	Diversified clientele segments (for better quality, avoid over-concentration in a given segment: diamond, platinum, gold, silver, bronze)
↑\$ ↑\$	Diversified business (more than one product per client account)
↑\$ ↑\$	Diversified sources of income in target portfolio (life insurance renewals, service commissions in mutual funds) PAC
↑\$ ↑\$	Diversified clients in different account value brackets (avoid over-concentration in small or large accounts)
↑\$ ↑\$	Diversified clients in terms of risk profile
↑\$ ↑\$	Diversified clients in terms of markets reached (families, corporate professionals etc.)

Recession puts red light on investment transactions

As the recession erodes the value of investment clienteles, buyer interest is fading. Investment products with guarantees are shining in this bleak environment.


Bob Labrecque

Several specialists confirm that the recession is slowing the pace of purchases and sales of books of business. Sellers are feeling the pinch. Investment fund assets are shrinking in these difficult markets, which reduces income from charges or fees. This lowers the value of the book even more. Several advisors that planned to sell may wait for the recovery first.

Bob Labrecque director of succession planning, Independent Advisor Channel, of **Manulife Financial** told *The Insurance Journal* he sees a slowdown in activity in the clientele transfer market. He thinks that declining assets have dampened enthusiasm for investment clienteles. “Sales of books will be down this year, that’s for sure,” he says.

Mr. Labrecque makes it clear he is not referring to the activities he supervises at Manulife. Rather, his prediction that transfers of books will slow in 2009 is based on his observations of the market in general.

Succession programs

As for Manulife, he says that he is spending more time building succession programs for advisors that plan to hire a junior associate, for example, or prepare an emergency plan in case of death or illness.

“It’s a good time to buy, but not as good to sell,” he says. For people that decide to sell anyway, Mr. Labrecque advises them to structure the transaction so that they can recoup the loss of value caused by the decline in assets.

For example, the seller can ensure that the price of the transaction reflects the average income the block of business has produced in the past two to three years.

Mr. Labrecque says he has seen a few sales in the market that factor in a future recovery. Such sellers can take advantage of a market upswing should it happen one year or 18 months after the transaction.

Generally, blocks of business in segregated funds gain value over time. Because of the guarantees, investors remain in the funds or opt for transfers within the same fund family. They then wait patiently for the markets to regain steam.

Mr. Labrecque says that the current plight of investment funds has serious implications for book transfers. He points out that the value of a block of business is based largely on investment products rather than life insurance products.

Disability insurance products are an exception: they should retain much of their value owing to the high renewal commissions they pay, over a generally longer duration than life insurance products.

Image is another factor stunting sales during the recession. “Many potential sellers are waiting six months, even a year, to act, because they do not want to give the impression that they are dropping their books when the going gets tough.”

Reassuring clients is crucial, he continues. Advisors must sit down with each client and discuss the reasons that their investment portfolio is 30% or even 40% lighter.

Alain Thériault

Do your due diligence when it comes to large policies

Large policies in a book may look and be enticing to a buyer, but do your due diligence, advises Jeff Botosan of HUB Financial and HUB Capital.

“Large policies are earning a lot of renewal commission, therefore there is more exposure.”

The exposure risk is that if the policy lapses or if the client decides to change advisors after the block is sold, then that high renewal commission will be lost. To illustrate this point, he gives the hypothetical scenario of one policy that earns $1000 a year in renewal commissions versus 1000 policies earning one dollar in commission. The group of smaller policies allows for more diversified risk and has less exposure.

He adds that, “It is nice to have large policies in a block, but the acquiring advisor should be aware of the risk and do the due diligence.” For example, check to see whether the client is likely to continue paying the premiums, or is likely to remain as a client after the sale. (DG)

BUYER STRUCTURE	
↑$ ↑$ ↑$	Firm (assistant, associates, systems etc.)
↑$ ↑$	Individual buyer with administrative assistant
↑$	Individual buyer

INVESTMENT PRODUCT CLIENTELE	
↑$ ↑$ ↑$	Average client contribution increasing
↑$ ↑$ ↑$	Book contains several long-time clients who also bought other types of financial products from you
↑$ ↑$ ↑$	Buyer able to analyze fund statements in detail
↑$ ↑$ ↑$	Elderly clients whose RRSPs are near maturity (opportunities of transferring into income products)
↑$ ↑$	In recent years, fund contributions exceed withdrawals
↑$ ↑$	Clients’ age points to good potential for future contributions
↓$ ↓$ ↓$	Clientele turnover rate reveals low business retention rate
↓$ ↓$ ↓$	Income available for investment low for a majority of clientele
↓$ ↓$ ↓$	Withdrawals exceeded deposits and no reason found in client files
↓$ ↓$ ↓$	Average contribution paid by clients to funds is decreasing
☆ Tip	Buyer must ensure that the “know your client” rule is applied to each client in the book bought

AVERAGE AGE OF INVESTMENT CLIENTELE	
↑$	Young
↑$	Average
↓$	Old

ASSETS UNDER MANAGEMENT – INVESTMENT PRODUCTS	
↑$ ↑$ ↑$	$40 million and up (2.0% to 3.0% of assets under management)
↑$ ↑$	About $20 M and up (1.5% to 2.0% of assets under management)
↑$	About $10 M (1% to 1.5% of assets under management)
↓$	About $1 M (less than 1.0%)

Note: The type of products is not that important if the asset volume is high because the buyer then has manoeuvring room to renew the portfolio