Managing Profit-Sharing Volatility for Independent Insurance Agents

Profit-share agreements with carriers are a potentially lucrative source of additional revenue for independent insurance agents. These agreements enable agents to earn more on their book of business based on the profitability of their book with the respective carriers.

The details of carriers' profit-sharing agreements vary, but include performance-based compensation incentives based in part on the yearly loss history of the agency's clients as well as the agency's year-over-year growth. Many carriers have minimum premium thresholds for these agreements, making it more difficult for smaller agents to participate in the profit-sharing plans.

Prior to 2020 the performance of carrier profit-sharing plans had been relatively steady, and agents with the scale to meet premium minimums on these plans could count on a meaningful boost in revenue as carriers distributed profit-share payments, usually in the first quarter of each year for prior year performance. Depending on the financial risk appetite of the agency principal, these funds could represent a meaningful source of working capital for the business, or at a minimum, represent a welcome windfall to kick off the new year.

A New Decade for Profit Sharing?

The past three years since 2020 have been a roller coaster ride for profit-sharing results to independent insurance agents, especially in the personal lines space. There has been an unprecedented boom/bust cycle in profit share, primarily driven by policies related to the COVID response.

In 2020, economic activity nearly came to a halt as business and school closures coupled with overall slowdown in the economy led to unprecedented low claims activity and loss ratios, especially in personal lines auto. Profit-share payments from carriers reached an all-time high, offering some cushion against lower premium growth across the P&C industry.

This trend continued into the early part of 2021, but by mid-year, economic activity took off with a vengeance – and by year's end, it seemed that COVID-related disruptions were in the rearview mirror. However, it wasn't quite that simple. 2022 developed into the perfect storm that extended well beyond changes in driving behavior during the pandemic.

While the final results are not all in, 2022 will go down as an extremely challenging year for the P&C business. Overall, personal lines markets are not performing well, while commercial lines markets are seeing mixed results depending on the line of business.

Several key factors are in play, including increases in loss costs; supply chain disruption; reinsurance rate increases of 10% to 30% or more; and carriers' inability to increase rates quickly enough, often in the face of a difficult regulatory environment.

Personal auto has been hurt by increased frequency and severity in losses, influenced by speed and distracted driving, higher costs for repairs, longer wait times at repair facilities, and an increase in litigation-related expenses. Much of that loss activity has been spurred by increased driving as the U.S. population returned to normal activity following the pandemic that significantly reduced driver miles in 2020 and 2021.

The property market is reeling from the destruction wrought by Hurricane Ian, which according to Munich Re has caused approximately $60 billion in insured losses. The Swiss Re Institute expects Ian to become the second-costliest insured loss on record, exceeded only by Hurricane Katrina in 2005.

Additionally, social inflation – the amount of costly jury-awarded verdicts against insurers, and the return of those proceedings to courtrooms as the pandemic has eased – continue to adversely affect carriers' results.

All lines, meanwhile, are subject to the one thing impacting everyone: economic inflation. Price increases have been notably high for goods and services that drive personal insurance claims. According to the Consumer Price Index, prices for motor vehicle parts and equipment increased 9.8% over 12 months in 2022.

In hindsight, weak profit-sharing results in 2022 will nearly offset the upside from 2020. For an independent insurance agent, this volatility is difficult to manage and creates an environment of uncertainty going forward. Is the storm over, or is this the new normal for profit-sharing results?

Consistency and Resources Help to Ensure Stability

Independent agencies truly looking to mitigate the effects of profit-sharing volatility know that performance-based compensation is just one part of the wider solution. There are multiple steps to be taken to establish financial stability independent of the fluctuations of the P&C market, the most important of which are continued revenue growth and disciplined expense management to create a solid foundation that can withstand the impact of profit-share volatility. This is easy to say, but hard to do in practice; joining a member network could be an attractive option.

As part of a network, you remove the barriers presented by carrier premium thresholds and expand the number of carriers with which you're eligible for profit sharing, thus reducing the volatility of payouts while benefiting from the higher compensation levels networks can often negotiate.

Independent agents have become increasingly aware of the bargaining power represented by networks. Of the 40,000 independent agencies in the U.S. estimated by the Big "I," 22,000 of them currently are members of agency networks, according to the Insurance Networks Alliance. Of the approximately $138 billion in premium controlled by networks and agencies, networks control $66 billion.

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However, you need to look beyond carrier contracts. These are table stakes for an agency network. A more impactful network relationship will enable you to grow your business by offering technology solutions, resources, and expertise to take you to the next level of agency management.

This includes assistance with billing and invoicing, to save time and money on administrative tasks; access to a wide range of carriers, which increases your options to serve clients; placement teams that work with you to secure coverage for commercial lines risks; specialists dedicated to growing your agency; vendor discounts on agency management systems; and user-friendly, intuitive technology tools that make your agency money.

Even in a challenging P&C landscape, independent agents have been and will continue to be the most critical members of the insurance value chain. The past three years have tested all business owners, and the typically stable insurance distribution space has not been immune. Although there is no reason to panic, those searching for an edge should look to leverage every possible resource available to help them succeed.

The Premier Insurance Network

With the collective strength of three of the largest and most successful agency networks in the country, the Renaissance network is built to deliver local support to help independent agencies build, grow, and optimize your business.

Supported by a differentiated suite of technology products and services, Renaissance drives organic, profitable revenue growth. Our members earn more revenue and grow up to four times faster than the average independent agency.

More than a network, we are your partner in providing your agency with reliable, consistent revenue through growth, efficiency, and market expansion.

With no entrance or exit fees, Renaissance is the partner to help maintain your independence.

Learn more at **renaissanceins.com/how-it-works**

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