Standards & Guidelines For Appraising Insurance Agencies / Brokerages

Sanctioned & Published

By

AMERICAN ASSOCIATION of INSURANCE MANAGEMENT CONSULTANTS

January, 2016

v.2.0

www.AAIMCo.com

Table of Contents

STANDARDS OF VALUE

APPRAISAL & INSURANCE TERMINOLOGY

Acknowledgements

Whenever a committee is formed to develop and draw a document, whether it is a Code of Ethics, revised Bylaws, or a Standards & Guidelines manual, the committee initially searches for and investigates what has already been accomplished along those lines by similar organizations. It is said that there is no point in reinventing the wheel.

Although much of the information included in this document is based on original data supplied by AAIMCo contributors, parts of the Guidelines are closely modeled after, and, in a few instances, may even reflect similar wording to, those guidelines and standards published by other reliable and respected sources, such as the American Society of Appraisers.

We thank these other professional organizations for the guidance provided in developing these Standards & Guidelines, and we especially thank all of our AAIMCo members who shared their opinions and information for inclusion in this document.

I especially would like to personally thank the following AAIMCo members (listed alphabetically) who have significantly contributed to the form, content and ongoing evolution of this manual. Compiling this manual would have been impossible without their input and suggestions:

Thomas M. Braniff
Greg Deimling
Al Diamond
Van Hedges
Jon Persky
Col. Roy L. Phillips
Bob Pryor

Al Diamond
Chairperson, Appraisal Standards and Guidelines Committee, 2016

Forward

Throughout this publication, whenever the word “”agent or “agency” is used, it is meant to include “brokers” or brokerages”.

Insurance agencies have their own unique business attributes. For appraisal purposes, these attributes do not “fit the mold” that is used by the business appraisal community in general. Part of the reason for this is that the major asset owned by an insurance agency is an intangible one that is unique to insurance agencies. In few other businesses can the owner create a salable asset using simply “a pen and a promise”.

It is a well-founded premise in the appraisal community that performing an appraisal for any kind of business is not an exact science and that being an appraiser involves using a significant amount of informed judgment. Because informed judgment plays an important role in the appraisal process, for an appraiser of any kind of business to provide a reasonably accurate opinion of the business’ value, the appraiser must be intimately familiar with the operations of that particular kind of business, as well as of the industry associated with the business.

Over the years the members of the American Association of Insurance Management Consultants (AAIMCo) have experienced -- primarily from those who are not intimately familiar with our industry -- many misconceptions about appraising insurance agencies. ***Therefore, one of the primary purposes of publishing these Standards & Guidelines is to establish consistent procedures that can be recognized formally and legally by the courts and higher authorities.***

The major appraisal societies and organizations (such as the American Society of Appraisers) certify appraisers as qualified to appraise particular categories of businesses. ***Unfortunately, no nationally recognized appraisal society or organization offers an accreditation or designation for appraising insurance agencies. It is because of that fact that the American Association of Insurance Management Consultants has resolved to issue its own Standards & Guidelines for Appraising Insurance Agencies / Brokers manual.***

About AAIMCo

The American Association of Insurance Management Consultants ("AAIMCo") was founded on November 3, 1978. At that time, there were a handful of practitioners in the United States and Canada who were providing consulting services to the insurance industry.

Few knew of the existence of the others, and each was developing his or her own techniques and methods of problem solving. There was no one with whom to share or exchange ideas, and no standards of performance, knowledge or education had been established. There were no ethical guidelines, and the insurance industry had no basis for making an intelligent choice when situations arose which required the services of a consultant.

Since its inception, AAIMCo has grown to include many disciplines and has developed a Code of Ethics to which all members must subscribe in writing. Members share ideas, learning from each other in the many areas of specialization which membership represents.
Members practice in more than thirty specialties and subspecialties, offering advice and providing solutions to the numerous problems that the industry faces today.

AAIMCo consultants must meet certain standards for membership. The minimum consulting experience required for membership is three years, although most members have well over a decade of experience. Members include CPCU's, CIC's, CLU's, AAI's, ARM's, CPA's, JD's, PhD's, MBA's, and those who have earned many other professional and educational distinctions.

AAIMCo's ONGOING MISSION

AAIMCo is dedicated to helping the insurance industry to operate more efficiently and profitably, thus enabling them to provide improved service to the insurance buying public.

Insurance companies, agents can call upon any of our members for advice and counsel with the certain knowledge that they will obtain expert help in solving their various management and other industry issues.

AAIMCo's PURPOSES & BENEFITS

- To serve as a medium for exchange of ideas through conferences, a newsletter & a web site
- To provide a referral service to members in other specialties or where a client is beyond the geographic area serviced by the referrer
- To set professional standards of service and performance
- To provide a Code of Ethical Behavior
- To provide membership with the opportunity for further education through conferences and seminars
- To promote AAIMCo to the industry so that agents, brokers and carriers can be made aware of the services we can provide
- To provide an atmosphere that encourages networking and joint work among the members
- To achieve national recognition as professional practitioners
- To provide the industry with a roster of our members from which they can find the consultant who can serve them best

Mission and Purpose of These Standards & Guidelines

MISSION

It is our mission to **establish and promulgate specific industry recommended standards and guidelines** to be used and applied when **performing, preparing** and **reporting** appraisals of

1) insurance agencies, brokerages or
2) of other entities whose primary function is the sale and/or servicing and/or administration of insurance policies and programs and/or
3) of insurance-related books of business. The establishment of standardized procedures and methods will promote consistency and enhances the appraisal process and increases the appraisals credibility and reliability of the information with clients, courts and other interested parties.

The American Association of Insurance Management Consultants is dedicated to being the source for the establishment of appraisal standards and guidelines used in the evaluation of insurance entities providing sales and services within the insurance industry.

PURPOSE

The purpose of these Standards & Guidelines is not to provide a step-by-step manual for performing an appraisal or calculating an opinion of value. It is assumed that the appraiser who subscribes to the AAIMCo Standards & Guidelines possesses significant experience in insurance agency appraisals, and will already be well versed in the mechanics of calculating an insurance agency's value.

The purpose of these Standards & Guidelines is to provide accepted an industry-standard for performing an appraisal or calculating the value of an insurance entity providing sales and services within the insurance industry.

Each appraiser will ultimately define how to perform an appraisal and how to report the findings. However, it benefits both the appraiser and the client when the appraiser follows established industry standards that have their foundation in those particular facts uniquely applicable to the insurance industry.

By establishing and publishing these Standards & Guidelines, it is AAIMCo's purpose . . .

- to increase the quality of appraisals performed by AAIMCo members and other appraisers of insurance entities, and
- to establish procedures, standards, guidelines and methodologies that recognize the need for reliable, consistent presentation of financial information, and
- To promote to promote the broad based acceptance by both private and public users of such critical information in economic transactions, compliance and dispute resolution, such as the courts, buyers and sellers of these firms, financial institutions, and State Insurance Departments.

Credibility of Data & Profile of Contributors

Much of the information and data for these Standards & Guidelines was contributed by AAIMCo members. To lend credence to the data published herein, a profile of contributors was initially compiled in May, 2011 and updated in 2015.

INSURANCE INDUSTRY EXPERIENCE	
Average years as a full-time consultant to the insurance industry	22 years
Average years associated with the insurance industry	42 years
"Have you owned an insurance agency?"	All answered "Yes"
APPRAISAL EXPERIENCE	
Average years of experience performing agency appraisals	23 years
Total number of insurance agency appraisals performed by contributors	10,000+ appraisals
EXPERT TESTIMONY ABOUT APPRAISALS	
"Have you testified regarding agency value based on an appraisal you have performed?"	All but 3 answered "Yes"

In addition, contributors hold a number of professional designations including insurance industry-specific professional designations, including Certified Public Accountant (CPA), Certified Insurance Counselor (CIC) and Chartered Property and Casualty Underwriter (CPCU).

Contributor experience ranges from ownership of insurance agencies, brokerages, insurance company experience on both staff and executive levels, producer experience, claims experience and much more. In addition to past industry experience, present insurance consulting assignments include dealing in the sale, merger, acquisition and dissolution of insurance agencies.

General Preamble

1. The American Association of Insurance Management Consultants (“AAIMCo”) has adopted these Standards and Guidelines for Appraising Insurance Agencies/ Brokers (“Standards”).

2. These Standards should be followed, to the extent possible, by AAIMCo members who perform appraisals for the insurance industry.

3. These Standards provide general criteria for appraising insurance agencies.

4. These Standards are published for the purpose of promoting uniform, recognized practices and procedures for appraising insurance agencies.

5. If the appraiser departs from these general Standards, such departures should be disclosed and explained in the appraisal report.

6. These Standards are published to provide guidance to AAIMCo members who perform appraisals. Deviations from these Standards are not intended to form the basis of any civil liability and should not create any presumption or evidence that a legal duty has been breached. These Standards are offered for general information purposes, and are not intended to provide specific advice about individual legal, business or other matters. It has been prepared as a guide to assist professionals in the evaluation and appraisal of insurance agencies and / or their books of business.

Assignment Definition

Before an agency appraiser can begin an appraisal, it is incumbent on the appraiser to define the assignment by identifying the following elements. The elements below represent the most commonly used elements for an agency or book of business appraisal:

- The effective date of the appraisal

- The purpose for the appraisal
  - Sale
  - Merger
  - Acquisition
  - Divorce
  - ESOP
  - Loan
  - Estate Planning
  - Involuntary Conversion
  - Agency Perpetuation
  - Stockholder Valuation
  - Stock redemption or stock purchase
  - Business Dispute
  - Other purpose

- The standard of value to be used
  - Fair Market
  - Going Concern

- The asset to be valued
  - Book of Business
  - Business Entity (including the book of business)

- The scope of the assignment
  - Full appraisal, based on all relevant information and data
  - Limited appraisal, based on limited relevant information and data

Data and Information Sources

The appraiser needs to collect various types of data and information to perform an appraisal. The appraiser should consider the appraisal purpose and knowledge of the appraisal situation to determine the combination of the data sources below that are relevant for a particular appraisal. Some items below are more pertinent to the actual valuation calculations, while others may relate more to the use of informed judgment by the appraiser.

- Income and expense data (minimum of three years)
- Balance sheet data
- Production data for all types of commissions
- List of all employees by job classification
- Compensation history
- Other income data
- Contingency (company bonus and profit sharing) data
- Loss ratios (Carrier Production/Loss Documents) for at least three years
- Producer ownership, vesting and options
- Ownership options issued to others in the agency
- Errors and omissions information
- Errors and omissions prevention practices
- Errors & Omissions History (at least five years)
- Catastrophic loss data
- Producer or associate contracts, including non-piracy and noncompetition clauses
- Contracts with carriers
- Automation information
- Data about producers and employees
- Management information
- Marketing information
- Advertising information
- Basic client demographics
- Office location information
- Specialty and niche market information
- Agency competition
- Community involvement of the principals and producers
- Web site exposure
- Money management practices of the agency
- Relationships with insurance carriers
- Large (target) account data and information
- Agency, producer and employee licensing data
- Agency insurance and risk management information
- Background and historical information about the agency and its principals
- Tax, legal and disciplinary actions
- Other documents, data and information relating to the agency's particular situation or status
- The purpose of the appraisal

Methods for Appraising Books of Business

There are several methods an appraiser may choose in appraising a business. However, not every method applies to every kind of business.

The following methods are deemed by the experienced contributors to these Standards to be the most appropriate when appraising an agency or a books of business.

No two agencies are identical. Therefore, no particular appraisal method is "most appropriate" for every situation. Consequently, *the Appraisal Methods below are listed in alphabetical order.* Some of the methods may be known by other names.

The appraiser should select and apply appropriate Appraisal Methods and procedures based on the purpose and scope of the assignment.

THE FIVE MOST COMMONLY USED APPRAISAL METHODS (alphabetical order)

- Buy/Sell Agreement -- defined formula
- Capitalization of Earnings
- Discounted Future Earnings
- Multiple of Pre-Tax Earnings
- Prior Stock Sales (or comparables when available)

ADDITIONAL APPRAISAL METHODS THAT ARE SOMETIMES USED (alphabetical order)

- Potentials (for future earnings)
- Price/Earnings
- Retention Basis
- Wasting Asset

USE OF MORE THAN ONE METHOD

Only under very limited circumstances should an appraiser utilize only one method for appraising a book of business. Should this become the case, a well-documented explanation should be included in the appraisal report.

When using more than one method to value a book of business, each method should be weighed against the others for appropriateness to the agency situation and circumstances.

A NOTE ABOUT THE “MULTIPLE OF COMMISSIONS” RULE OF THUMB

For decades it has been a common practice among insurance agents to express the perceived value of their agencies or books of business in terms of a “Multiple of Commissions”. (Example: An agent may feel that the agency or book of business is worth “1.5 times” the commissions that are written by the agency.)

The Multiple of Commissions is not an appropriate method for placing values on agencies. It gives no consideration whatsoever to the adjusted profits and cash flow of the agency. For instance, if two agencies each have $500,000 in commissions, but Agency A has $100,000 of profits and Agency B has $200,000 of profits, using the Multiple of Commissions method, both agencies would have the same value. Of course, simple logic and common sense dictate that Agency B would always be worth more to a buyer because it generates greater profit.

Even though the Multiple of Commissions rule of thumb is widely used in general discussions regarding agency values, that does not make it a correct measure of value. Knowledgeable appraisers of agencies agree that the best method of valuation is based on adjusted earnings and cash flow. The use of Multiples of Commissions should never be used in formal appraisals.

Valuation of Contingencies, Profit-Sharing and Growth & Retention Bonuses

LOOKBACK PERIOD

Although it is normally less certain that Contingencies will be received than policy renewal commissions, in many instances, over time, they do develop a realistic, appraisable income stream.

It is the general consensus among contributors that Contingencies . . .

- Should be considered when appraising the agency's income stream.
- Have value if they have been received consistently for a period of several years.

VALUATION FACTORS

Because the income stream from Contingencies is less reliable than the receipt of policy renewal commissions, contributors consistently stated that the appraisal of Contingencies should consider the following factors:

- Consistency of receipt of the commissions over the past three to five years
- Deviation from the mean Contingency received during the look back period
- Trend of the Contingencies received
- Knowledge of future changes to the existing book of business as well as changes to carrier contingency calculation formulas.
- Application of an informed judgment discount factor that addresses the reliability of this adjusted income stream.
- Consideration of a) changes to contingency contracts and their effect on future contingency potentials, and b) volume trends with the carrier as they would affect contingencies (i.e. growth into higher contingency levels).

Computing an average of the ratio of Contingency Income received by an agency in one year compared to property and casualty insurance commissions earned in the prior year, and then repeating this calculation over a period of five to ten years, will assist the appraiser in determining the potential trends in Contingency Income for future years.

Balance Sheet Valuation

BALANCE SHEET VALUE

Many insurance agencies have two components of value, the value of their books of business and the value of their Tangible Net Worth ("TNW").

TNW (also called Hard Net Worth) is calculated by taking the value of the agency's total assets and subtracting the value of intangible assets and total liabilities (excluding those liabilities associated with the acquisition of a book of business). It identifies the value of an agency's net worth (retained earnings, plus additional paid in capital) less its intangible assets (Treasury stock, notes or advances to Officers that are not expected to be repaid), and renewals and expirations (net of any debt associated with the renewals and expirations). Most insurance agency's TNW defines the money invested in the agency since its inception plus its accumulated retained earnings.

Many insurance agencies have little or no TNW because they invest little in the start-up of the business and use all available funds every year toward expenses and owner's income.

It is possible for agencies to have a negative TNW, whether through normal business procedures like repurchasing stock into Treasury Stock or through mismanagement of agency assets. A negative TNW would affect agency value in a stock transfer. Agencies that are fiscally conservative may have substantial and growing TNW as reserves available to invest in the growth of their business.

Appraisers should include TNW, as well as the value of the book of business in the calculation of the value of any insurance agency entity.

Valuation of Wholesale Brokerages, General Agents and Managing General Agents

Wholesale Brokerages, General Agents and Managing General Agencies occupy a unique and valued position in the insurance industry. These intermediaries place business for Retail Agents with a variety of standard or excess and surplus lines carriers, based on specific underwriting of unusual or target market accounts.

The valuation of Wholesale Brokerages, General Agencies or Managing General Agencies should be treated like the value of any cash-flow related business that does not "own" its client base. The primary value of these entities lies in their carrier relationships, the continuity and expertise of their underwriting managers and the continuity and relationship with the retailers who they serve as their clientele, and should be based on the earnings and cash flow potential of these entities for the client for whom the appraiser is valuing the business entity.

Rates, Ranges, Discounts and Premiums

CAPITALIZATION RATES

Various appraisal methods require the use of capitalization rates. These rates relate to alternative uses of an owner's or buyer's capital. They also relate to the risk of owning the agency.

It is the consensus of the contributors to this document that the following rate ranges and data are applicable to the appraisal of insurance agencies.

RISK FREE RATE SOURCES

It is the consensus of respondents that the risk free rate should be based on low risk securities. Some acceptable securities may include:

- High quality corporate securities
- Treasury notes
- Treasury constant maturities

INHERENT RISK RATE

Quality of Agency or Book of Business	**Average Inherent Risk Rate**
Below Average Agency or Book	13% - 23%
Average Agency or Book	10% - 14%
Above Average Agency or Book	5% - 10%

The above numbers reflect calculated averages of ranges supplied by respondents. Ranges supplied by respondents, as well as informed judgment, allow for deviation outside these average ranges.

The experienced appraiser will determine the Inherent Risk Rate of an agency based on a multitude of specific risk conditions, both positive (adding value) and negative (lowering value) that will be specific to the agency in question. The averages above are not meant to confine an agency into only one of three risk groups.

Inherent Risk Rate and Risk Free Rates are to be added together to achieve the common Risk Discount Rate for and agency.

USE OF MULTIPLES

Over many generations, agents have been prone to using multiples (of revenue, of earnings, of EBITDA, of commissions, etc.) to express their agency's value. However, it is not appropriate to assume one agency's / broker's multiple, without proper adjustments, applies to any other agency.

It is important to note that one of the first steps in beginning to value an agency is to create Proforma Pre-Tax Earnings based on known changes that will result from the activity that necessitates the valuation. This compilation is generally known as a Pro forma Income Statement. The basis of value against which premiums or discounts are applied (see section on Premium and Discounts) is, in fact, the total earnings potential for the number of years that the appraiser is willing to give up the agency's earnings potential to the seller or financier in order to purchase the agency. In most cases, we have found that this is from three to seven years. However, every person valuing an agency has a different need or assumed expectations of earnings. That is why the same agency might be valued be worth different amounts to different buyers.

NON-PIRACY / NON-COMPETITION AGREEMENTS

A well written agreement between an agency and its employees and independent contractors (including producers) results in a stronger and more defined relationship for all concerned. Such a written agreement regarding their conduct in the event of termination of the relationship increases the value of the agency, and the lack thereof tends to diminish an agency's potential value.

Non-Piracy / Non-Competition agreements can range from providing that the agency owns all business, to the producer owning all business he/she develops, to each party having a percentage ownership in business generated by the producer. If no agreement is in place that addresses the ownership of client relationships, and the duration of time for which parties may solicit and accept business from the clients in question, the parties ownership rights are questionable, which can seriously affect the value of an agency.

PREMIUMS AND DISCOUNTS

A discount or premium quantifies an adjustment to account for differences in characteristics affecting the value of the asset being valued, whether it is the agency or a book of business.

PREMIUMS

Premiums may be applied to the value of an agency or a book of business by the appraiser for . . .

- Extraordinary agency location
- Extraordinary company representation or benefit
- Extraordinary producers
- Other extraordinary talent in the agency
- Niche or specialty markets developed or written by the agency
- Other factors that may enhance the value of an agency or book of business to others

The appraiser must use informed judgment when determining the premium to apply.

DISCOUNTS

A number of factors can affect the discounts that an appraiser may apply in a particular situation. The ranges shown below are provided for guidance only and were compiled from data supplied by contributors to these Standards and Guidelines.

Deviation above or below the guideline ranges may be acceptable and appropriate, and for any given situation the discount may be as high as 100% or as low as 0%.

Discount Situation	Discount Rate Range
Minority interest	10% - 50%
Reduced salability	20% - 50%
Personal goodwill (divorce)	10% - 35%
Professional goodwill (commercial)	10%-50%
Death of owner -- highly active in production & management	15% - 35%
Death of owner -- somewhat active in production & management	15% - 25%
Death of owner -- not active in production or management	0% - 15%
Death of owner -- high community involvement & visibility	10% - 35%
Unwillingness for seller to sign non-piracy or non-compete agreement	50% - 100%
Lack of non-piracy agreement for a producer or key person	10% - 50%

The base value to which premiums or discounts are applied should be stated in the appraisal report.

Appraisal Report Format

WRITTEN REPORT IS REQUIRED

Although an oral report may be provided to the appraiser's client, the appraiser should also issue a written report to the client.

CONFIDENTIALITY

Only the client should receive copies of the appraisal report. When the appraiser knows that others will receive a copy of the appraisal report, these copies should be provided to the client for distribution.

CONTENT OF THE APPRAISAL REPORT

The appraisal report should, at a minimum, include the following sections or data:

(a) DEFINITION OF THE ASSIGNMENT

The following information should be defined:

- The business interest and the assets being valued
- The purpose and use of the valuation
- The standard of value used in the valuation
- The effective date and report date
- The name of the person or entity that hired the appraiser

(b) AGENCY DESCRIPTION

The description should include relevant factual areas, such as:

- The form of the agency's organization (corporation, partnership, sole proprietorship, etc.)
- The agency's history
- The evolution of the agency's ownership
- The types of policies written and services provided
- The markets and customer demographics
- Management information
- Sources of information used

(c) DATA USED FOR ARRIVING AT THE OPINION OF VALUE

The appraiser should include a listing of the types of data relied on for arriving at the opinion of value.

(d) VALUATION METHODOLOGY AND THE APPRAISER'S OPINION OF VALUE

The appraiser should include the following valuation method information:

- The appraisal methods used
- Why the selected methods were used
- A summary of the results yielded by the methods used
- How each method was weighted in comparison to the other methods utilized
- Explanations for any discounts and premiums that were applied
- Explanations for any actions the appraiser took that deviate from the norm
- Assumptions and limiting conditions made by the appraiser

(e) CERTIFICATION BY APPRAISER

The appraiser should include a certification that states, at a minimum, that . . .

- The appraiser has no interest in the asset being appraised, or any other conflict that could cause a question as to the appraiser's independence or objectivity; or, if such an interest or conflict exists, it must be disclosed.

- Where appropriate, the appraiser relied on data supplied by others, without further verification by the appraiser;

- The valuation is valid only for the valuation date indicated and for the purpose stated. The certification must be signed by the appraiser.

(f) QUALIFICATIONS OF THE APPRAISER

The report should include the appraiser's qualifications.

(g) EXHIBITS

Because every appraisal is unique, the appraiser should choose appropriate exhibits to include in the appraisal report.

Retention of Documentation

The appraisers should take care to . . .

- Document all relevant facts and calculations relied on for performing the appraisal.

- Retain all documents and work product relevant to the appraisal.

Standards of Value

Purpose of Appraisal	Standard of Value
Sale or Acquisition	FMV
Merger	FMV
Dissolution	FMV
Buy/Sell Agreement	FMV or Going Concern
Divorce	FMV (if for an agency sale) Going Concern (if agency is to be retained)
Estate	FMV*
Tax Matters	FMV*
ESOP	Going Concern
Loan	Going Concern
Minority Interest	FMV

*Per Revenue Ruling 59-60

Appraisal & Insurance Terminology

Those outside the appraisal community who are not intimately familiar with insurance and appraisal terminology will find certain often misunderstood or incorrectly used words and phrases defined below, with comments that are applicable. Although sometimes slightly modified, some of the definitions have their basis in definitions adopted by the Business Valuation Committee of the American Society of Appraisers (indicated by “ASA” below).

APPRAISAL TERMINOLOGY

Adjusted Gross Income (AGI) -- Gross Income includes ALL forms of income for an agency. However, one form of income, (a negative to income) Commission Expense, refers to commissions paid to the producing agent who owns or controls a client or account. This leaves only those commissions that are owned and controlled by the agency, and the net commissions retained by the agency on non-owned business placed with the agency. AGI refers to the Gross Income of the agency, less the Commission Expense paid out on non-owned insurance clients.

Adjusted Net Income -- For certain appraisal methods, it is necessary for an appraiser to adjust the financial statements of the agency to reflect only those revenue and expense sources that relate specifically to the operations of the agency and the production of income. As an example, if the agency is expensing three automobiles and two are used solely for personal use by family members of one of the owners, the expenses associated with the personal use autos should be expunged. An appraiser’s adjustments may often result in an adjusted net income amount that is greater than the business’ taxable net income.

Appraisal or Valuation vs. Evaluation (ASA) -- This is the act or process of determining value. Appraisal is synonymous with Valuation. Often this act or process is incorrectly referred to as an “evaluation”, which more appropriately refers to the examination of data.

Appraiser (ASA) -- This is a person who is qualified by education, training or experience to perform an appraisal of a business and/or its intangible assets. This is a commonly used term in the appraisal community and one with which most people can relate. It is preferable to “evaluator”, “valuer”, “valuator” or other terms.

Appraised Value (ASA) -- The appraiser’s opinion or determination of value.

Capitalization Rate - A factor used to convert a defined stream of income to a present indicated value.

Discount Rate – A rate of return used to convert a series of future income amounts into their present value.

EBITDA -- This is an acronym for “Earnings Before Interest, Taxes, Depreciation and Amortization”. Appraisers may adjust financial statements to exclude these elements in order to more realistically represent the cash flow to a buyer before payment of income taxes.

Fair Market Value (ASA) -- The amount at which property would change hands between a willing seller and a willing buyer at arm's length in an open and unrestricted market when neither is acting under compulsion and when both have reasonable knowledge of all relevant facts.

Going Concern Value (ASA) -- (1) The value of an enterprise, or an interest therein, as a going concern that is expected to continue to operate into the future. (2) Intangible elements of value in a business enterprise resulting from factors such as having a trained workforce, an operational plant, and the necessary licenses, systems and procedures in place.

Going Concern Value is the Value of an agency under continued current ownership and / or management with no (or only limited known) changes taking place. A Going Concern Value is appropriate for estate planning purposes and for some divorce or business dispute valuations in which the agency is expected to continue to operate in a fashion similar to its current and recent performance and operation.

Goodwill -- The intangible advantage or benefits enjoyed by a company beyond the mere value of the capital stock, funds or property employed therein, resulting in the general patronage and encouragement which it receives from constant and habitual customers on account of its local position, reputation, skill or influence.

(a) **Enterprise / Commercial Goodwill** -- An intangible asset arising as a result of name identity, reputation, customer loyalty, location, products, services, and similar factors; which exists independent of any individual owner or employee.

(b) **Personal / Professional Goodwill** -- An intangible asset which attaches to the person or professional as a result of confidence in his/her skill and ability; which would likely be extinguished in the event of the person's death, retirement or disability.

Inherent Risk Rate – The expected industry specific risk premium which must be added to the Risk Free Rate in order to develop the applicable Discount Rate.

Net Income vs. Income (ASA) -- Often confused, "net income" refers to monetary receipts less expenses, including taxes. "Income" refers to monetary receipts without regard to expenses and taxes.

Net Operating Income -- Operating Income, less Commission Expense for ceded commissions and / or fees to other agents or producers who own the Expiration Rights associated with clients that are placed through the agency being valued.

Operating Income-- Generally, income generated directly from client revenues, including commission income (both direct billed and agency billed) and fee income.

Pro forma Income Statement -- An income and expense statement that is purified of non-recurring income or expenses, and altered for changes to income and expenses as the result of known or projected changes, with the assumed modifications documented as appropriate to the circumstances of the valuation.

Risk Free Rate – The rate of return available in the market on an investment free of default risk.

INSURANCE TERMINOLOGY

Big I and PIA -- The two largest national associations of insurance agents in the United States are the Independent Insurance Agents and Brokers of America (IIABA, also known as the “Big I” because of its logo), and the Professional Insurance Agents of America (“PIA”). Each association acts as the umbrella association for its affiliated state and local associations.

Book of Business -- Unless otherwise categorized, this phrase generally refers to all of the policies written by an agency. Book of Business may also refer to a subset of policies written by an agency, often classified by an insurance company’s name (e.g., “the Hartford book of business”), by line (e.g., “the commercial lines book of business”) or by class (e.g., “the automobile book of business”).

Book of Business Value vs. Agency Value -- When an appraisal of an insurance agency is performed, it can be calculated for either a "Book of Business” or for the “Agency”.

When an appraiser has been engaged by a client to perform an appraisal, the appraiser often appraises only the intangible asset referred to as a Book of Business (i.e. the income stream received from the commissions related to customers that make up the “book of business”).

On the other hand, if an appraiser is hired to appraise “the Agency”, this generally refers to the determination of the entire value of the business enterprise, which includes intangible assets (e.g., the policies written by the agency), tangible assets (such as furniture, fixtures and equipment) and real assets (such as cash and receivables, buildings and land).

Unless the appraiser is qualified, the balance sheet value of tangible and real assets should be based on CPA prepared balance sheets whenever possible or on a valuation of these assets by an appraiser who is experienced and qualified to do so.

Commissions vs. Revenue & Income -- Commissions are paid by insurance companies to insurance agencies for the sale of policies. The terms “revenue” and “income” refer to all commissions, fees and contingency income (i.e., bonuses and profit sharing paid by insurance companies) plus all other monetary receipts of the agency or brokerage being appraised. Other monetary receipts may include interest income, sale of assets, risk management income and fee income(from customer fees as well as from administrative fees (like late fees), among other things. Commissions will equal revenues or income only when there are no other sources of income.

Commission Expense -- The commissions ceded back to producers of an agency who own the Expiration Rights associated with the clients that are placed through the agency being valued. The clients included in this category may not be “sold” by the agency being valued, since those clients are not legitimately owned or controlled by the agency being valued. Commission Expense also includes the commissions ceded back to brokers who own their clients and place them through the host agency. The balance of the commissions retained by the agency are justifiable operating income as servicing and administrative revenues for managing accounts placed through the agency.

Company vs. Carrier -- These are interchangeable words that generally refer to the companies that issue policies to the public and others. Examples of well-known carriers include Allstate, State Farm and Hartford.

Company or Carrier vs. Agency -- An agency is a business that represents one or more insurance carriers. Consumers and businesses normally purchase policies directly from agencies, and agencies represent the carriers that issue the policies. Agencies often also service the policies issued by carriers, acting as a liaison between the consumer and the carrier.

Contingency and Profit-Sharing Income -- Contingency income refers to special bonuses that agencies receive from insurance carriers. These may also be referred to as company profit-sharing bonuses. The calculation of contingency amounts is normally based on (1) how profitable the agency is for a carrier, or (2) production growth, or (3) retention of policies, or (4) a combination of these factors during a defined calculation period, usually a calendar year.

Direct Writer System -- A system of marketing insurance through employees of the insurance company that only market products of that company. The direct writer insurance company retains ownership, use and control of policy records and expirations rights.

Employee Benefits Business -- Programs or plans that employers provide to their employees, that usually are paid for or partially paid for by the employer, which generally include health, life and disability insurance, as well as other related products.

Employment / Independent Contractor Agreement – A written agreement setting forth the rights and duties between an agency and its employee or independent contractor representative, which often includes non-piracy (or non-solicitation),or non-competition provisions.

Exclusive / Captive Agency System -- An insurance distribution system through independent contractor agents that represent only one company or a group of companies under similar management. The insurance company retains ownership, use and control of policy records and expirations rights.

Expirations / Expiration Rights -- "'Expirations' or 'book of business' refers to the policies or copies of policies which include the name and address of the insured, a description of the article insured, expiration date of the policy, premium, and all other information necessary to execute an insurance contract. Such information is of vital assistance to the agency in carrying on the insurance business and is recognized as a valuable asset in the nature of goodwill." *From "Couch on Insurance."*

Fees -- Includes revenue generated from services provided to clients in addition to or in lieu of commissions paid by insurance companies. Fees are a form of Operating Income (like Commissions), as distinguished from Contingency Income. Fees include, but are not limited to, Risk Management Fees, Policy Fees, Service Fees and even Premium Financing Charges.

Independent Agency System – A system of marketing insurance through independent contractors (agents / brokers) who sell insurance on a commission or fee basis with one or more insurers. An independent agent retains ownership, use and control of policy records as well as Expiration Rights associated with business; and is free to move customers from company to company.

Independent Agency vs. Exclusive / Captive Agency -- An independent agent has the freedom and choice to represent more than one carrier, if the agent so chooses. A captive or exclusive agent, on the other hand, is bound contractually by the carrier it represents to represent that carrier exclusively.

Insurance Agent / Agency -- A person or organization that solicits, negotiates, or instigates insurance contracts on behalf of an insurer. Agents are generally legal representatives of insurers, rather than policyholders, with the right to perform certain acts on behalf of the insurers they represent.

Insurance Broker -- In the United States, a broker is an insurance intermediary that represents the insured rather than the insurance company. They often do not have the authority to act on behalf of insurers. While some brokers do have agency contracts with some insurers, brokers usually remain obligated to represent the interests of the insureds rather than insurers. In Canada, and many foreign countries the term “broker” and “agent” have no difference in meaning.

Loss Ratio -- Carriers judge the profitability of the book of business written by an agency by examining the book’s loss ratio. Although a loss ratio may be calculated using various elements, in its simplest form a loss ratio represents the dollar amount of losses paid by the carrier divided by the dollar amount of premiums written by an agency, all during a specified period of time. Loss ratios are expressed as a percentage. For example, if there are $250,000 of losses for policies that generate $500,000 of premiums, the loss ratio would be expressed as being 50%. Among other elements often included in the loss ratio calculation are “loss adjustment expense” and “reserves” assigned to claim that have not been settled

Non-Competition Covenant -- A provision in a written agreement which seeks to prevent an employee or independent contractor from competing in the same business in a specific geographic area during the term of employment, and for a limited period of time after termination of employment. Certain states require that a Non-Competition Covenant be restricted to a specific geographic area.

Non-Piracy Covenant -- A limited form of non-competition or non-solicitation covenant which seeks to prevent an employee or independent contractor producer from soliciting or placing insurance or financial services products for customers and active prospects of the agency for a limited period of time after termination of the employee’s or independent contractor’s relationship with the agency.

Premiums vs. Commission -- Quite often those who are not associated with the industry but who make comments (such as those related to the press and the legal system) incorrectly refer to policy “premiums” when they should be referring to commissions. Premium refers to the cost that a consumer pays for a policy. Commissions are generally a percentage of the premiums that are paid by insurance company to insurance agencies for the sale and/or servicing of a policy. Commissions of an agency are appraised and valued; premiums are not.

Property / Casualty Insurance -- Property insurance is primarily concerned with loss or damage to property owned by the insured. Casualty insurance provides coverage for the insured's legal liability to others. Property and casualty insurance is generally marketed in unison with one another.

Wholesale Broker -- A broker who acts as an intermediary between an agent (often referred to as a "retail agent") and an insurance company. The insurance company normally does not have any contact with the insured. There are two types of wholesale brokers: managing general agents (MGA's) and surplus lines brokers. A Managing General Agent normally has underwriting and binding authority from the companies that it represents, while Surplus Lines Brokers work with the "retail agent" and the insurer to obtain coverage for specialized risks but normally does not have the authority to bind coverage on behalf of the insurer.