

Buying or selling a brokerage business

By Philip Sheps and Joe Barnsley, Pitblado Law

Whether you are buying or selling an insurance brokerage business, you want a deal that goes smoothly. Making that happen means, for the Seller, planning ahead so that the business is structured to achieve for you the best return. For the Buyer, knowing what you are buying, and what risks are being assumed, is critical.

In most brokerage deals, the real value is in the book of business. The Seller's goodwill can play a large part in holding and growing that book of business, so, while both sides will negotiate hard, you do not want to come out of the sale as enemies.

Be aware of how the industry values insurance brokerage businesses. Multiples of earnings are the common method, and those multiples rise and fall over time depending on the market. There is no point in starting this sale and purchase process if both parties are not within the ballpark in their valuation expectations.

ASSETS OR SHARES

Another critical question is, what is being bought and sold? **Is this a sale of assets or a sale of shares?** The consequences, the structure of the deal and even the price may be substantially different if the transaction is a sale of assets as opposed to a sale of shares.

Many Sellers want to sell shares to take advantage of capital gains exemptions and SAVE TAXES. In most cases shares have to be held for at least two years prior to a sale to qualify for that exemption. For many family businesses, tax planning can mean hundreds of thousands of dollars in your pocket – a critical factor when this represents your retirement fund. Do not leave your tax planning until it is too late!

Buyers may prefer to buy assets to have higher asset values to write off (and SAVE TAXES) and to not have to assume the 'skeletons in the closet' that come with buying a corporation rather than just its assets.



COMPETING FACTORS

Successful negotiations mean you need to understand the consequences and risks of the deal and its complexity, how to protect yourself, and how to price the business accordingly. It is recommended that you seek the input of your advisors, your lawyer and accountant, to help you understand your options and protect your interests before you start negotiating, not after you have committed to something that may not really be appropriate for you.

THE OFFER

Once you have the basic terms of the deal - price or price formula and process (i.e., it is a sale of assets or it is a sale of shares) then the second step is to move to a formal offer to purchase, executed by both parties. The offer sets out the business terms of the transaction. These offers are often in the form of a binding letter of intent or a memorandum of understanding. The offer provides that if the parties are in agreement on the business terms, a formal purchase and sale agreement will be negotiated. Most offers are subject to conditions, such as due diligence, financing and negotiating the terms of the formal agreement of



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purchase and sale. Until those conditions are satisfied, there is no binding deal.

Negotiating of terms of the formal purchase and sale agreement is just as important as deciding on the price. The devil IS in the details.

Most Buyers are concerned with:

- (a) Due diligence. Ensure that within the limited period allowed, the Buyer can review the records of the business, be able to confirm what is being purchased, and discover any and all problems that might arise from or after the purchase;
- (b) Financing;
- (c) Protecting against business drop-off through non-competition agreements

and price adjustments; and
 (d) Risk management. Representations and warranties are given by the Seller to define what the Buyer is purchasing and the risks the Buyer is assuming. The Buyer will also be concerned about the enforcement of the representations and warranties and if the Seller has the wherewithal to remedy any incorrect representation and/or warranty.

Sellers are concerned about payment of the purchase price and determining:

- (a) If there is a sufficient deposit;
- (b) If there is financing, how secure it is (again, a risk management issue);
- (c) If there are any adjustments to the purchase price, such as holdbacks based on the continuation of the amount of the post-closing business; and
- (d) If there are any other contingencies that could reduce the money in the Seller's pocket.

Both parties will want to cover:

- (a) Tax planning – have all of the pieces been put in place and is the transac-


tion structured to satisfy the requirements needed to achieve the anticipated tax treatment?

- (b) Approvals – are there any government or quasi-government agencies (such as MPI and ICM) or insurers from whom either Buyer or Seller requires approvals?
- (c) Due diligence – if you are a Seller, do you have all of the records, documentation, tax filings and the like in good order? If you are a Buyer, do you know what it is that you want to review and have you covered everything?

PROTECT AGAINST CLAIMS

Insurance professionals routinely encourage their clients to protect against the risk of claims through Liability/E&O coverage. When you sell a brokerage, you usually have to promise that there are no claims against the business. If a claim arises later you may have to compensate the Buyer for it. That can mean paying back some or all of the proceeds of sale – which may be your retirement fund. You can insure against that risk

through tail insurance. It covers claims that are caused before the closing of the sale and pays on your behalf. This can offer peace of mind.

Whether you are a Buyer or a Seller, you will not go wrong in first assembling your team of advisors and ensuring that the process you want to follow can be successful with the minimum amount of cost and complexity. 

About Pitblado Law

At Pitblado Law we understand the Insurance Industry. We can help you plan for succession, sale or expansion. We represent Buyers and Sellers of brokerages, large and small, the banks and credit unions who finance those deals, and the insurance companies whose products you sell. How can we help you?

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