

# Strategies for Negotiating Your Brokers' Compensation

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## ■ Choosing your broker

In choosing an insurance agent or insurance broker, each organization must determine those items that are most important or necessary for their risk management programs to succeed and to be effective. This will not be the same for all organizations, nor will every insurance agency or insurance broker provide the same level or type of services, nor will every insurance agency or insurance broker charge you equally.

## ■ Developing a broker agreement

An insurance agent's/broker's compensation should be outlined in a mutually agreed upon, written contract or agreement. Along with the method and type of compensation, it should be clearly understood what services will be rendered, additional services available, services to be contracted, fees for additional services, and other variables associated with a comprehensive written contract/agreement.

## ■ Negotiating with your insurance broker

- Negotiate from a positive posture
- Negotiate from a mutual trust and full disclosure position
- Negotiate with knowledge from *both* sides
- Negotiate fairly, so both sides may “win”
- Negotiate quantifiable issues as much as possible
- Negotiate to determine:
  - /// basic services
  - /// possible services
  - /// add-on services
- Negotiate an equitable compensation

## ■ Determine value for services

- What is the value (fee, commission, etc.) to be paid?
- What do you reasonably expect in return?
- Is the value commensurate with the return?
- Will management agree that the value is commiserate with the return?

# Insurance broker expectations and compensation

- What services should we expect from our insurance broker?
- What key points should be addressed in insurance broker service contracts?
- How should your insurance broker be compensated?
- How do contingency/ profit sharing arrangements with insurers impact my organization?

## What key points should be addressed in broker service contracts?

- Compensation method, calculation process, amounts to be included, and amount
- Term of engagement
- Termination criteria (cancellation notice, compensation earned, etc.)
- Rules of disclosure and confidentiality
- Disclosure of conflicts of interest (contingency arrangements, "reward" plans, etc.)
- Run-off services (minimum 3 to 5 years after separation)

## ■ What key points should be addressed in broker service contracts? (con't.)

### ■ Minimum or basic service requirements

- /// Are all services included in compensation?
- /// Identify limitations on “included services” (loss control, actuarial services, etc.)
- /// Will a stewardship report be prepared?
- /// Timetable/deadlines for services

### ■ Timing of stewardship and renewal meetings

### ■ Ownership of data and intellectual property

### ■ Travel, expenses, overhead costs, etc.

### ■ Utilization of broker's facilities and resources

### ■ Designated service team and alternatives



## What key points should be addressed in broker service contracts? (con't.)

- Minimum professional liability insurance requirements
- Assignability of contract to successor organization
- Compensation audit provisions
- Signature/date block

# How should our insurance broker be compensated?

## ■ Compensation considerations

- /// Do I have a right to know everything I am paying for?
- /// What if I don't want to pay for ALL of the services available?
- /// At what point should I consider a negotiated fee approach?
- /// How do I know my broker is disclosing all compensation earned on my account?
- /// When is the broker's compensation "earned"?
- /// How is an appropriate compensation amount developed?

# How should our insurance broker be compensated?

## ■ Sources of compensation

- /// Commissions on Premium
- /// Fees
- /// Profit sharing/contingency arrangements
- /// Float income
- /// Affiliated surplus/wholesale brokers
- /// Reinsurance and underwriting
  - support for primary insurer
  - captive support
- /// Captive management services
- /// TPA fees
- /// RMIS fees
- /// Loss control
- /// Referral fees (TPA's, premium finance, appraisal fees, etc.)

# How should our insurance broker be compensated?

## ■ Negotiated compensation

- /// Commissions
- /// Flat amount (retainer)
- /// Time and expense
- /// Fee for services: specific tasks
- /// Performance or incentive based
- /// Combinations

# How should our insurance broker be compensated?

## ■ Commissions from insurers

- /// Percentage of premium
- /// May be on a sliding scale basis
- /// Varies by insurer, region, line of business, broker, etc.
- /// Common on small or less complex accounts - easy to administer
- /// Is NOT always the most expensive compensation basis
- /// Typically not directly tied to services rendered
- /// Possibility for conflicts of interest
- /// Possible bias for insurance solutions
- /// May be non-transferable to new broker - BOR

# How should our insurance broker be compensated?

## ■ Flat amount/retainer - How is the fee amount calculated?

### /// The accounting estimate

- Estimate of time for each member of service team times applicable rate
- Rates may vary by skills/experience
- Expenses may be in or out
- Ancillary services may be extra

### /// The commission estimate

### /// The market driven “pull it out of the air” estimate

# How should our insurance broker be compensated?

## ■ Incentive compensation

/// Strategy: Consider aligning incentives with corporate/departmental objectives

### /// Guidelines:

- Goals should be specific and measurable
  - “X” percent reduction in cost of risk
  - “X” percent reduction in fixed costs
  - Maintenance of loss ratio below “X”
  - Extraordinary performance on claims resolution
  - Score of greater than 80% on client satisfactory survey
  - Arranging favorable insurance program in a tough market
- Incentive compensation should reward broker for exceeding - not just meeting - client expectations
  - Additional fee payment
  - Individual team member awards

# Types of contingency/project sharing arrangements my insurers may use

## ■ Types of arrangements

- /// Growth of book
- /// Profit sharing
- /// Multi-year plan
- /// Individual incentives
- /// Others

## ■ Issues for consideration

- /// Require disclosure
- /// Understand the implications
- /// Eliminate/avoid if a conflict exists
- /// Others



## ■ Pros/cons of compensation alternatives

### ■ Advantages

#### /// Commissions

- Easy to understand
- Easy to administer
- No special senior management approval
- May be less expensive on small accounts

#### /// Fees

- Can be based on level of service
- Eliminated/reduces conflicts of interest
- Encourages non-insurance solution
- May be less expensive

**\*\*May combine elements of both.\*\***

# ■ Pros/cons of compensation alternatives

## ■ Disadvantages

### /// Commissions

- Compensation subject to insurance cycle
- Conflicts of interest
- Bias toward insurance solutions
- Not necessarily reflective of services performed

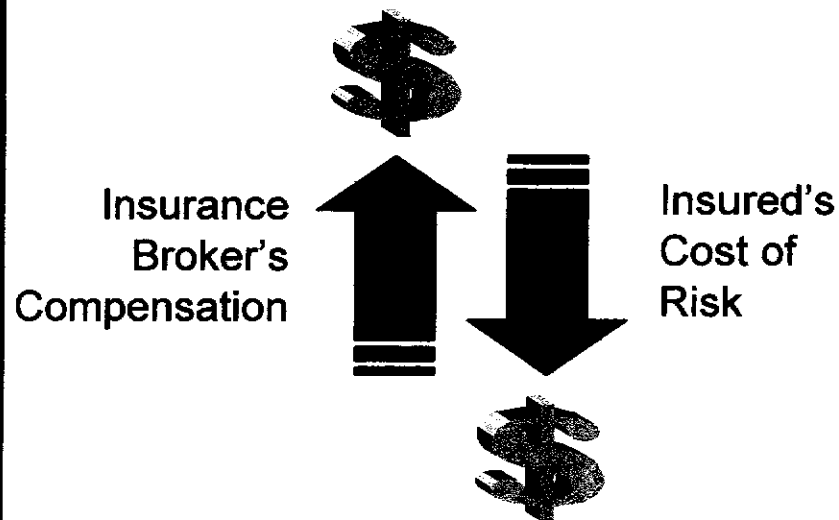
### /// Fees

- May have to “sell” to management
- May be more expensive
- More difficult to develop appropriate amount
- May be more complicated to administer

**\*\*One method is not always better than another method.\*\***

# Commissions vs. fees

■ In theory . . . .



In reality . . . .

