December 2020

Burand's Insurance Agency Adviser

Resources and Information for the P&C Insurance Industry

Volume 25, Number 10

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Chris Burand,
Certified Business Appraiser

Burand & Associates, LLC
215 S. Victoria Ave., Suite E
Pueblo, CO 81003
719/485-3868
chris@burand-associates.com

Visit us at:
burand-associates.com

Reading Recommendation

I highly recommend reading Matt Masiello's book, "Insurance Agency 4.0." Matt is the CEO of SIAA having worked his way through the entire agency system and hierarchy. SIAA is the United States' largest alliance of independent insurance agencies with approximately 5,000 agencies and $9 billion in premium (larger than about 875 out of 900 insurance carriers). It is full of practical advice, tools, and what agency owners need to consider relative to digital marketing and digital operations.

Matt's book is available for order here:
https://mattmasiello.com/ia40/

Hiring the Right Producer

A few steps are required in order to hire the right producer. Combined with the right training program, my clients enjoy around a 75% success rate with their new hires rather than the 75% failure rate that is common at other agencies. These are facts, not just wishful thinking. I'll cover the steps for hiring producers here.

1. Are you hiring for the right purpose? One of the most common and important reasons so many producer hires fail is not due to the producer. It is because of management. Agency owners and managers are not interested in hiring successful producers. They are interested in hiring producers that are mediocre at best. These are not conscious thoughts -- that would be ridiculous. However, the reality is that many people running agencies want to be king or queen and they do not want to be challenged as the top producer. Since most are good producers, the only position left for other producers is mediocre producer. The facts back up my position. Most producers never get past about $250,000 - $300,000 in commissions. That may not even be the breakeven point.

Before spending and wasting money on hiring a producer, figure out if you really want to hire someone who may challenge you. The question is no small point. You run the agency and it makes sense that you would be concerned about an employee creating a challenge to your position. Of course this is an ego issue to some degree. It is a control issue. However, it is a real issue and if you are cognizant of your emotions, you will make a better decision.

2. If you are hiring for the right purpose, then hire using high quality tests rather than your gut. Your gut is likely to lead you astray. Somewhere between 90% and 100% of the agency owners I've ever met had guts that told them to hire producers they liked. Whether or not you personally like the producer should be secondary. The first criteria should be whether they can sell. The two criteria are not synonymous.
I definitely have my favorite hiring test. It has served my clients well for twenty years. This is the test from Behavioral Sciences Research Press.

In early 2020 a little tiny book titled, "*The New Psychology of Sales Performance"* was published by Timothy Coomer, PhD. Tim is the genius who invented ModMaster, is a founder and CEO of SixSigma Actuarial Consulting, and is one of the smartest people in this industry. He took a leave of absence to complete his PhD during which he completed his dissertation by studying which personality traits are most highly correlated to sales success.

As noted, this is literally a tiny book, about forty pages in all and the pages are small. It is really an introduction to his online material that delivers the details and tools agency executives need. Because the book is so short, summarizing key points is difficult without repeating the book. I encourage every reader to purchase Tim's book.

There are two points which I will summarize and build upon using my own experience. The first is Tim's surprising conclusion that "Openness to Experience" is negatively correlated to sales performance. As he notes in the book, this was a surprise finding. Crucial to understanding this key finding is the required distinction between openness to internal vs. external experiences. The study only deals with internal experiences -- not external. My suggestion to readers is to ABSOLUTELY not confuse the two.

Tim's theory is that openness to internal experience leads to too much anxiety and possibly doubts and hesitation. In Tim's opinion, the way to identify whether a person has too much openness to internal experiences is to identify whether they have call reluctance. The test offered by Behavioral Sciences is focused on identifying Call Reluctance. Its nickname is the Call Reluctance Test.

My experience with producers who succeed but are numbskulls kind of confirms Tim's hypothesis. Although the following is anecdotal and I don't have the statistics to prove a correlation, over time I have seen so many producers succeed who probably should not have succeeded because they really did not have a clue what they were doing. Some were pretty stupid and all within this segment were ignorant. However, they were all really confident. These producers would believe everything their boss or a company representative told them about a product. They never questioned the validity of that information and repeated what they heard to clients and prospects with so much confidence, they made sales. These producers had zero internal openness to internal experiences.

I know of one direct writing company that, maybe by design, maybe by luck or other means, specifically hires producers with this trait. The producers have no idea what they are doing, do not know coverages and do not know how to think. One reason most fail when they come over to the independent side is that independent agency systems usually require producers to know something about coverages and agencies do not provide enough support to clean up after the producer leaves the client's office.

Perhaps agencies should rethink this process, but if they do they should reduce producer compensation substantially to pay for all the extra support because someone has to be able to think.

The second point that Tim makes which is essential to success is that training must be methodical, especially for younger producers who lack grit (his study shows younger producers lack the grit older producers possess -- whether this is the result of winnowing out producers over time or a generational issue is not determined). The training must be multi-dimensional too.

Historically, methodical, multi-dimensional training has been beyond the ability of almost all agencies and brokers. Most agency owners and executives cannot even conceptualize what this means. Tim's book gives a good preview of the kinds of training required.

The good news is that now the industry has the various resources available to almost any agency that truly wishes for high quality producers to be part of their team. These are third-party resources. One must use these various resources, but you don't have to do the training yourself. The owner/executive must coordinate the training or hire a third-party to do so.

Recognizing multiple training resources is so important. Using only one trainer has been an Achilles' heel of producer training for too long. Someone training in one area is an expert in that area but a good producer needs many skills. Think of training a producer like training an athlete. An athlete has different coaches for improving different skills. A producer needs sales training, coverage training, grit training, at times Emotional Quotient training, communication skill training, and sometimes, especially for newer producers, training in how to dress.

I strongly recommend reading Tim Coomer's book. I am excited to add this book and its resources to my list of hiring and training resources that will become part of my methodical playbook for my clients. Maybe we can push the success ratio just a little higher now!

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Hyper Personal Personal Insurance

I have seen a few articles recently that have focused on and/or were titled "Hyper Personal" Personal Insurance. Like lots of things, it does not sound that good to me, but a creative marketing person has probably discovered this phrase sounds good to consumers.

The idea is that someone or something, not necessarily an agency or even a person as it could easily be a software program, will hyper personalize a consumer's insurance experience relative to identifying their insurance needs due to changes in life and lifestyle. It sounds good.

But, good agents have been and are already creating personalized insurance plans for their clients. They are staying in contact with their clients regularly so they already know of their life and lifestyle events and make coverage recommendations accordingly. The fact that investors are spending millions of dollars on the creation of automated software to do this, are capturing headlines, and even more investment dollars speaks to the fact that most agents are not doing their jobs well or at the very least, they are not being recognized for doing their jobs well.

Software has additional advantages. First, no discipline is required. Program it and run it. No one needs to remind people to do their jobs. (That said, quite often the problem is exacerbated by a lack of procedures and quality job descriptions, so staff often have no specific instructions to be more proactive.) Second, the building of software is paid for by investors and comes off the balance sheet. In these days of relatively easy investment money, that money is considered by many to be cheaper than money expended on the income statement. Employees' salaries are paid and accounted for on the income statement. Furthermore, once the software is built, beyond maintenance, it is paid for. Employees always need that next paycheck and are more expensive than software (potentially and depending on the software model).

The offset is better for good, professional agents, however. The most "hyper" personalized insurance is made possible by simply talking to the insured and learning what exposures they have to cover. Building a program to identify when it is time to sell someone a second policy or to send out a birthday card are superfluous to the client's actual needs. The best service a professional agent can provide, the most personalized service a professional agency can provide, is to identify which coverages are truly needed and then discuss those coverages with the client.

Matching coverages and exposures is tough work. The software companies promising hyper personalized service are not dealing with the fact that most customers do not even know what their exposures are. I cannot begin to tell you how many agents, much less their clients, do not understand the true value of high UM/UIM limits. Many retirees who have paid off their homes do not understand why they should maintain a homeowners policy -- for the liability coverage if for nothing else!

Millions of different combinations of homeowners policies exist, just using basic endorsements and ignoring varying policy limits. Then consider all the different forms. No single family should ever find themselves with the same coverages as any other family if the agent does their job well.

The choices are binary. Try and compete with new players who have better marketing, better software, better advertising, and ultimately lower expenses without offering the personalized experience clients truly need. You will lose. Or, become a true professional and personalize the customer's experience in the most valuable manner possible and hit the jackpot! What choice will you make?

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Three Kinds of EBITDA

Agency owners are like gossiping kids, always asking and telling what the latest multiple of EBITDA their agency's value is. But they never ever discuss the EBITDA. Let's say the multiple is 6. Then it is 6 times EBITDA, but what is the EBITDA? Three, at least three, different kinds of EBITDA exist, and it pays to know which EBITDA is being multiplied.

EBITDA stands for earnings before interest, taxes, depreciation, and amortization. The idea is to identify cash flow excluding financing effects (if you want to identify true cash flow including financing effects such as loan repayments and interest, use "free cash flow" which is a better measure of value anyway). However, EBITDA has now been bastardized in so many different ways that there is even disagreement as to what the "E" for Earnings represents. Different people use different numbers for the same firm's "E". I find that almost no agency owner understands how the EBITDA formula actually works in the real M&A world. Here then are three examples, and by no means are these comprehensive in variety or detail.

EBITDA #1, Actual EBITDA -- Actual EBITDA is your actual, unadjusted EBITDA.

For example:

	Agency's Actual, Unadjusted Numbers
Commissions	$1,000,000
+Contingency	$100,000
-Compensation	$600,000
-Sales Expenses	$50,000
-Administrative Expenses	$200,000
+Interest	$10,000
+Taxes	$20,000
+Depreciation	$20,000
+Amortization	$40,000
Actual EBITDA	$330,000

Your actual, unadjusted EBITDA IS NOT the EBITDA upon which your value is determined! The EBITDA used is an adjusted EBITDA if the valuation is done correctly.

EBITDA #2 -- Pro Forma EBITDA adjusted for the sale to a large buyer:

	Agency's Actual, Unadjusted Numbers
Commissions	$1,000,000
+Contingency	$130,000
-Compensation	$500,000
-Sales Expenses	$50,000
-Administrative Expenses	$250,000
+Interest	$30,000
+Taxes	$10,000
+Depreciation	$20,000
+Amortization	$80,000
Actual EBITDA	$470,000

If you sell for 6 x $330,000 rather than 6 x $470,000, then you leave 6 x $140,000, or $840,000 on the table.

EBTIDA #3 -- Pro forma EBITDA for a strict Fair Market Value situation:

	Agency's Actual, Unadjusted Numbers
Commissions	$1,000,000
+Contingency	$100,000
-Compensation	$500,000
-Sales Expenses	$50,000
-Administrative Expenses	$180,000
+Interest	$10,000
+Taxes	$20,000
+Depreciation	$20,000
+Amortization	$40,000
Actual EBITDA	$450,000

These are just examples and should not be taken as literal in any way whatsoever. My point is that not only is each agency's EBITDA different, but the EBITDA for each agency must be different for each kind of buyer. Not knowing the applicable EBITDA renders the multiple irrelevant. For example, I once saw an agency brag about selling for 11 times EBITDA. Their actual EBITDA was, let's say $1,000,000. They were paid $11,000,000. Their pro forma EBITDA, the EBITDA that actually mattered, was $1,800,000. They actually were paid a less than normal price, but they did not know it.

On the other hand, some owners see the big EBITDA dollars after a buyer or some consultant has worked through the agency's numbers. They take the results to a bank and expect the bank to loan on that grossed up profit margin for an internal sale. Do not do this. You will only embarrass yourself because banks, at least those knowing what they are doing when loaning to an agency, typically only use the strict Fair Market Value EBITDA, not the larger EBITDA calculated when selling to private equity and publicly traded brokers.

The adjustments are different depending on the type of buyer. Compensation is often a huge difference because many buyers only pay 20%-25% renewal commission and then exclude any commission on accounts generating less than $X (and that $X can be large). Producer compensation reductions are not usually as large in other scenarios. Also, those big buyers are usually making extra money in a myriad of ways that regular buyers will not make. They also get favorable financing.

Valuations based on EBITDA sound simple, even alluringly sophisticated, but still simple enough for everyone to understand. Quality valuations using EBITDA are complex. Oversimplification serves business brokers and specific buyers well while injuring the sellers. Oversimplification can cause less knowledgeable sellers to make mistakes.

Because EBITDA calculations are so easy to manipulate and even disguise the manipulation, the U.S. Securities and Exchange Commission has warned against using EBITDA. Many academic studies show firms using EBITDA have numbers that should be viewed more carefully because, the authors conclude, some such firms may be abusing this method.

Not being taken advantage of is important. One really needs to know which of the three major kinds, much less the various deviations, of EBITDA to apply to your specific situation. I strongly recommend hiring an advisor who specializes in this area and is not a business broker to advise you if your local accountant is not steeped in insurance agency valuations.

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"Love Hurts," performed by Gram Parsons and Emmylou Harris

Love hurts and the plaintive emotions expressed by this duo resonates deeply. But criticism, even constructive criticism, hurts far more. I cannot find anyone who sings about constructive criticism. The website, Lyrics.com, advertises itself as "The Web's Largest Resource for Music, Songs & Lyrics" and a search found 10 lyrics, 0 artists, and only 2 albums matching "constructive criticism." On the other hand, it found 20,197 lyrics for "love hurts," 112 artists, and 100 albums. Maybe "love" and "hurt" is a yin and yang thing or part of a beck and call scenario while "constructive" and "criticism" does not quite work.

Constructive criticism lacks the romance but it still hurts, often hurts a lot. The fact that it is basic and not flashy does not diminish the pain. Just a different part of a person's ego hurts. Even when delivered with kindness, pain results. Someone can say, "But it's good for you," "Be strong," or "Get over it and use the criticism to your advantage." The person not criticized always has an easier time delivering the message than the target has receiving it.

The truth is that if a person can handle constructive criticism and get past the pain and their ego, their business and sales improve. I see agency owners, the ones that have built the most solid agencies not necessarily the biggest by any means, take constructive criticism far better than their peers. Taking constructive criticism and the ability and willingness to do so is one of the most fascinating and interesting aspects of why people own agencies and become executives. Their entire goal, if subconscious, is to hold a position where people will not criticize them. This is actually a testable personality trait and to date, I have not seen the test miss.

Criticism hurts all types of people but some people work constructively in response. The people who avoid criticism as entirely as possible are the owners and executives who need to be the boss for one reason–so they will not be criticized. They are not in business to actually build a business. They are in business to avoid being criticized. Without any exaggeration I have seen agencies go bankrupt, suffer E&O claims and suffer huge losses of value, which were all avoidable if the owner could have handled criticism. In the most extreme cases, they chose, explicitly, failure over criticism. I clearly remember the day when one owner broke down over the constructive criticism involving his agency's bankruptcy due to miss-spending trust monies. The failure of bankruptcy was less painful than the accompanying criticism and goes to show just how painful constructive criticism can be to some people.

The insurance industry has a large percentage of owners who cannot stand criticism and it hurts their agency's performance. I recently completed a deep study of which characteristics result in the truly best agencies. One defining factor was whether the owner ran the agency as an agency, for their personal purposes, or ran it as a business. Guess where sensitivity to criticism is least? Most?

I recently read a story exemplifying the best of both sides of constructive criticism. Constructive criticism was given 20 years ago to a particular younger person. They were clearly hurt. But it was fairly given and delivered without malice. Today, the person who gave the constructive criticism is going to work for the person to whom he delivered the criticism. She took the advice after licking her wounds and made herself better. She now owns her own business that she runs as a business and it is so successful, she has become a local economic force. The person who delivered the constructive criticism can now expect fair criticism at his employee reviews. By both parties working constructively, using the pain that entails positivity, everyone gets getter.

On the other hand, if I am a carrier and I am looking to appoint agencies with the best futures, I probably would focus on owners who are the least sensitive to constructive criticism. This is not so that companies can deliver criticism (some really should look in the mirror first) but because it is a characteristic of the most solid agency owners. I built proxy measures that are tangible and provable -- these are not "gut" instincts and a third-party test does exist to determine who is and who is not best able to deal with contractive criticism.

If I am a competitor, an opportunity exists to take advantage of those agencies run by people who are too sensitive to criticism. The bigger they are the more vulnerable they are. This is because their weaknesses are less likely to be addressed since a high probability exist no one will offer constructive criticism to these kinds of bosses and even if they do, the boss is less likely to listen.

If by chance you are someone that is extremely sensitive to constructive criticism, maybe it helps to know constructive criticism hurts for every adult on some level and some part of their ego. I know hard work can overcome an adequate portion of one's sensitivity. The advantage people have, that were excessively sensitive but grow stronger is they have empathy today that enables them to connect to many people more deeply. They have turned the lemon into lemonade.

Clearly this article's topic is not a normal insurance topic. However, in many agencies and situations, the ability and willingness to deal with constructive criticism is far more important to many agencies' futures. Everyone gets hurt in love and criticism. What you do with constructive criticism determines that future. How well do you deal with constructive criticism?

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Cloud Computing and Cyber Coverage

One of the main reasons commercial insureds do not buy cyber coverage is because they think they have absolute, complete coverage because they're in "The Cloud." I'm going to have some fun at their expense while attempting to help agents break their clients' absolutely, 100% wrong conclusion.

First of all, what is "The Cloud?" It is not that pretty little picture of an innocuous little cumulus cloud that is in all the "cloud" advertising graphics. That may come as a surprise to some agents too. One of the key reasons insureds don’t buy cyber when using the cloud is because a huge proportion of agents have absolutely no idea what "The Cloud" is either. They have that pretty little iconic picture in their own mind. Using "The Cloud" is nothing more than using someone else's network of computers that are supposed to be cheaper and more reliable and when something breaks, because the services are shared, usually the backup works immediately, but not always.

The security of "The Cloud" may or may not be better than what one might possess individually. Just as an FYI though, you might should consider choosing a cloud provider that has backup in multiple U.S. power grids. The best cloud services understand the importance of this point. Some of the less expensive ones might not.

Second, and to the heart of this is that even if one assumes, even if one is correct that "The Cloud" is safer, what almost every agent and it seems every client of every agent is clueless about is how "The Cloud" has split cyber exposures creating a whole new kind of cyber exposure. This is a nefarious exposure, one in which people are going to get burned. This is the contractual cyber exposure. People are signing cloud contracts without reading them and therefore not understanding they often accept responsibility for Fortune 100 companies' cyber exposures!

That is correct. Not only do you still have your cyber exposure but you're now on the hook for a Fortune 100 company's cyber exposures! How safe is "The Cloud" now? Is it more like an angry God sending lightning bolts down your throat? I'm being melodramatic but my point is real.

For example, here are some excerpts from "The Cloud" contract of a major cloud provider:
12. Warranties. ABC CLOUD PROVIDER, AND OUR AFFILIATES, RESELLERS, DISTRIBUTORS, AND VENDORS, MAKE NO WARRANTIES, EXPRESS OR IMPLIED, GUARANTEES OR CONDITIONS WITH RESPECT TO YOUR USE OF THE SERVICES. YOU UNDERSTAND THAT USE OF THE SERVICES IS AT YOUR OWN RISK AND THAT WE PROVIDE THE SERVICES ON AN "AS IS" BASIS "WITH ALL FAULTS" AND "AS AVAILABLE." YOU BEAR THE ENTIRE RISK OF USING THE SERVICES. ABC CLOUD PROVIDER DOESN'T GUARANTEE THE ACCURACY OR TIMELINESS OF THE SERVICES. TO THE EXTENT PERMITTED UNDER YOUR LOCAL LAW, WE EXCLUDE ANY IMPLIED WARRANTIES, INCLUDING FOR MERCHANTABILITY, SATISFACTORY QUALITY, FITNESS FOR A PARTICULAR PURPOSE, WORKMANLIKE EFFORT, AND NON-INFRINGEMENT. YOU MAY HAVE CERTAIN RIGHTS UNDER YOUR LOCAL LAW. NOTHING IN THESE TERMS IS INTENDED TO AFFECT THOSE RIGHTS, IF THEY ARE APPLICABLE. YOU ACKNOWLEDGE THAT COMPUTER AND TELECOMMUNICATIONS SYSTEMS ARE NOT FAULT-FREE AND OCCASIONAL PERIODS OF DOWNTIME OCCUR. WE DO NOT GUARANTEE THE SERVICES WILL BE UNINTERRUPTED, TIMELY, SECURE, OR ERROR-FREE OR THAT CONTENT LOSS WON'T OCCUR, NOR DO WE GUARANTEE ANY CONNECTION TO OR TRANSMISSION FROM THE COMPUTER NETWORKS.
13. Limitation of Liability. If you have any basis for recovering damages (including breach of these Terms), you agree that your exclusive remedy is to recover, from ABC Cloud Provider or any affiliates, resellers, distributors, Third-Party Apps and Services providers, and vendors, direct damages up to an amount equal to your Services fee for the month during which the loss or breach occurred (or up to $10.00 if the Services are free). You can't recover any other damages or losses, including direct, consequential, lost profits, special, indirect, incidental, or punitive. These limitations and exclusions apply even if this remedy doesn't fully compensate you for any losses or fails of its essential purpose or if we knew or should have known about the possibility of the damages. To the maximum extent permitted by law, these limitations and exclusions apply to anything or any claims related to these Terms, the Services, or the software related to the Services.

How then, can any sane person conclude that if they are using "The Cloud" that their cloud provider is going to provide all the cyber protection they need? In fact, **<u>they need more cyber protection using the cloud because of the way the contract reads!</u>**

Getting insureds to read their cloud contracts is often an impossibility though for several reasons. First, who wants to read such a dense document? Second, who wants to read such a document only to learn they have more exposures? Ignorance is truly bliss. Let's stay ignorant and enjoy bliss while it lasts.
So, if you as a producer push too hard telling them to read the contract, the odds of making a sale decrease because you are destroying their bliss. Don't be a bliss destroyer.

Instead, offer to read their contracts for them and then, walk them through a contract that increases their risk of loss by asking question, after question, after question. DO NOT TELL THEM ANYTHING! They must conclude on their own they need cyber.

The only conclusive statement you can make is to say, "I can help. Would you like my help minimizing your exposure to uncovered cyber related events?"

Willful denial is one of the most intransigent psychological features of the human brain. Considerable research over the last ten years has been developed that when someone wants to believe something, something that may be totally wrong, that no statements work to change their minds. Interestingly, the more facts one presents, regardless of the situation whether it be political, or vaccines or cyber, the more people believe in the myth. In other words, if you present a fact, they will believe in the myth even more. They will deny reality harder.

To make sales in these situations then, barring them facing the harsh reality of a bad cyber claim resulting in their reality check, one can only ask questions. You can't even tell stories in situations like this because those stories are only apply to others, never, ever them. Questions are the only wedge to their rational brains that will work. Questions are the only way to hit the constructive emotional buttons. Everything else will hit the denial emotional buttons.

If you want to learn more about actual cyber coverages and how to communicate with your clients, let me know. I have a world class cyber education program.

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Chris Burand is president and owner of Burand & Associates, LLC, a management consulting firm that has been specializing in the property/casualty insurance industry since 1992. Burand is recognized as a leading consultant for agency valuations, helping agents increase profits and reduce the cost of sales. His services include: agency valuations/due diligence, producer compensation plans, expert witness services, E&O carrier approved E&O procedure reviews, and agency operation enhancement reviews. He also provides the acclaimed Contingency Contract Analysis® Service and has the largest database and knowledge of contingency contracts in the insurance industry.

Burand has more than 30 years' experience in the insurance industry. He is a featured speaker across the continent at more than 300 conventions and educational programs. He has written for numerous industry publications including *Insurance Journal*, *American Agent & Broker*, and *National Underwriter*. He also publishes *Burand's Insurance Agency Adviser* for independent insurance agents.

Burand is a member of the Institute of Business Appraisers and NACVA, a department head for the Independent Insurance Agents and Brokers of America's Virtual University, an instructor for Insurance Journal's Academy of Insurance, and a volunteer counselor for the Small Business Administration's SCORE program. Chris Burand is also a Certified Business Appraiser and certified E&O Auditor.

Burand & Associates, LLC is an advocate of agencies which constructively manage and improve their contingency contracts by learning how to negotiate and use their contingency contracts more effectively. We maintain that agents can achieve considerably better results without *ever* taking actions that are detrimental or disadvantageous to the insureds. We have ***never*** and would not ever recommend an agent or agency implement a policy or otherwise advocate increasing its contingency income ahead of the insureds' interests.

A complete understanding of the subjects covered in this newsletter may require broader and additional knowledge beyond the information presented. None of the materials in this newsletter should be construed as offering legal advice, and the specific advice of legal counsel is recommended before acting on any matter discussed in this newsletter. Regulated individuals/entities should also ensure that they comply with all applicable laws, rules, and regulations.
