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# Challenges and Opportunities

INSURANCE AGENTS MUST CAREFULLY MANAGE THEIR CLIENTS TO RESPOND TO CURRENT BUSINESS AND SOCIOPOLITICAL TRENDS.

**T**he COVID-19 pandemic created permanent changes in the way we will live, work and operate our businesses for years to come. Understanding the nature of the potential changes, as well as how they will impact us, and adapting ahead of the herd will allow many to seize new opportunities. Times of fundamental or even radical change can be frightening but they can create enormous opportunity.

Some of these trends were already emerging but developed more quickly due to the pandemic environment in 2020 and 2021. Four areas of significant, permanent change have already begun to impact the insurance-agency business. They are:

- A developing talent crisis;
- Increasing consumer service demands requiring digital tool adoption;
- More permanent low(er) interest rates; and
- The rise of video communication.

As if those pressures weren't enough, inflation, rising interest rates, tax policy changes and increases are also challenging the insurance marketplace and will create new winners and losers as we move through 2022.

And finally, the insurance industry itself is undergoing some important developments that will further cloud our vision and complicate our future, including:

- A massive cyber exposure with inadequate reserves and premiums;
- An impending increase in carrier consolidation; and
- The slow tumble and collapse of the captive distribution system.

Any one of these things would have profound potential impacts on our businesses. Together, a bit like a mad scientist's laboratory brew, it's hard to predict exactly how they will force change. That said, it is possible to explore likely outcomes.

## ► AGENT & BROKER

### INFLATION, INTEREST RATES

Inflation is here, and it's significant. It will likely last several years as supply chain disruption, changing consumer appetites and a glut of excess cash in bank accounts are trends that seem to be here for a while. At the same time, policy responses are moving very slowly.

This trend will impact agents with higher employee costs. Additionally, the competition for talent is going to be fiercer as employees continue to decide to retire early, move and demand increased flexibility in work arrangements.

It will also impact agents negatively with lower profit-sharing potential in 2023 and beyond. This may surprise many, but think about the double-digit increases in construction costs and used car prices. Those increases are currently being met with single-digit premium increases. If this trend continues, losses will rise, lowering carrier profitability and contingent payments to agents and building an increased financial vulnerability in carriers.

Agents can adapt now by carefully managing their books of business and making sure loss-sensitive business is in the right places. Further, agents should increase their monitoring of carrier financial strength.

As rates inevitably adjust, agents will see higher commissions. But some will also see higher E&O claims. This will result in real replacement costs for those who failed to keep their clients' coverage in line. Aggressive agents will recognize this failure in others and see it as an opportunity to grow their books of business.

### TAX POLICY

The Federal Reserve has indicated that it intends to raise interest rates several times in 2022 and by as much as 2.1% in an effort to curb inflation. This is a huge change and the first time in more than a dozen years for such a policy adjustment.

Rate increases obviously make it more expensive to borrow. So, if an agent needed to buy a building, equipment or a business, now would be the time to lock in loans. For those thinking about selling their agency, bear in mind that low rates are in part driving the current acquisition boom and certainly are driving prices. So, expect agency values to moderate. Coupled with increasing owner retirements, this may be the time for those agency owners to become competitive as an acquirer.



### The Changing Landscape

Captive insurance companies continue to see their market share in their traditional bread-and-butter business of private passenger auto and homeowners insurance shrink, according to the Big "I" Research Market Share Report. This presents an opportunity for independent agency owners not only to continue to grow their books of business, but to hire well-trained and experienced service and production employees away from a declining industry.

Also, as the money from the Infrastructure Investment and Jobs Act and potentially money from the Build Back Better Act floods into the economy, it will be on top of record business and personal cash reserves created by COVID recovery efforts of 2020 and 2021. This will not only fuel inflation and the issues it creates for business owners, it will likely be funded with tax increases, which have the net effect of lowering margins.


Lower margins put pressure on a business owner's ability to invest in growing their business or paying higher wages. Finally, increased tax and interest rates usually create lower stock prices on their own as well as lower agency values and profits. Combined, these two factors frequently create recessions and result in lower payrolls and sales leading to lower premiums and commissions.

To meet these challenges, agents must make a massive investment in technology, which in turn requires capital created with profits. Those profits have been challenged by weather and lower interest rates for a long time now. Weaker balance sheets are going to be dramatically challenged by the looming economic forces. This could lead to more consolidations, increases in insolvencies and reductions in commissions.

### THE INSURANCE INDUSTRY

We are seeing a growing realization that carriers may not have understood their cyber exposures. We are seeing massive price increases for policies and a ramping up of client requirements to obtain coverage.

Another worrisome trend: As our workforce continues to grow older, the impacts of the "Great Resignation" and wage inflation will

increase pressure on agencies' abilities to attract and retain talent. But here, COVID-19 has offered an opportunity, as virtually everyone is now equipped, trained and competent in video communication. This means agencies that manage employees based on productivity can hire anywhere thus easing their employment challenges. 

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