## *Myths Busted: Agency Trust Money and Capitalization*

By Chris Burand

July 8, 2010 Insurance Journal: *FBI Raids Tennessee Payroll, Insurance Firm Sommet Group*

July 7, 2010 BestDay News: *Former Agency Owner Arrested in $1.3 Million Insurance Scam*

July 1, 2010 Insurance Journal: *Louisiana Agent Accused of Misappropriating Premium*

These are just three headlines of many that have been hitting the newswires and Internet almost daily for many months. In almost all cases, the headlines involve agents who have not forwarded premiums to companies. In other words, they have violated their fiduciary duty to hold in trust money paid to them by insureds until it is time to forward the money to the appropriate carrier(s).

Dozens and dozens of agency owners have told me that because their states have no trust laws, they don't have to be in trust. The states in the headlines don't have trust laws either, per se. So why are these agents in trouble? They are in trouble because *all* states and the federal government require that money that is supposed to be held in a fiduciary capacity be held in a fiduciary capacity. This means agents are not supposed to spend this money under any circumstances!

I continually find agency owners who believe that because their state does not have a trust law, they can spend their clients' money as long as they pay their carriers on time. Generally, the lack of a trust law only means that an agency can commingle trust monies with operating monies. It *does not* mean an agency can spend its clients' or carriers' money!

It is also a myth that as long as the agency pays its premiums on time, it does not have to be in trust. A generic definition of being "in trust" is: (cash + receivables) / (premiums payable + binder bill) > 1. If the agency's trust ratio is less than one, it means the agency has spent money that does not belong to it. If the agency's trust ratio is less than one and it is current in its premium payments, the agency must be robbing Peter to pay Paul. In other words, it must be using customer B's premiums to pay customer A's premiums.

How is this ethical or right? Too many agents believe the myth that this is permitted because the company is being paid on time. The problem with this musical chairs is that sooner or later someone is not going to get paid, the agency will have to be recapitalized with expensive after tax dollars, or it will have to be sold at a steep discount because the agency has violated its fiduciary responsibility.

I get the impression some consultants downplay the significance of this issue. I can tell you with certainty that a consultant who delivers news that the $500,000 or $1,000,000 missing from the trust account is diminishing the agency's value to almost nothing is not a very popular person.

More than once I have had agency owners ask me, "Why haven't any of the other consultants told us this was an issue? We've been doing this for years." Sometimes they fire me, sometimes they get mad, and sometimes they go into denial. Other, more pro-active owners realize the situation and work immediately to fix the problem.

Some consultants have perpetuated another myth by contending that agents are currently better capitalized than any time in recent history. That has not been my experience and the headlines certainly do not support this supposition. Perhaps part of this difference in views is that some people may not know how to read a balance sheet. If this is the case, agency owners need to be quite careful whom they choose as advisors.

I have heard it said that balance sheets do not matter because an agency can always find more cheap capital. Maybe that was true a couple of years ago, but I do not believe that is true today. While being out of trust is not always an immediate death sentence, especially now as some companies are helping agencies that cannot pay on time out of fear of losing books of business, it is a major mistake to think this makes being out of trust OK.

Well-capitalized agencies have the opportunity today to invest in top people, buy distressed agencies, invest in better sales tools, and contract with better carriers. With all these benefits, now is a great time to make being in trust a top priority.

***Chris Burand*** is president of Burand & Associates, LLC, an insurance agency consulting firm. Readers may contact Chris at (719) 485-3868 or by e-mail at chris@burand-associates.com.



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