Acquiring Producers: The Legal Basics

September 2009

A Producer is the colloquial name given to an insurance intermediary who generates business for insurers. A Producer can be any type of insurance intermediary; for example it might be an insurance broker acting as agent of the insured, placing business with insurers selected by the broker. It might also be an underwriting agent writing business under a binding authority as agent of the insurer. The key feature is the insurance intermediary's book of business.

Producer acquisitions have become increasingly common as insurance carriers and other intermediaries, such as wholesale (or placing) brokers, seek to secure sources of business. This article examines some of the common legal issues that can arise on a Producer acquisition.

What are the Acquisition Options?
There are three main options:

- ***Share Acquisition***: the Acquirer acquires the shares of the Producer company.
- ***Business/Assets Acquisition***: the Acquirer acquires the underlying business, staff and assets of the Producer company.
- ***Team Move***: the Acquirer recruits a team of key production personnel from the Producer company.

Some of the Issues
Each acquisition option has pros and cons. These will obviously be very fact specific depending on the nature of the Producer itself and its book of business. We look at some of the key advantages and disadvantages below.

Skeletons in the Closet
On a share acquisition, the Acquirer buys the company with all of its business, assets and liabilities, whether the Acquirer (or the seller) knows about them or not. The Acquirer should seek to protect itself by extensive due diligence, coupled with effective post-completion protections (for example warranties, indemnities and possibly insurance).

In contrast, a business/asset acquisition gives the Acquirer the option of cherry picking assets and liabilities. The Acquirer will only assume liabilities which it consciously takes on; this is a major advantage over share acquisitions. There are certain exceptions, a key one being in relation to employee liabilities. If there is a transfer of an "undertaking" – for example, the transfer of a business unit – the undertaking's employees (and the liabilities in relation to them) transfer by operation of law to the Acquirer (under the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE)). It is important to remember that under TUPE employees transfer on their existing employment terms and with continuity of service. The employment terms cannot be changed in connection with the transfer. This is a significant issue on a business transfer. In practice, under TUPE employees are unlikely to object if they are offered improved terms as part of any acquisition, but imposing new terms such as restrictive covenants is legally difficult to achieve.

A team move also has the advantage that it is 'clean', except again possibly the employee liabilities. Whether employees and their liabilities transfer by TUPE to the Acquirer on a team move will depend on whether, and to what extent, the business of the team (which for TUPE purposes means the transfer of an economic entity that retains its identity) moves as well. As team moves are generally aggressive in relation to the existing employer, great care needs to be taken to ensure that team members do not breach their duties to the existing employer, for example, by encouraging other employees to move, copying confidential customer information or approaching customers to move their business. Such actions can give rise not only to legal (and regulatory) action instigated by the existing employer against the employees for breach of contract but also against the Acquirer for inducing that breach.

People
It is trite to say that insurance is a people industry, based on relationships. Personnel will be at the heart of any Producer acquisition. Whichever route is chosen, the Acquirer will need to ensure that its new staff are suitably incentivised to produce and to remain with the business in the long-term, are not prevented from bringing with them their business relationships, and that (should key staff decide to leave) there are adequate protections in place. With a Producer, the simple fact is that if key people leave, the business effectively walks out the door with them.

On a share acquisition the Acquirer should seek to include robust (or more robust) restrictive covenants in key staff's employment contracts. Most likely the Acquirer will be able to negotiate this because key staff will receive part of the purchase price or because they are getting a significantly improved remuneration package. This is not possible on a business acquisition (or a team move where there is a TUPE transfer) because the transferred employees' terms and conditions cannot change. On a TUPE transfer the Acquirer will need to check adequate restrictive covenants already exist. In our experience there is often room for marked improvements in the terms of existing restrictive covenants.

Another advantage of a company or business acquisition is that since the acquisition is friendly, the Seller will not be seeking to restrict the activities of departing staff (and indeed will probably itself be entering into non-compete restrictions). This is a major potential disadvantage of a team move. The Acquirer may be seeking to extract a key team from one of its competitors; which of course means that the competitor is likely to resist this move – whether by way of seeking to encourage all or some of the team to stay (say with a counter-offer) or by enforcing their contractual obligations (discussed above). Team moves can become messy and expensive. That said, although of course the incoming team will have to be remunerated, the Acquirer will not have to pay a purchase price for the team.

Regulation
A Producer acquisition will involve consideration of regulatory issues. The Acquirer will need to establish the Producer's current regulatory status, determine how it will be regulated post-completion and allow sufficient time for obtaining regulatory consents or applications.

Producers are very likely to be carrying on activities regulated under the Financial Services and Markets Act (FSMA). To comply with the law, a Producer can either hold its own permission from the Financial Services Authority (FSA) or another EEA regulator or be exempt as the appointed representative (AR) of an authorised person (the Principal).

An authorised Producer is directly regulated by the FSA or another EEA regulator. In contrast an AR is indirectly regulated. The AR is appointed by the Principal, which is responsible for supervising the AR and ensuring its regulatory compliance. If the AR does not comply with the rules the FSA will hold the Principal responsible.

On a share acquisition of an authorised Producer the Acquirer will require change of control consent from the FSA. Under FSMA this can take up to 60 working days (with possible extensions if further information is required) but a straightforward case is likely to take closer to 20 working days.

A FSA authorisation will not transfer as part of a business/asset acquisition or a team move. If the Acquirer does not already have authorisation or the necessary mediation permissions, it will need to obtain them before the acquisition or team move is completed. Under FSMA such an application must be determined within six months of being received by the FSA, although in practice three months will probably be adequate if a fully developed business plan and information are provided at the time of application.

A Producer's AR status will not transfer on a business acquisition or a team move. There is also likely to be a term in the AR's appointment preventing it transferring automatically on a share acquisition. The Acquirer has a number of options. On a business acquisition or team move the Acquirer's permissions may already cover the new business, alternatively the Acquirer could apply for an authorisation or for top-up permissions for the new business.

On a share acquisition, if the Producer is not authorised, the Acquirer might itself appoint the Producer as its AR (if the Acquirer has the requisite permissions) or seek authorisation for the Producer. Alternatively the Acquirer could seek to retain the AR Producer's existing appointments (although clearly this will not be possible if the Acquirer is a competitor of the Producer's Principal). The position will be further complicated if the AR Producer is the appointed representative of a number of Principals. Renewal of the AR status would need to be agreed with all Principals.

Contracts

Along with personnel, contracts are likely to be a key factor in any Producer acquisition.

Although one of the potential advantages of a company acquisition is that there is no need to transfer or assign the business contracts (the contracting party – the Producer – remains unchanged), it is fairly common that certain insurance-related contracts (such as binding authorities and terms of business agreements) contain change of control clauses. In other words, the other parties to these contracts may need to consent to the acquisition of the Producer.

For business acquisitions and team moves, the counterparties to contracts must consent to their assignment or novation.

Transfer/assignment of insurance-related contracts is important for a number of reasons, for example:

- The Producer holds binding authorities which are key to the Acquirer's acquisition decision; if the Acquirer wants the binders to remain in place following completion, the Producer/Acquirer will need to obtain the carrier's approval. Obtaining approval should be a condition precedent to completion.
- The Producer holds binding authorities; however on closing the Acquirer wants to terminate the binders and write the business on its own paper. The Producer/Acquirer will need to consider the contracts carefully. Is termination permitted? If so, what (if anything) does the contract provide as to 'ownership' of the business or of the records? Does the Producer have to return, or give access to, the underwriting records to the original carrier – enabling the original carrier to compete with the Acquirer? Would the Producer have ongoing obligations after termination (for example, run-off responsibilities)?
- In the case of a team move, does the team have a close enough relationship with the carrier to negotiate a new binding authority? Can the team's former employer continue to carry on the team's business without the team (and prevent the team using customer information)?

In our experience these issues are common, and some of the issues have resulted in reported case law.

Tax

Tax is often a crucial driver of acquisition structures; the parties will naturally seek legally to minimise their tax exposures. The key taxes are capital gains tax (CGT) and income tax.

Sellers are liable to CGT at 18% on any capital gain on a sale of a company or business. In the past certain sellers could reduce their CGT tax bills to 10% with taper relief. Today Entrepreneur's Relief can still potentially reduce CGT to 10%, however it is a much more limited tax relief. These rates need to be compared with income tax rates of up to 40% (50% from April 2010).

Since CGT rates are lower than income tax rates, there are obvious tax savings if payments to key staff can be structured as capital rather than income. The consideration payable on a company or business disposal is likely to be capital and not income. It might be possible to structure some of the on-going incentives for the Buyer's new staff as capital rather than income.

Conclusion

Producer acquisitions make sound commercial sense in the current economy as carriers and intermediaries seek to secure their sources of business. We expect the number of Producer deals to continue to rise. Structuring is key to any acquisition to ensure a balance between commercial risk and legal protections.