Inside the Numbers: Who is the operational benefactor of the Farmers Insurance Exchanges?

Farmers® Agents can be proud that Farmers provides:

- Quality policy offerings (opinion of writer) along with optional endorsements to compete with coverage in the marketplace.
- Above-average claim experience. This can be verified by the National Association of Insurance Commissioners (NAIC) justified compliant ratio index. This Index can easily be correlated as a measure for carrier claim quality. Most complaints occur after claims. You can get this Index report for each carrier at your State's Department of Insurance website.

If agents have good policy offering and claim services, then why has Farmers Insurance Exchange and its Affiliated Property and Casualty Insurers been losing Market Share[1] over the past 10 years? Farmers Management (Farmer Group, Inc. (FGI)) and Farmers agents should be in a marriage to grow policyholders. So….why are we not growing? If you posed this question to Agents and Management …..answers would likely revolve around rates and/or marketing:

1. **Rating Perspectives:**
   - **Tenured Agents View:** Farmers new business/renewal rates continue to stress agencies policyholder/referral relationships. New business rates currently appeal to a marginal percentage of risks. Insurance prospects put a heavy weight on the rate component when making relationship and buying decisions.
   - **Farmers Management**: "You have competitive rates……. you're just not quoting enough".

AND/OR

2. **Marketing Perspectives**:
   - **Farmers Management**: Take steps to further Invest in your agency with increased marketing and staffing. This ensures you can more than replace the policyholders you are losing.
   - **Tenured Agents View:** Captive and Farmers agents return on marketing investment per dollar is much less than Independent Agencies. Farmers agents need laser precision prospect targeting to get a comparable closing ratios vs. Independent Agencies (with different carrier pricing). Additionally we need more tools to retain existing customers happy with our agency service to prevent them from moving to a competitor. *Bottom Line message to Company*….provide more attractive long-term pricing and/or tools for existing clients and increase new market competiveness and agencies will have the confidence to reinvest deeper with new business marketing and/or expanded staffing.

Truly objective folks would agree that both the corporate and tenured agent views have merit, but that information disclosure has not solved the continuing problem. Even though Farmers has grown its operating territory (Eastern Expansion) consistently Farmers has lost Market share[1]. Our goal starting with this and future articles is to take a deeper dive into real numbers to help explain this dilemma. Our agency asks our clients why they leave, as most agencies do….so that we have a better understanding as to why they are leaving. However, we plan to provide data to help you formulate and initiate discussions for positive change. P*lease have some patience when reading the next couple of paragraphs. Every Farmers agent needs to truly understand the Company we represent.*

Insurance companies operate differently depending on their governing documents. Most insurance companies are either Mutual (owned by the policyholders-like State Farm®) and/or stock owned (owned by shareholders – like Allstate®). **Farmers operates a little differently** (similar to USAA®).

Farmers operates as a Reciprocal Company designed and owned by the policyholders (subscribers) to pool individuals/businesses risks to obtain better insurance rates. Farmers Insurance Exchange policyholder's subscribe via the subscription agreement to one or more of their Reciprocal Exchanges: Farmers, Truck, and Fire Insurance. Exchange surplus "Assets of the Company" owned by the policyholders takes on the risk of policyholder claims. Farmers Management, FGI, acts as the Exchanges attorney-in-fact (AIF) overseeing the daily operation of the Exchanges. Exchange Board of Governors (BOG) are elected by policyholders (see subscription agreement) to ensure the AIF operates the Exchanges for the benefit of the policyholder. Farmers and USAA are similar in operation to this point. USAA's AIF is under the complete direction of its board of governors. FGI is under the direction of the Exchange BOG and Zurich Insurance Group (a stock company, FGI being a fully owned subsidiary). FGI responsibilities to Zurich, operate the Farmers Insurance Exchanges to retain an acceptable profit. In contrast to the Exchanges, Farmers New World Life and Farmers Reinsurance (Farmers Re) stock companies are owned by FGI.

FGI as the Exchanges AIF has two primary responsibilities:

- Manage Exchange claims employees (adjustors, attorneys and managers) who are paid directly from the Farmers Insurance Exchange (i.e. – these services are not affiliated with the AIF management fee).

- Provide non-claims service management for the Exchanges, such as setting rates, marketing, and other administration. For these non-claim AIF services the Farmers Exchanges pay a contractual management fee which does not have any risk to policyholder claims. In accordance to the policyholder subscription agreement the AIF can be paid a management fee up to 20-25% (depending on which Exchange) of earned premium. In the past 10-yrs. the management fee actually paid to FGI has reduced from a high of 15.25% to a low of 13.75% [10% reduction] in 2019.

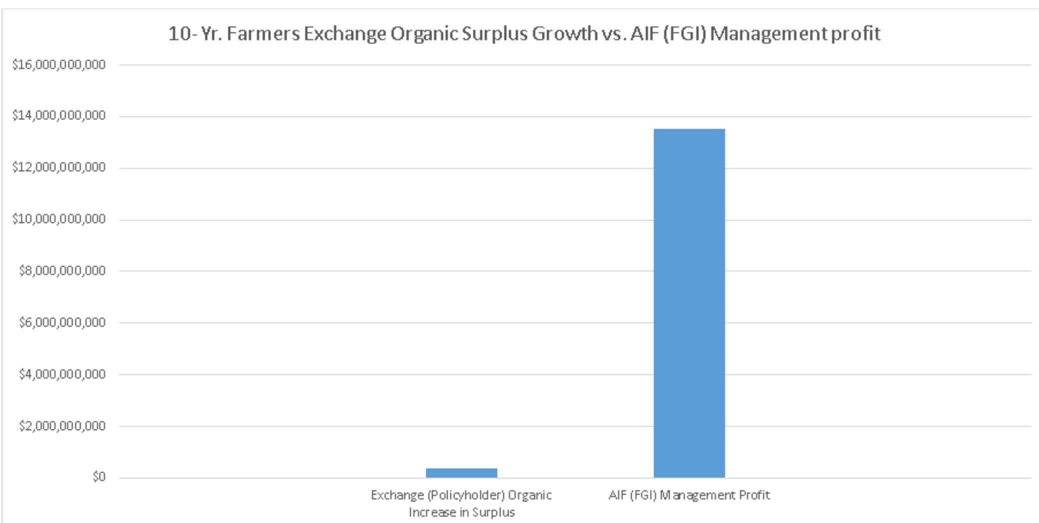
Farmers agents are expected to maintain a local Farmers storefront, prospect new policyholders, and service existing clients. The agency service agreement traditionally paid a base renewal personal line commissions (before 2018) of 10% and 14-18%, In 2018 base commissions were cut an average of 15% as base renewal commissions were reduced to 9% and 10%, respectively for auto and fire products. This income similar to the AIF management fee is not at risk to policyholder claims. Agent's base commissions can be increased with Bonuses: Profitable Growth Bonus – based on Gross Written Premium (GWP) growth (>5%) assuming a satisfactory Underwriting Quality Index (UQI). Since UQI has components which take into account auto and home profitability, this bonus income is susceptible to policyholder claims. In November 2020 Farmers management announced Agent base average compensation would be reduced again by about 5% in the 4th Quarter of 2021 (Agency Sales Compensation Program). Please keep in mind, these future changes will also affect your contract and/or market value of your agency.

Question: Does your agency operation retain a profit after paying all expenses including fair compensation to the principal agent? Most new agencies invest capital into their operations. Many agencies (new & existing) reinvest in their operations by getting loans and/or putting additional owner capital at risk. Believe most established agencies operational expenses are close to break even. It is possibly that some agencies could earn a profit/dividend on base commission but its likely 10% or less.

Let's look at the Farmers Management (FGI) AIF profit after paying all FGI expenses including employees' salaries and bonuses. Historically after AIF administrative expenses have been paid the profit margin retained by the AIF (FGI) has been about 50% of the management fee[2]. FGI has an agreement in place with the Exchange ensuring their profit cannot exceed 7% of policyholder gross earned premium. So how much money does this profit represent? In 2019 the FGI management fee profit was $1.3 Billion[2].

We want our reader to mindful of the AIF (Management Company) profit and compare it to the Farmers Insurance Exchange policyholder's operational profit which is measured by the growth in the surplus value. The Exchange (policyholder) surplus value for the past 10-yrs has varied from around $5.56B to $6.33B. The total surplus value at the end of 2019 was around $6.2B [*Important Note: This includes about $2.0B in surplus loans. So, really the net value is $4.2B.* The *Exchange has maintained surplus loans (notes) consistently totaling around $2.0B over these past 10-yrs.*]

Below you will find a 10-yr. graph reflective of cumulative management fee profits[2] verse policyholder organic Surplus growth[3] (Surplus increase and net surplus notes paid). Keep in mind, insurance companies who increase their Surplus generally have more stable rates and flexibility to grow their business.



We will let you make your determination based on the money flow to answer the biggest questions:

- **Who benefits more from the operation of the Farmers Insurance Group of Companies:**
  - Farmers Insurance Exchange policyholders (subscribers - Owners of the Exchange) **OR**
  - FGI Exchange AIF? (Managers of the Exchange)?

Hopefully you have more opinions and questions:

- Is the spirit of the governing Reciprocal documents (policyholder owner Exchange) agreement being maintained?

- Should the Exchange Board of Governors (BOG) review the last 10-yr performance of the AIF and question whether or not the current AIF compensation will benefit a long-term relationship with the Exchanges? Is a 50% profit for contractual management services acceptable?
- How would the Exchange BOG or FGI respond to a policyholders concern on the 10-yr graph reflective of management fee profits vs. Exchange organic policyholder surplus growth?
- Agent's base commission's cuts were significant in 2018. FGI Management would argue that AIF management fees have been reduced by 10% in the last 10-yrs. Has this fee reduction cut into the FGI's AIF profit margin? If you review Zurich's Annual financial reports – FGI's management fee profit has been maintained at about 7% of GWP[2].
    - Should agencies operate in the same manner as their partnering management company? Maintain a 50% profit margin after paying all expenses (Including principal agent's salary and bonus). The profit would resemble 4.5-5% of your policyholder's premium or 50% of your total commissions. If this was even feasible...ask yourself if you would feel guilty profiting at this level on a service contract?
    - The Exchange BOG is likely required to approve management decision to cut agents base commissions as your agent contract is with the Exchanges and not the management company FGI. Shouldn't the BOG's compensate the AIF similarly? Put the AIF compensation on a lower base management fee with the ability to increase its compensation with growth in Farmers market share and/or surplus growth?
- FGI wants agents to spend more on marketing and staffing. Should we be asking FGI management if this stance is hypocritical? Wouldn't all parties (Exchange, AIF, and Agents) benefit if the management company relinquished some of its profit margin to help grow market share? P.S. - It would also be nice to pay down the $2.0B in Exchange Surplus Notes.

Your agencies future and your existing policyholder's expect you to ask the hard questions to FGI Management to initiate change. Provide constructive feedback with facts to back-up your statements! Talk to President Council (PC) members about this issue. Ask these PC agents if management listened and acted on any of their prior requests for change. If you have connections- have a serious discussion with a Farmers Exchange Board of Governor(s), and/or FGI C-Level manager(s) or possibly Zurich. Talk about this issue and educate your fellow agents.

Agents happy with the status quo….with Farmers retention ratios around 80% (at least on our state) plan on recycling your client base every 5 years. Typical captive agencies with 85-90% retention levels will minimizes the client recycle to 7+ years. **Bottom Line-** Better retention increases referral networks and allows better focus on new business marketing. This most definitely has positive impacts your agency market and/or contract value.

If you got something out of this article……awesome. You're getting this information because the United Farmers Agents Association (UFAA) is committed to protect the interests of Farmers agents. UFAA needs growth in new agent memberships. **Please join UFAA today….even if it's an anonymous membership or a donation!**

Believe it's time for the Farmers Insurance Exchange BOG's to seriously review FGI's AIF compensation. An announcement of this type would definitely improve the ability for the Farmers Exchanges to grow its surplus, market share, improve retention, and elevate agent morale?

Future- Inside the Numbers articles:

- Surplus Growth Peer Comparisons
- Reciprocal Company Management fee peer comparisons
- Why is it that Farmers Combined Ratio always near or over 100%.
- Peer Comparison: Management employee Expense ratios & Executive compensation.

References:

1- National Association of Insurance Commissioners (NAIC): Market Share (Total Premium) Reports 2009-2019 for Property/Casualty Groups & Companies (www.naic.org/prod_serv_publications.htm)
2- Zurich Insurance Group LTD- Annual Financial statements:
3- NAIC Company Data : Company Code 00698- Farmers Insurance Exchange Combined Statement reviews 2009-2019

** Disclosure: After researching and reading publicly available information on the internet, I felt the need to express my opinion through this article. While I believe the article to be factual and informative in nature, it is my intention that the reader decide for themselves.