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December 21, 2021

2021, Another Record Year for Consolidation - What to Expect in 2022

Over the last two years, we have witnessed the most significant consolidation within the insurance distribution system ever. In 2020, we saw 718 reported transactions driven by three primary factors: (1) record high valuations, (2) the desire/need to achieve “scale” and the competitive advantage that can come from it, and (3) concerns about the election in November of 2020 and fear that a new administration would materially increase capital gains tax rates.

As that new administration came into office in 2021, it wasn’t long before President Biden told a joint session of Congress that he wanted to see capital gains rates increase from 20% to 39.6%. We knew tax hikes would not happen immediately and possibly not until 2022. But as a result of Biden’s stated tax intent, along with the continued need for scale and another round of record valuations, it seems 2021 will close with a new record of reported transactions – potentially over 800.

Well, what is in store for 2022? On the tax front, we have an ever-evolving picture. As of last week, taxes in the Build Back Better (BBB) legislation suggested that there would not be material changes to capital gains or small (under \$1B in profits) corporate or “non-super wealthy” individual income tax rates. With Joe Manchin’s declaration of non-support for this legislation over the weekend, BBB looks like it is dead, but it could be revived, or alternative legislation could be floated in 2022. As a result, we don’t have an impending tax hike, but we still have some uncertainty as to what might surface later in 2022. With this uncertainty, it is possible that consolidation will continue at a record pace, but we could also argue that after

There are other factors that could negatively affect valuations and the level of activity. We will likely see interest rates go up, which will negatively impact buyers. The P&C market could begin to soften which will dampen future organic growth rates. We could see a stock market correction brought on by Omicron or the next COVID-19 strain, bad economic news, or political instability. As for the need for scale, there are other ways to achieve scale without selling (e.g., joining networks, merging with other privates, or specialization) but the need for scale will likely continue to be a factor in driving firms to sell.

There are several firm specific factors impacting perpetuation decisions, including the operating results of firms (e.g., are they selling from a position of operating strength), how equipped they are to perpetuate internally (if that is their desire), and their outlook for the future (pessimistic or optimistic).

What does this all suggest? The demand for acquisitions is as strong as ever and the supply of quality candidates is not increasing. Money will continue to flow to investments in insurance distribution because of the industry's resilience and positive characteristics, resulting in valuations staying strong, if not at continued record levels. The desire/need for scale and the competitive advantages that can come from scale are not going away and will likely become more prevalent.

We are in a good place as an industry – great fundamentals, operating results, and outlook for the future. For those that are buyers, most have done amazingly well. For those that want to sell, you can still do so and get outstanding results as respects the price you will be paid, the taxes you will pay, and the quality of the firms you can join. For those that want to remain private, you are not missing the last opportunity to favorably sell and, as we have written about in this space, there are many benefits to remaining privately held. If you add all of this up, we expect that the number of transactions in 2022 will be strong but will not be a new record – likely falling somewhere in the 700-800 range that we've seen over the last 24 months.

Whether you are a buyer, seller, or you are remaining privately held, we should all be thankful for being in such a fantastic industry that is populated with a lot of wonderful people. Thanks for the part you play in it. We wish you a Merry Christmas, Happy Hanukkah, and a Happy New Year.

Bobby Reagan
CEO and Partner, Reagan Consulting

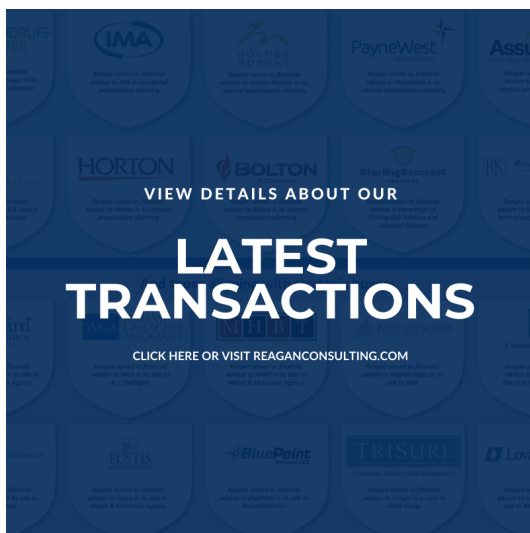


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