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Commission Rates

A. Is there justification for paying higher rates of commissions to experienced agents? Has it been found feasible to do so?
B. Is grading of commission rates by size of policy, as is done in group insurance, appropriate for Ordinary insurance?
C. In what ways have normal commission scales been modified in connection with the sale of permanent insurance on the "minimum deposit plan"?
D. What practical methods are available to maintain consistency between the levels of commission payments for pension plans funded by means of individual policies and group annuities?

Toronto Regional Meeting

MR. LESLIE A. CANNON: Although other considerations have kept most companies from adopting this practice, paying compensation in excess of the standard commission scale to an experienced agent whose sales record is satisfactory may be justified for the following reasons: the reduced cost of training, supervising and financing, and the saving in expense resulting from retaining a greater proportion of experienced agents under contract; the substantial saving in replacement costs; the development of a mature and loyal agency force; the better advice and service given by an experienced agent to his policyholders.

A review of agent's compensation plans of the larger Canadian companies shows that additional compensation is frequently paid for good performance in a number of areas. These include consistent production, good persistency, annual premium business, minimum number of sales during the year, and attainment of certain levels of net paid production or first year commission earnings. These incentive bonuses are generally available to all agents who qualify. However, a large share of this extra compensation would normally be earned by experienced agents. One company pays an allowance of 5% of the previous year's commission income, subject to a maximum amount, to agents with more than 3 years' service who produce a reasonable minimum volume of new business. Two other companies pay renewal commissions after the 10th policy year where the agent is still producing a reasonable amount of new business or has a minimum volume of business in force.

MR. DONALD M. ELLIS: I feel that paying higher commissions to agents with experience would be a mistake. A good many are still not good agents and, therefore, to give them a higher rate of commission would produce inequities which we do not now have. I feel rather that our contracts should be designed to pay a greater rate of compensation for the better class of business, such as business with good persistency.

Concerning section D, Canada Life has in the past done a fair amount of pension trust business without attempting to maintain any substantial consistency between the commissions on such business and those paid on group annuities. Had we realized the difficulties this would cause in conserving the business, we would probably have graded commissions for pension trusts from the outset.

MR. THOMAS B. MORRISON: There could be considerable difference of opinion on a satisfactory definition of an "experienced" agent. Most people would agree that a new agent could properly be called "inexperienced." Production costs with inexperienced agents are generally high and in fact may apply to business not actually written. Since it is generally hoped that these costs will reduce when such agents become established, it seems inconsistent to contemplate higher commissions to compensate for this decrease in cost. However, if we accept as an experienced agent one who can produce quality business that stays on the books at better than average renewal rates, I think there is justification for paying higher rates of commission. Our company (The Manufacturers Life) pays, to agents meeting modest production requirements, conservation allowances which in Canada take the form of a bonus of 12% of new commissions for agents with a lapse rate in the previous year of not more than 10% of combined first and second year business. (This formula will take effect in 1962.)

With regard to section B, an agent who sells mainly to his own age group would tend to write larger policies as his duration in the business increased, since financial ability to purchase larger policies normally increases with age. This results in an increasing income with length of service which parallels the situation in most salaried jobs. I therefore feel it would be unfortunate to grade down the commission rates for the larger policies.

Concerning section C, The Manufacturers Life has one plan of insurance with high early cash values in our United States operation for "minimum deposit" business. The plan is "Life paid-up at age 90" and the commissions payable are 25% first year, followed by 9 renewals of 10%. This compares with the normal 60% first year commissions, 10% second year, and eight 5%'s under the regular whole life plan. A commission scale differential of this type seems entirely justified for minimum deposit business because a certain proportion of business sold on this plan is, in reality, short-term term insurance, and the remuneration for such business is quite handsome compared to that for regular term insurance. If the business persists, the total compensation is consistent with that for the whole life plan.

MR. GEORGE RYRIE: Regarding commission rates to experienced agents, it seems to me that the reverse is in effect when you think of some of the liberal financing plans in existence.

MR. WILLIAM M. ANDERSON: My answer to the question in section B is "No."

In Canada, the number of new ordinary sales is about 80 times as great as the number of new group sales. In other words, the average number of sales of ordinary per agent is in the neighborhood of 60 per year, whereas that for group is roughly three-quarters of one per year. The disparity in the amounts in force is even more startling and is of the order of 180 times. This indicates that the typical agent dealing with ordinary handles many transactions in the course of a year and the question of relating the cost of his services to individual contracts becomes extremely difficult, whereas it is possible to determine much more accurately the value of the agent's time in relation to each group case.

Another indication that we are not dealing with the same kind of merchandise in the two fields may be given by comparing the average annual premium per policy, which is around $80.00 for ordinary policy and about $6,000 for group. In this regard consideration should also be given to the enormously wide dispersion about the average in the case of group as compared with ordinary. This dispersion is especially evident in dealing with the business of a particular agent.

In group business the insurer traditionally has attempted to charge the policyholder for explicit services rendered and, within the bounds of credibility factors, for his own claims experience. Accordingly, it is understandable that group commissions are determined as far as practicable in relation to the value of the services rendered by the underwriter for each particular case. The cost of ordinary insurance on the other hand is determined on the basis of very broad averages and striving to avoid what might be called discrimination between policyholders.

Reference should also be made to the type of competition the group business meets. The small group policy may have costs and commissions comparable to the alternative of ordinary policies, but the alternative to the large group case is self-administration and the charges made by the insurer must be compatible with the costs of this alternative.

Increases in group policies occurring after issue often involve little work for the life underwriter and the graded commissions under group produce relatively low marginal rates of commission on the increased amount. On the other hand, where increases occur on ordinary policies the agent is often involved in substantial additional work and there is every reason why he should get substantial marginal compensation.

It is very seldom that a particular policyholder will own several group master contracts covering the same type of protection. On the other hand in the ordinary market the typical policyholder owns a number of policies and an attempt on the part of an insurer to grade commissions by size could readily be defeated by agents spreading insurance purchases over several policies possibly among different companies.

In conclusion, I would like to register my disapproval of two practices which have the effect of grading commissions by size.

1. The practice of paying the same rate of commission on fractional and annual premiums has the effect of grading commissions because of the larger proportion of fractional premiums on smaller policies.
2. The practice of grading premiums by size has the effect of providing a lower commission per thousand for larger policies.

MR. E. J. MOORHEAD: The traditional freedom and independence of our agency organizations, desirable as it is in many ways, places barriers in the way of experiments such as are contemplated in sections A and B.

Theoretical justification of higher commissions to experienced agents presumably arises from the higher quality of the business and the greater value of the service they render to their clients. Nevertheless, the major difficulty most companies face today concerns the earning power of the new rather than the experienced agent. It can be argued that the earnings of an experienced agent are already at a more favorable level as a result of the larger renewals accruing from business with good persistency. Nevertheless, cases have been known where general agents have shared a portion of their overriding commissions with experienced members of their agencies in the form of expense allowances.

With regard to section D, grading commission rates by size is already in operation in reverse in some companies in that higher commissions are paid on regular policies, say $5,000 and over, than on the very small policies. Awkward problems could arise where lower commission rates are paid on larger amounts, such as the possibility of splitting policies into separate smaller amounts so as to qualify for the higher commission rate on each part. It is quite possible the agent might even split the policy between different companies.

MR. PEARCE SHEPHERD: My answer to the question in section B is "Yes." For many years we have paid 40% first year commission on ordinary of less than $2,000, 50% graded for policies from $2,000 to $5,000, and 55% from $5,000 up. Such a scaling of compensation gives the added incentive which we feel is desirable to raise the sights of our agents to the larger amounts.

Incidentally, this 40% commission rate on policies under $2,000 helped us a great deal when we came to the decision that we wanted to have a minimum policy of $2,000.

MR. GORDON G. MYER: Better persistency and service justifies a higher rate of commission, but the experienced agent does in fact receive higher compensation simply because his policies persist, and he therefore draws more renewals than the inexperienced agent. However, to get the new man started, we must pay him relatively more than the experienced agent. Some years ago, Confederation Life had a "quality production bonus" which paid up to $10 per thousand for high production with very good persistency. This certainly paid experienced men more than new men, simply because they had a better persistency record, but it also paid a good new man more than normal in the first year because his business had not developed its full lapse potential.

It seems logical that commissions be graded down as the size of the policy increases. Not only is there the argument of work done not being proportional to the size of policy, but it seems likely that the company would rather have 10 or 20 smaller policies of say $100,000 or $50,000 each, rather than 1 for $1,000,000.

It would seem very difficult to enforce any commission scale lower than normal on a policy financed by a bank loan. It would even be difficult to do if financed by a policy loan, although some companies pay commissions only on a premium "paid-in-cash" basis. One of our policies has a relatively high first year cash value and is often used for "minimum deposit" business. In order to avoid loss through early lapsation, we pay a lower first year and higher renewal commission on this plan.

With regard to section D, one practical measure would be to refuse to allow an overlap of limits. Cases larger than a certain size would have to be written on group and smaller cases would have to use individual policies. Some companies have reduced the normal commission scale and premium rates when individual policies are used to fund pension plans, paying perhaps one-half the normal scale in such cases.

Los Angeles Regional Meeting

MR. GARNETT E. CANNON: I will mention a paper by Frank J. Schwentker in which he comments on the high cost of distribution under the agency system. Mr. Schwentker observes that life insurance is the only major business or industry in the United States that has failed to reduce its cost of distribution as volume of business has risen. He also observes that in the past fifty years group insurance, which has the lowest distribution cost, has shown the largest relative growth, while industrial insurance with the higher distribution cost has experienced the least growth and in recent years has been practically standing still.

MR. CLARENCE H. TOOKEY: When the Occidental entered Canada, it was then against the law to use a policy minimum size of more than $1,000. In order to have a competitive rate for the larger policies and still have an adequate rate for the $1,000 policies, the Occidental issued agency contracts in Canada which graded commissions all the way from $1,000 to $10,000. This approach appeared to be quite satisfactory to the agency force in Canada. In 1936 the Occidental tried this same type of contract in the United States. This was not successful since it had not been carefully sold to the general agents and managers. This approach was discarded after approximately one year.

I believe that prior to the introduction of grading premiums by size, it would have been appropriate to use higher commission rates for larger policies. However, this would not be feasible for a company grading premiums by size since this would mean paying the same savings twice.

MR. RALPH J. WALKER: I believe a company would have considerable difficulty in paying higher rates of commissions to "experienced" agents since it would have considerable difficulty in defining the class of agents who are "experienced." Also, with a given set of premiums, dividends and expenses, there is only so much money to pay to agents in commissions. To pay one class of agents more money means increased premiums and less dividends.

I prefer to define a better agent as one who sells a larger volume of insurance and who has good persistency. Volume in this context could mean either face amount or premiums, depending upon which definition management chooses to use. Of course, the commission scale produces greater compensation for greater persistency. As to volume, you can give greater compensation to your "experienced" agents, subject to New York law in some instances, by way of telephone allowances, housing accommodations, secretarial help and group insurance. I believe that the answer to the question of section A is that there is no justification for higher rates of commission but that we can and do compensate our better agents more.

MR. CHARLES F. B. RICHARDSON: While we do not pay higher rates of commissions to experienced agents, we do, in fact, pay more total commissions because they write business that is much more persistent than that of new agents. As a practical matter, it is necessary to pay higher rates of compensation to new agents in their early years. No matter what you call it, you have to pay more money than under the commission scale for mature agents, because a subsidy is necessitated by the nature of our deferred compensation system.

Section B apparently implies a grading of commissions on an incremental basis. I agree with Mr. Tookey that this is completely impractical in the Ordinary business. Many companies grade commissions by size of policy, and a few grade them by size of premium. My own company pays a lower commission rate on policies with small annual premiums, in spite of our quantity discount based on the policy fee system. This lower commission is justified since as a practical matter you cannot charge an adequate policy fee for a $1,000 or $2,000 policy.

As to section D, I have always thought that the traditional group annuity commission scales were much too low on the smaller cases to compensate the agent or consultant for the amount of work involved. I believe the commission rates on small group annuities should be graded into the commission rate that would be paid on a 10 or 25 life individual policy pension trust case. In the absence of that type of grading, individual policy pension trusts compete with the group annuity department within the same company.

MR. BEN J. HELPHAND: In order to discuss section C, I surveyed those companies with over $1 billion of insurance in force which apparently had some type of minimum deposit policy. I received twenty replies from this survey. Four companies indicated they do not have minimum deposit plans currently; one of these said they withdrew their plan in January 1961, and another said that although they have higher cash values on policies over $15,000 or more, they pay the same rate of commission regardless of amount, and the last two indicated they have a higher cash value plan specifically designed for split dollar policies which they carefully police so that they will not be used for minimum deposit plans. Of the other sixteen, a few said their policies were split dollar policies, not minimum deposit. For these sixteen companies, the first year cash value varies from 35 percent to 70 percent of the gross premium. Seven of these companies redistributed their commissions from 55% and nine 5's to 25% and nine 10's by reducing first year commissions and increasing renewal commissions. Six other companies generally reduce their first year commission allowances with some modification in the renewal years. Two companies pay the same commission as on their regular form. One company replied that they redesigned their policy to comply with New York Regulation 39, and that they pay commissions varying by age at issue.

MR. JOHN R. TAYLOR: I believe that the problem posed in section D is very broad and is not limited to individual policies and group annuities. The broader problem is to maintain consistency in commission payments between all kinds of pension plans. Consistency does not necessarily mean equality in amount. A commission difference between individual policy and group pension plans often is justified because the agent is performing services which save the company some expense elsewhere.

It is desirable to consider other than just commission arrangements in trying to maintain consistency in levels of commission payments. Other factors may be just as effective. For example:

1. A company might consider not writing individual policy plans above the plan size where the company is willing to write group annuity plans. This removes the "competition" as to commission scales.
2. Group permanent plans can be offered to employers desiring the types of benefits provided by individual policies. It may be easier to be consistent between group permanent and group annuity plans than it is between the latter arrangement and an individual policy plan.

If it becomes necessary to work directly on the commission schedules to maintain consistency, the following are possibilities:

1. Grade individual policy commissions for plan size.
2. Reduce individual policy commissions if the total plan exceeds the size above which the company is willing to write a group plan.
3. Pitch group annuity commissions for smallest size plans to a level reasonably realistic for the low premium involved.

MR. CHARLES F. PESTAL: Since Mr. Cannon talked about distribution costs, I believe that you will be interested in knowing that at Northwestern National we recently made a thorough study of our commission system for subagents. We have now changed from a renewal commission system based on the amount of insurance to a renewal commission system based on a percentage of premiums. In considering an ideal commission scale, we discussed the grading of commissions by size of policy, but abandoned the idea for administrative reasons and also since the gradation of premiums already pays out the savings by size to the policyholder. Another consideration during our deliberation was the marginal producer. This is the agent that is costing us money and we want to terminate him as soon as possible. A program in one of our 7070 runs examines the record of each new agent and prints out a report on the marginal agents which is sent to the agency department. We thus hope to terminate the marginal producer sooner and reduce our distribution costs.

MR. CHRISTOPHER H. WAIN: I believe the point of reducing distribution cost is worth more exploration than the possibility of reducing commissions. Trying to cut commissions is difficult. It can cause serious losses in agency morale, increase turnover, and reduce production. Reductions in distribution cost can produce gains for all concerned.

We can reduce distribution costs by getting more business out of an agency and by finding ways to have more producing agents per member of agency management. Perhaps we can also do without some of the fancy facilities that we provide. For instance, if an agent could operate from his home, there would be a saving to the insurance company and a possible gain for the agent through tax credits on his housing costs.

MR. ALEXANDER MARSHALL: We, at West Coast Life, have a device in our agent's compensation plan to reward experienced agents who are doing a good job. One way we measure the quality of our agent's performance is to calculate a rating factor for each agent based on the first two policy years' persistency rate. The agent may earn up to 15% more (persistency of 90% or greater) or as much as 10% less (persistency of less than 60%) in first year commission dollars, depending on this persistency rating factor. We also add 5% of first year premiums to commissions for policies of $5,000 or more, and reduce the commission by 10% of the premium for policies less than $2,000. We also reward our experienced agents with an income per thousand of business written in the fifth preceding year which persists to the end of the fifth year. The rate at which this additional income is calculated increases with length of service of the agent.