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MISCELLANEOUS QUESTIONS

A. To what extent is it practical for smaller companies to follow the action of some of the larger companies in offering new policy forms and riders, such as:
   (i) Guaranteed Insurability Option on birth of a child (the Stork Option)
   (ii) Educational Plans
   (iii) Father-Son Policies
   (iv) Life and health insurance protection for future children (the Cradle Protection Plan)?

B. How much emphasis should the smaller companies put on conservation in the form of persistency bonuses and other incentives?

Toronto Regional Meeting

MR. GEOFFREY F. N. SMITH: In connection with section A, one of the major problems facing the smaller companies as they view the large number of special plans, riders and benefits being introduced every day is that of selectivity. The smaller company should, it seems to me, try to restrict its new plans or benefits to those which fit the market served by its agency force and which, in addition, can be expected to produce a substantial volume of business in order to justify the expense involved in their introduction.

Being associated with a smaller company (Sovereign Life) which has been in business for almost sixty years I can testify to the extra work and expense of servicing, administering and valuing the six or seven remaining policies on some special plan or benefit introduced in the 1920's or 1930's and then dropped a year or two later because of lack of sales.

It seems to me that the smaller company actuary has to take a long-term view and ask himself questions such as:

1. Does the new plan or benefit meet a specific need of some part of the insuring public in a better or more attractive way than existing policies?
2. Does the benefit meet a need of that portion of the life insurance public served by our agency force?
3. Does the benefit appear to have sufficient sales appeal so that we may expect a good cross section of business with sufficient volume to justify development and promotional expenses?
4. Are there any underwriting, valuation or other administrative problems associated with this benefit which either at issue or in later years might bring about unfavorable mortality experience or unexpectedly high administrative expenses?

MR. STANLEY W. BOYLE: In the consideration of a new plan or rider introduced by other companies, an important factor is whether or not one believes that this plan or rider would have a material sales value for one's own particular company. A larger company offering this new insurance may be aiming at a section of the market in which one has little present or probable future interest, so that unless the new form seems to have particular merit it might be wise to wait at least until some indication of the extent of its popularity is evident.

Subject to this reservation I feel that our company (Industrial Life) will generally follow the larger companies. I suggest also that the small company should be alive to the possibility of having some special form of policy or rider of its own. We have had one special policy which, while generally sold in small amounts, has proved to be very popular with many of our agents and has provided a considerable volume of sales over a number of years.

In so far as riders providing options to buy new insurance at some future date are concerned, there is the practical problem of measuring the risk involved and the probable cost, which latter might be increased appreciably by the extra reinsurance arrangements needed. Special characteristics of a company operation might also require special attention when considering a new form of insurance. Since the Industrial Life sells the bulk of its business in the Province of Quebec, our Family Policy premiums have to take into account both a higher average number of children per family and a higher rate of infant mortality than for Canada as a whole.

While a new development usually causes agitation from the field force for the adoption of similar coverage, it is sometimes possible to point out that an existing form of insurance would accomplish almost the same result. Nevertheless, it is often necessary to follow the leader, particularly where the leader is a large company which advertises widely. If you issue a similar product you may cash in on the publicity of your competitor and also improve your agents' morale, thereby displaying the aggressiveness the smaller company must show in order to grow.

MR. GEORGE R. WALLACE: There is often a considerable amount of agency pressure put on smaller companies to follow the lead of larger companies in the introduction of new forms. The actuary of the smaller company had to decide whether the results achieved in the preparation of the new form would be worth while, considering the cost involved in preparing premium rates, policy forms and valuation factors and the probable effect on the agency force in terms of the ability to compete and of morale. If sufficient sales can be anticipated to cover the cost of preparation, it is generally desirable to write such new forms, provided that they are socially desirable and not merely sales "gimmicks."

The Continental Life (Canada) avoids, wherever possible, copying plans brought out by the larger companies, since their value can be measured only in defensive terms. We prefer to design special policies which are unique with our company, thus giving our field force sales advantages which cannot be compared with companies of our own size or even the larger companies. Although this course is more difficult because of the lack of a large actuarial staff, we feel it is an interesting challenge which we have met to date with some small measure of success.

These unique forms weaken considerably the pressure from the field force to introduce new forms of coverage. Generally speaking, the desire for something new is not specific but arises primarily from what seems to be a fear of standing still. As long as this fear is overcome, the necessity of following the larger companies is considerably diminished.

MR. HERBERT H. BLAKEMAN: My company, the Empire Life, has learned from experience that the promotional effort to initiate the special forms may be costly for the smaller company and disappointing in the amount of business resulting. I believe there is frequently an advantage to the smaller company in leaving the innovation of policy forms to the larger companies, thereby avoiding much of the costly advertising and promotional effort and allowing time to assess the impact of the new product on the typical market of the company's own sales force.

I think that where possible the smaller company might gain by designing its sales organization and facilities for a limited area of the market or specific markets and perhaps for a limited extent of territory. Potential efficiency for the smaller company may be seriously curtailed by attempting to provide facilities for the entire range of markets on a nationwide basis.

MR. SMITH: Concerning section B, the experience of the Sovereign Life has been that by far the greatest part of our persistency problem arises from the activity of men in their first two years in the business who ultimately fail. Since the great majority of new men are on a fixed financing basis under a validation schedule, incentive in the form of persistency bonuses has little or no effect at that stage of their careers. As a result, our efforts in this direction have turned to the managers' compensation and they are gradually changing our managers over to a contract which places great weight on the persistency of business produced in the agency. While it is still too early to produce valid statistical evidence as to the effectiveness of this approach, the immediate reactions of our managers definitely indicate that they are far more concerned about early lapses and are doing more to improve persistency.

MR. WALLACE: The results which the Continental Life has obtained over the last three years with a new agent's contract which applies to both new and existing agents, and which includes a persistency bonus which forms a considerable portion of the agent's compensation, have been less favorable than expected. We have, at the same time, given publicity to both branches and agents with good persistency and have held contests based on business with better than average persistency. We are forced to the conclusion that other factors play a larger and more important part in the writing of persistent business.

It seems to us that the agent himself is the primary factor in determining the persistency of the business written by a company. An agent whose business is particularly good or bad will be little affected by incentives, but there appears to be a middle group, whose persistency might be called average, who may be affected. Our experience has been that with the new contract this middle group has tended to write business that is somewhat more persistent. It appears to us that the most important factors in writing persistent business are the recruiting of agents of a calibre who will write persistent business and providing an atmosphere in the sales organization which encourages the sale of such business—an atmosphere which has to come largely from specific individuals by training and example rather than from bonuses or other incentives.

MR. BLAKEMAN: Lapse rates have been on the uptrend for the past eight years and the resulting wastage of business is cause for concern. Our experience suggests that incentive remuneration may have a worthwhile influence upon persistency. Over ten years ago the Empire Life introduced into its agents' contract a scheme of persistency bonus which is a percentage of first year commissions graded by the annual amount earned by the agent and by a lapse index revised quarterly. Also, it is our practice to transfer orphan business including the renewal commissions to other agents for servicing where possible. Although we have had during this period a relatively high level of recruiting and turnover of agents, which caused approximately one-half of the lapses realized, our lapse and termination rates were both well below the average for the Canadian companies reporting to the L.I.A.M.A. surveys on lapses and gain of insurance in force.

MR. JOHN C. BERTRAM: At the recent L.I.A.M.A. combination company meeting, widespread dissatisfaction was expressed over the usefulness of the conservation element in agents' contracts. Although State Capital Life changed two years ago to a commission and conservation contract, I believe that the long-term effect on persistency of this change has been minor. The conservation commission under this new contract amounts to about 10% of the agent's total earnings.

It seems to me that the conservation element in the contract should be considered only one tool among many and that emphasis on persistency through selection and training of agents and general company atmosphere are equally important. While I think that a smaller company should place as much emphasis on persistency as a large one, I am afraid that generally the smaller companies cannot match the record of the giants and will have to continue to meet this situation by providing smaller nonforfeiture values.

MR. PAUL E. MARTIN: Three years ago the Ohio National revised its agents' contracts to pay extra compensation for good persistency. The base commissions are 60% and nine 5's graded, since we do not like the idea of heaped renewals because it pays a bonus on the renewing business of even the agents with very poor persistency. The plan permits the agent to earn an additional 20, 40, 60, 80 or 100 percent of his base renewals for the second and third policy years, depending on how good his first year persistency rate by amount is. The bonus starts with a first year persistency rate of 85% and is advanced in steps for each additional three persistency percentage points to the maximum for a first year persistency rate of 97% or better. The first year persistency rate results from the amount of business paying some part of the second year's premium out of the amount of business paid for during a twelve month period. The general agent has a parallel arrangement with respect to his renewal overriding commissions during the second and third policy years dependent on the total agency first year persistency rate by amount of insurance.

Based on our own expense assumptions the level of the persistency bonus was set in such a way as to pay to the agent all of the tangible dollar gains arising from persistency better than that just below the minimum for which a bonus was paid. We reasoned that we would still come out ahead if the bonus incentive resulted in improved persistency, because of important intangible gains which do not readily lend themselves to determination in dollars.

We are gratified that our first year persistency rate improved for 1960 as compared with the previous year. This may have been influenced also by other factors, one of which was the establishment of a conservation committee of two officers from the sales division and two from the insurance administration area to look into all phases of the company's operations as they might affect persistency of business and to make appropriate recommendations for action. This committee seems to have been useful also in making all home office and sales personnel more persistency conscious. Another factor was that in order for agents to qualify for attendance at company conventions they have to meet, as well as a production requirement, a minimum persistency requirement which is set approximately five percentage points below the company average persistency.

Los Angeles Regional Meeting

MR. ROBERT C. TOOKEY: I think that every smaller company should have a policy with unique features, if only to attract agents. You can consider the four plans and riders listed in the program, although they are better suited to the established company's operation. You should have a rate book that has a few unique plans that the competitors from the large companies cannot compare with their own standard plans. The unit premiums should be high and the loading should be sizable to obtain an adequate margin for expenses and enable the agents to earn a satisfactory income. A recent study showed that the rising expense rate is hitting the smaller companies somewhat harder than the larger companies.

The return of premium benefit is offered very extensively by smaller companies and in some areas it has lost its unique appeal because of wide availability. In such cases, you can offer a double return of premium benefit, providing "double your money back." The cost of this benefit is not excessive since it is on a 20 year term basis as most of these "specials" are basically 20 payment life policies. I know of one new company that has the guaranteed purchase option that becomes available when the insured gets married, and the purchase option is a standard provision in their juvenile policies so that the child will be able to purchase additional insurance when he gets married.

Other special features include the introduction of variable endowments in states that permit it, and other variations in the variable annuity concept. There are family income riders providing for a two-and-one-half percent increase in benefits each calendar year to offset the effects of inflation. Many of these special contracts contain special options that normal contracts do not have, thus giving them additional sales appeal. I think that you have to design a policy that the agent can romance and yet the company can live with. It is important to have ample loading in the premium rate to cover expenses and assure a normal profit. Since these specials do not readily lend themselves to cost comparisons, cost competition is not an obstacle to the establishing of adequate margins.

MR. JOHN F. HOOK: Whether or not a company has good persistency can make a great deal of difference in its ability to offer competitive-priced policies, to support a reasonable growth program, to build reasonable surplus, and to produce satisfactory profits.

The Life Insurance Agency Management Association publishes first year lapse statistics for 30 large companies (over $1 billion of ordinary insurance in force on January 1, 1958) and 28 smaller companies. The highest, median, and lowest of the lapse rates reported for 1960 are shown here (figures approximate). Larger companies: 44%, 22%, 10%; smaller companies: 48%, 27%, 15%.

Ten-year asset share calculations show that a 5% improvement in persistency for just the first year is roughly equivalent to ¼% improvement in interest rate for a ten-year period or 5% improvement in mortality for a ten-year period or 2½% improvement in first year percentage expense.

Standard Insurance Company has provided a persistency bonus in its contracts for about 20 years. An important feature of these contracts is that the bonus is paid at the time of sale of each policy. This bonus is based on the predicted persistency of the policy as determined from a persistency rating chart. The chart predicts persistency on the basis of: (1) attributes of the buyer, (2) type of sale, and (3) agent's own persistency record. First-year commissions vary by as much as 15 percentage points depending on the predicted 2-year persistency.

Providing this type of persistency bonus requires maintenance of a somewhat elaborate system of persistency statistics by agent. It requires some special care in determining the factors which agents are assigned for use in completing persistency charts. Determination of these factors involves interpretation of each agent's statistical record, consideration of the effect of lapse of an occasional large case, consideration of a change in agent's residence, and anything else which might provide insight as to how the agent's business will persist.

It is believed that most of our agents write more persistent business because of this incentive. Maintaining the statistics necessary for the operation of the system, although involving extra expense, keeps management and salaried personnel aware of persistency. Thus, nearly everyone connected with the Company is persistency conscious.

MR. TOOKEY: High acquisition costs and the difficulty of recruiting and training good agents makes persistency a most important factor in the success of a smaller company. But it is very impractical to seek the same persistency as an older company. Persistency characteristics are determined largely by the circumstances of the sale; nevertheless, collecting the second premium is very important. Persistency bonuses, high second commissions, and disqualification to company conventions for poor persistency are incentives to write persistent business. Persistency bonuses, to be at all effective, must be large and administered by an experienced staff. The actuary should make model estimates every year to evaluate persistency bonuses. *Perhaps* the bonus, in small companies, might be paid to the general agent instead of to the agent. Some companies reverse the general agent's override on policies not renewing into the fifteenth month.

The persistency bonus system requires that the agency director and the actuary work closely together. When a strong system is installed, you could end up with "a bear by the tail" in that you might be faced by permanent additional cost if the system is not administered carefully. Where you allow, for example, $7 per thousand on the excess business over the expected renewals of, say, 80%, the agents might broker all questionable persistency risks to other companies. If you guess wrong on your factors, you must remember that you cannot change them abruptly, but they must be gradually adjusted year by year. It is well to have a flexible plan so that, in the agreement, the persistency bonus is merely set forth as extra compensation that a company will pay for good persistency in accordance with the persistency bonus plan in effect at that time and *is not part of the agent's contract.* The standards must be raised each year and administration gets complicated when bonuses become so sizable that the agents get to depend on them. Then the company may have to estimate the bonuses in advance and pay them to the agents on a monthly basis.

Perhaps the best way to encourage persistency is to require that the agent write a certain quality of business and to require annual premiums as often as possible. The Lincoln National has developed a Persistency Rater based on their recent lapse study reported in *TSA* XII, page 258, by Norman Buck. This Persistency Rater is available on request.

MR. LOUIS GARFIN: Speaking for an older and larger company in regard to paying a persistency bonus to the general agent, as mentioned by Mr. Tookey, we had a persistency bonus in our company at one time that was introduced on a temporary basis, payable to the general agents. It was quite ineffective in improving persistency experience. We discovered that the general agencies in which the persistency had been good were very happy to receive the bonus. The general agencies in which the persistency had not been so good were used to getting along without it anyway. Now all of them get along without it.