TRANSACTIONS OF SOCIETY OF ACTUARIES
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AGENCY PROBLEMS

Agency Expenses

A. What studies are being made to determine the relative cost of operating the individual agencies of the company? What consideration is being given in such studies to variations in underwriting and issue expenses by policy size and class of business? How are the expenses of not-taken and lapsed policies allowed for?

B. In comparing agency costs, are adjustments made to recognize differing distributions of agents by duration of service within the agencies? Is any allowance being made for differences in mortality and morbidity experience?

MR. WENDEL J. DROBNYK: The Prudential produces a quarterly expense analysis for each agency to determine the relative cost of operation. Commissions and overriding compensation on commissions are excluded. For a number of expense categories, including salaries, employee benefits, rent, travel, telephone, furniture, etc., each agency's expenses are related to a standard expense to develop a cost index for each category and for the agency's total expenses. The measures used in calculating standard expenses are number of policies and amount of insurance paid for and in force, amount of new premiums, number of premium billings and net potential commissions for agents on the incentive salary plan. The unit cost for these standard measures is the result of an expense analysis of all established agencies during a selected base period. The measures are recognized as being broad measures and were so chosen to facilitate making the quarterly expense analysis. Distribution of agents by duration of service is recognized only through the cost measure based on potential commissions for agents on the incentive salary plan. No allowance is made for differences in mortality and morbidity experience.

MR. HARRY D. GARBER: The Equitable Society prepares an annual expense analysis for each agency, excluding group and A&S business. Included in each agency's costs are all direct first year costs, including salaries, rent and financing costs, as well as the first year home office and field cashiers' costs which arise from the business submitted by the agency. The agency's direct costs are obtained from the company's accounting records. First year costs are then split from the total cost, and the Ordinary portion of the first year cost is obtained from the ratio of Ordinary first year commissions to total first year commissions. Home office and field cashiers' expenses assigned to the various agencies comprise underwriting, issue, and first year administration expenses. The underwriting and issue expenses for the Society as a whole are converted into expense rates based on the number of policies written in each of three size groups, separate factors being determined for (i) policies arising from original applications, (ii) policies arising from additional application with separate underwriting action and (iii) other policies. The other first year home office and field cashiers' expenses are subdivided into those associated with not-taken policies and those associated with paid policies and expense rates are determined. These expense rates are then applied to each agency's production figures to obtain the expenses to be assigned to each agency.

First year expense rates for each agency are computed by dividing its expenses by the amount of insurance paid for, and these rates are compared with a company "par," the latter being based on the expense rates for the company as a whole and the agency's distribution of business by size, plan, age, etc. Lapses are introduced by subtracting from the denominator first year lapses based on each agency's lapse rate for the preceding year.

Fluctuations in production from year to year can cause considerable variation in the expense rates produced, and this must be borne in mind in interpreting the results. At present no special adjustments are made for differences in the distribution of agents by year of service nor for differences in mortality experience. We believe that the former should be recognized in order to produce valid comparisons and plan to do so in future analyses. Since our study is limited to the first policy year, we do not plan to take into account differences in mortality experience which could have only a minor effect on the over-all results.

MR. NORMAN F. BUCK: The Lincoln National currently makes four studies of agency expenses and is planning for next year a detailed study of unit costs per agent. The first of these, referred to as the cost analysis for agencies, covers branch office salaries, rent, postage, telephone and subsidies to new general agents. These expenses are exhibited for each agency in dollar amount and also as a percentage of first year premium income and compared with the company average for all agencies.

Our second study, the branch office promotional expense report, is prepared once every three years. This study is based on the cost analysis, excluding group business and subsidies to new general agents. The expenses included in the cost analysis are shown separately as percentages of first year premium income for each agency. For comparison purposes the agencies are divided according to (1) amount of first year premiums, (2) established agencies and new agencies, (3) first year and renewal collection offices, (4) offices where promotional expenses are paid by the general agent and by the company.

A third study, the branch office cost comparison, is maintained as a part of an expense analysis covering the company's entire cost of operation. The fourth study, the annual analysis of first year expense, expresses the amounts of the various company expenses, such as those for maintaining agencies, in terms of cost per policy. These agency expenses include supervision and travel, conventions and other meetings, branch office expenses and balances charged off. They exclude expenses of the agency department of the home office, which are covered by departmental cost reports.

None of these reports take into consideration variations in underwriting and issue expenses by policy size and class of business, nor do they allow for the expenses of not-taken and lapsed policies. Although duration of service is recognized for the general agents, no special adjustments are made for differences in the distribution of the soliciting agents by year of service. No allowance is made for differences in mortality and morbidity experience.

MR. ROBERT T. JACKSON: At the Phoenix Mutual we have attempted in the last three years to develop asset shares by plan and age for each agency, using 10 major plan groups and 7 age groups. These asset shares are used to develop the present value of the block of business over the first 20 years at the date of issue. The present value shows the profit to the company after deducting all renewal expenses, costs of lapse and mortality, and home office new business expenses, but before deducting the agency's new business expenses. The agency's new business expense is then compared with this present value.

Mortality experience and renewal expenses are company averages, whereas lapse rates and first year costs are those for the individual agencies, the lapse rates used being estimated from the average in the agency for the first two years. The interest rate used was the average earned by the company in the year. Since variations in distribution of plans of insurance and age can have a large effect on the results of a small agency, we found it necessary to use some averaging of profits by plan and age to get results which were reasonably useful for agency management.

One factor which is not included in our studies and is essential in determining the effectiveness of agency management is the growth in agents. Since the agency's capital is its writing agents, some sort of corporate capital account should be kept, crediting the agency for developing new successful manpower and debiting for financing losses (which we included in our regular asset shares) and for the presumptive gradual waste in capital where no replacement manpower is added.

In addition to our standard asset shares we developed purely marginal asset shares showing the profit or loss of agencies without contribution to company overhead. Whenever a loss occurs on the marginal basis an immediate profit can, of course, be realized by discontinuing the losing agency. However, in our experience almost all newly opened agencies will show a loss even on the marginal basis.

MR. MENO T. LAKE: For the past 15 years at the Occidental we have been comparing the expenses of our branch offices with those of our general agencies. All the agency expenses, plus home office supervision, are expressed partly as a percentage of first year premiums, partly as a charge per thousand of new business, and partly as a charge per new policy. In the early years of this study it was found that the costs were about the same in the branch offices and general agencies when allowance was made for the value of future overriding commissions on the general agency business. However, in recent years the branch office expenses are being found to exceed those of the general agencies showing the effect of inflation on the branch office operation. This has not been paralleled in the general agency operation since the general agent's only compensation is overriding commissions.