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Agency Compensation

A. What have been the recent trends, and what can be expected in the near future, of factors which affect financing losses on terminated agents:
   1. Agent turnover?
   2. Lapse rates?
   3. Other?

B. In attempting to emphasize sales and success of new agents, and at the same time minimize financial losses:
   1. What formerly successful financing arrangements now seem less appropriate?
   2. What financing arrangements now seem most successful?
   3. How can field management compensation best be designed?
   4. What are advantages and disadvantages of more leveling of commissions?

Jacksonville Regional Meeting

MR. JAMES A. LIVINGSTON, JR.: Our agency turnover rates seem to depend on some factors which are within our control and others which are not. Among the controlling factors are rate of expansion of the field force and our selection and training procedures.

At Liberty National Life, we have made a study of agents terminating in the past year. The main causes of termination were short service, inability to sell and district morale. Concerning the first, 46% of terminating agents had less than one year's service; 68% had less than two years' service and 91% had less than five years' service. An analysis of cause of separation showed that 38% of those terminating left because of inability to sell. We found that if a new agent was placed in a well established district where there were many successful agents, his chances of surviving seemed improved.

The objective we are seeking is the most rapid orderly growth of our agency force consistent with an acceptable level of turnover and its attendant expense.

MR. MANUEL GELLES: An important reason for lack of improvement in agent termination is often the high production standards for continuance set by many companies. A January 1962 report from LIAMA showed that of 4,056 inexperienced recruits in 22 companies, only 37% survived one year, 17% producing $300,000 or more and 20% producing less than $300,000 of new business. With the lower production standard, the survival rate is more than doubled.

Lapse rates on business written by less experienced agents is much higher than company averages. A contributing factor is the high proportion of fractional premium business written by new men.

With respect to question B, an aspect of financing new agents which

has generally had poor results is payment of substantial salaries to promising-looking men. At the New York Life, we find a sounder approach to be lower salaries with added incentive payments made promptly for new business production in excess of amounts needed to keep stated credit balances.

Since recruiting is at the heart of agency development, many companies feel that successful recruiting and development of new agents should be important elements in management compensation.

It is hard to see any advantage in a leveling of commissions for new men. Financing programs, in fact, are designed to do the opposite, so as to cushion the first two or three years for a new agent.

MR. CHARLES W. JACOBY: I recommend a very interesting article on this subject, entitled "The Mystique of Supersalesmanship," in the March-April, 1961, issue of *Harvard Business Review.*

Chicago Regional Meeting

MR. HAROLD G. INGRAHAM, JR.: The Massachusetts Mutual has been financing agents for the past decade under a plan which possesses the following characteristics: There are quarterly validation requirements based on lives and commission. A level monthly advance is provided for a 30-month period with a provision that commissions in excess of the validation requirements may be withdrawn one-half at the end of each quarter, and the remainder upon successful completion of the financing period. The agent completes the plan free of debt, and renewal commissions from business written during the financing period are paid to him as long as he retains his full-time status. He must be under a full-time contract to participate in financing. The plan is available only for men that are new to life insurance business. Financing losses are shared between the Company and the general agent on a sliding scale basis with the general agent sharing 50-50 with the Company in financing losses occasioned by first quarter turnover, grading to the point where the Company bears the full burden of the loss on men who complete 30 months successfully.

Our turnover experience with new agents financed during the past three years indicates an ominous upward trend. By turnover rates, I refer to the rates at which our financed agents fail to validate, and thus become automatically disqualified for continued financing. Such rates, of course, are considerably higher than the Company's over-all turnover rate experienced by all full-time agents.

The dramatically sharp increase in our financed agents' turnover rates is spotlighted by the following figures:

Calendar Year Agents Hired	% Completing 3 Months	% Completing 12 Months	% Completing 30 Months
1952–1955	73	44	29
1956–1958	79	62	33
1959–1961	68	38	....

We are not sure why turnover rates on financed agents—or indeed all agents—in our Company have been steadily rising for the past few years. Some possible reasons for this trend might be:

1. An increasingly large percentage of our new manpower is being developed by our district managers. Because of the district manager's compensation on the production of men in his unit, he has everything to gain and nothing to lose by submitting marginal men. Some of the general agents have attempted to maintain a control in this area by requiring the district manager or staff supervisor to share in the financing losses of failing agents. We try to emphasize to our general agents that the recruiting of quality manpower is their personal responsibility and should not be delegated.
2. Level of unemployment.—During periods of increased unemployment, we must guard against hiring men who are looking for a temporary job rather than a career in the life insurance business. The agent, by the very nature of his work, is constantly calling on people and this could give him an opportunity to continue his search for a new job—at the expense of the Company and the general agent. Also, a recent LIAMA study showed some correlation between a high termination rate and the number of unemployed, giving some weight to the theory that, in periods of higher unemployment, the general agent may be in a position of being selected against rather than selecting the men.
3. Level of Financing.—There has been a noticeable increase in the amount being requested, no doubt reflecting the creeping inflationary trend and this may be a factor increasing the turnover rates. Overfinancing can and frequently does cause a man to be financed out of the business. It is important to sell the *career* not the financing plan and not be misled by the "advance hound" who will play you against your competitors.

The first few months that an agent is under financing constitute the most vital period in evaluating his chances of succeeding and subsequently validating his finance plan. It is imperative to establish and maintain regular programs providing good training, close supervision and continual analysis of sales patterns. This is particularly important during the first few months that an agent is under a contract, to better fit him for the increasing complications of the modern market.

Supervision represents considerable work, but reluctance to do this

kind of work breeds financing losses. We try to emphasize to our general agents that it is better to finance one man adequately, train him well and supervise him closely, than to scatter the feed to many men who may not be doing a day's work.

To more clearly delineate the impact of training and supervisory programs on the turnover rates on financed agents, we recently analyzed the turnover experience of 849 financed agents hired in the years 1959–1960 inclusive exposed to quarterly anniversaries in the first 3 months of 1962. Turnover rates were obtained for agents classified by quality of training and supervision ratings—excellent, adequate, or poor. This study shows that:

1. For the "Excellent" group—for each 100 agents hired, 73 completed the 1st quarter, 40 completed the 1st year, and 29 successfully completed financing.
2. For the "Adequate" group—for each 100 agents hired, 70 completed the 1st quarter, 38 completed the 1st year, and 16 successfully completed financing.
3. For the "Poor" group—for each 100 agents hired, 59 completed the 1st quarter, 28 completed the 1st year, and 10 successfully completed financing.

The study appeared to statistically buttress the intuitively obvious fact that as the quality of training and supervision deteriorates the level of turnover rates will increase, and vice versa. The difference appeared really pronounced in the second year—the period when the inadequately trained financed agent "runs dry," *i.e.*, is unable to prospect beyond his initial, rather circumscribed market. We have also found that 2nd year turnover rates for financed agents are considerably higher in agencies located in the smaller population centers.

In the final analysis a financing plan is supposed to provide a helping hand to get the new agent over the hump so that he can continue in the business on a straight commission basis. The dollars that we invest in the man do not make him successful, but rather it is the effectiveness of supervision and training during the period that he is participating in the financing plan that really counts.

MR. WILLIAM A. BAILEY: In a recent study we analyzed about a dozen different characteristics of agents who have participated in the Massachusetts Mutual new agent financing plan. The purpose was to determine what weights our agency department should place on various data submitted in connection with an application for financing.

The most important single factor appeared to be the financial status of the applicant; the second most important had to do with the level of financing; and the third most significant factor appeared to be the number

of dependents. In general a better financial status or a higher level of financing or a larger number of dependents seemed to improve the probability of the financed agent's successfully completing the 30-month financing period; the only exception was where the number of dependents exceeded four.

All of these factors are, of course, interdependent and there may be other factors which we did not consider but which are even more controlling.

MR. RUSSELL R. JENSEN: We have not seen much change in agent turnover recently at Northwestern Mutual. The following table shows the number of agents we would expect to survive to the end of each contract year, out of 100 originally contracted:

End of Year	No. of Surviving Agents
1	70
2	50
3	40
4	35
5	30

Two factors militate against much improvement: selection continues to be a difficult task; and most general agents do not get exposed to a large enough number of prospective recruits to exercise stringent selection standards. As a practical matter, it is still necessary to contract marginal men and terminate them as soon as there is evidence of impending failure.

Once the agent has quit, the persistency of the business he has placed will continue to bear on the amount of loss. In this regard, our lapse rates in recent years have shown a moderate upward trend, and the upward pace has quickened in the last two years. We have attempted to relate this to the fact that an increasing percentage of new business is coming from new men. If we assume that agents with less than 3 years' experience have double the lapse rates of more experienced agents, we have accounted for all of the upward increase in total company lapse rates in the last two years. We have not made lapse studies by length of agents' service but believe the above substantiates the experience reported by Norman F. Buck (*TSA* XIII, 283) and has strong implications for finance plans.

Another aspect of this question, and of particular impact at Northwestern Mutual Life, relates to a graded increasing premium form of permanent insurance. The new agent has been writing three times as much of this on the average as his more experienced counterpart. The lapse rate on the plan is naturally not as good as that on permanent, and

when it is written by a new agent we believe it would be notably worse. Our treatment of the plan in validation for the finance plan had resulted in encouraging its sale by new men, but the finance plan has recently been amended to de-emphasize the worth of such insurance for validating the finance plan.

We do charge back first year lapses against validation credit, and the finance plan reduces the agent's income when such a lapse occurs. Also, we are putting great stress on following up orphan business in our orphan reclamation effort program.

As a final point, the increasing expense of doing business has marked impact on the new agent, and brings about pressure for a higher level of financing or supplementary loans, all of which increases the risk of loss.

MR. JOHN S. ACHESON: If any company is to emphasize sales, it must concentrate upon the development of new manpower. Such development in any era has meant substantial expenditures, but with the economic environment of the past fifteen years, the threat of financial loss has grown to such proportion as to demand the attention of all agency and actuarial heads of our industry.

Some years ago, most companies had but one form of financing, the advance system. The principle was simply one of funds being advanced by the company to the agent against the value of future commissions. Theoretically, a new agent financed himself into the business but, in doing so, incurred a substantial debt. In the case of a successful agent, the debit balance was to be paid back over a period of years as his earnings grew. In the case of the unsuccessful agent, the deferred first year and renewal commissions, which reverted to the company, were expected to cover the debt. Undoubtedly, many fine life representatives were developed under this arrangement, and, to that extent, the advance system may be said to have been successful—but not without substantial outlays by the companies. In practice, debit balances of terminating agents were often much higher than the value of deferred commissions. Write-offs were necessary. The indebtedness of successful agents proved a millstone around their necks, threatening future earnings, and again the companies often resorted to write-offs. We will never know how much more or less successful another system might have been.

While advances to new agents are still employed by a few companies, economic developments following the Second World War, such as (1) a rapidly increasing cost of living, (2) higher starting salaries and incomes generally, (3) increased competition for manpower, and (4) a greater emphasis on security, necessitated the birth of various financing plans for

new agents, most of which involve some form of subsidy, often called training allowance or salary.

Great hopes were held out for these financing schemes which incorporated a "forgiveness feature." Basically, the ideas behind subsidized financing were these: it was believed that some allowance, not charged against future earnings, would assist in the selection of men, by making managers and agency officers cost-conscious; would provide a floor of income for new recruits until earnings had had a chance to rise above the starting level, thus assisting in the retention of successful life insurance salesmen; would demand of the new agent consistent and sound work habits through the requirements of the validation schedule, which is an integral part of any forgiveness plan; and, finally, would present a realistic yardstick for postselection.

Have these expectations been met? Experience varies, of course, not only between companies but between agencies. We do know that, as an industry, we have poured hundreds of millions of dollars into the financing of new men within the past twelve years. Few will claim that our selection standards are now higher. Our retention ratios are viewed by many with alarm. It is doubtful that our salesmen's work habits are any more consistent or sound. Managers and home office officials alike have allowed optimism and unfounded hope to overrule, all too often, the demands of postselection.

At great cost, we have progressed very little in this area of new manpower development. There are a number of reasons why the main objectives of the revised financing of new agents have not been met.

In the first place, too much was expected of those charged with the administration of the plans. The cost of the subsidies involved was expected to make general agents and managers conscious of the need for sound initial selection, but, in a period of intense competition for manpower and intense home office pressure to expand, it has been only human nature to ignore many "amber lights" and even "red lights," and to see only the strengths of a prospective new agent.

Subsidized incomes, which were originally intended to be a floor of protection, have become bargaining tools. Financing has been bid up and up, with one agency vying with others for the services of an untried salesman.

Validation requirements, instead of remaining sound guides to minimum performance, are often taken as goals or objectives as far as new agent production is concerned. Since they are to be guides to postselection, they cannot be set at a level appropriate for objectives, because this would tend to eliminate many potentially good producers who were not

quite meeting objective standards. Still the tendency, or human weakness, exists to produce at a level which will just meet these minimum requirements, and to some extent, therefore, validation requirements are fostering mediocrity. Through abuse, subsidies or training allowances far in excess of those originally contemplated are being offered to new agents, and the accompanying validation requirements for these levels of financing are often completely unrealistic.

Expectations regarding postselection have been disappointing, particularly where the entire subsidy is considered a home office expense. Human optimism, on the part of managers and agency officers alike, can so easily result in financing a failing agent well beyond the point of sound postselection. Time and effort, as well as money, are wasted on this "long shot" betting.

Reference has been made to some of the problems involved in setting a validation schedule. There are many others, not the least of which is the growth factor which should be a realistic projection of the minimum production to be expected, period by period, of a new agent from the time he enters the selling field until he graduates to a straight commission basis of compensation. The growth factor should be such that a validating agent finds his income increasing throughout the financing period, and has an earned commission income on leaving the financing period at least equal to that received during the final month of financing. Obviously, the level of basic commissions will have a direct bearing upon this growth factor. Since the traditional method of commission compensation in our industry has been a relatively high first year rate with nine renewals, maximum commission income for a given level of production builds up slowly over the ten year period. This slow buildup of commission income has aggravated the problems involved in setting a realistic performance pattern for a new man. For any given level of financing, the increase in minimum production requirements must be relatively steep throughout the two or three year period, which is common for financing, in order to assure that the agent's earned commission as he leaves financing will be at least as high as the level of income in the final month of financing. What we demand of our new agents today has often been criticized and, perhaps, rightly so. The problem is twofold: (1) We have abused the level of financing, offering starting incomes which often range from $500 to $1,000 per month without proper regard to an agent's minimum financial need or earning potential as a life insurance salesman. The demands of the validation schedules which accompany these high levels of subsidized incomes have frequently resulted in our financing men right out of the business. (2) Because of the incidence of renewal commissions, the growth

in minimum production requirements is exaggerated in order to avoid the otherwise inevitable drop in income which an agent would encounter at the end of the financing period.

I am not criticizing our renewal system of commission compensation, but I do say that the incidence of these renewal payments belongs to an era which has long passed. In any company with an adequate pension plan for agents, the need, from the agent's standpoint, for a long renewal commission period has been eliminated. From the Company's standpoint, it is a well known fact that the first few policy years comprise the critical lapsation period. After a policyholder has paid a premium for, say, five years, the services of the agent have very little bearing upon the persistency of that business. With higher renewal commissions for a shorter period of time, the problem of replacement would be alleviated during those first few critical years, and the chances of replacement after, say, five policy years is not great. The heaping of renewals would mean that a new agent's earned commissions would sweep up much more rapidly for any given level of production and the much criticized slope of the growth factor in financing plans could be moderated. While ultimate income, assuming an agent reaches a given level of production, would not be any higher, he would attain the maximum income much earlier in his career, as does a salesman in most other industries. In a highly competitive market for salesmen, this could prove to be an important factor.

Further realization at the home office and agency level is necessary regarding the fact that no amount of subsidy can substitute for sound methods of selection, training, and supervision. Far too much has been expected of these formal financing plans. They were seized by many as a panacea for all the problems of manpower building. At best, any financing plan is but a crutch to assist an agent to our commission method of compensation.

Perhaps the most common criterion today to measure an agent's performance during his financing period is the net annualized premium or commission. Under this method the agent receives a validation credit for the annualized amount, regardless of premium frequency, but is debited with a portion of his annualized credit in the case of a lapse within the first policy year. The administration of these chargebacks is troublesome, but more important, an agent with poor persistency may be financed for two or three months beyond the point of nonvalidation on the strength of business on which premiums are no longer being paid. The Dominion Life recently introduced a revised financing plan under which the measure of performance is a "monthlyized" premium credit. Under this system, if a financed agent places a case with an annual premium having been paid,

he receives full commission credit but a validation credit of one-twelfth the annual premium in each of twelve consecutive months. These credits are guaranteed. Similarly with a semiannual premium, six equal guaranteed validation credits are granted over a six month period. This is repeated if and when the second semiannual premium is paid. The same principle is followed in handling quarterly premium cases. With monthly business the agent receives a validation credit in each month that the premium is paid. In this way, we have no administrative difficulties with lapses, since they are reflected immediately and automatically in the agent's performance score for the month. Very few problems were encountered at the introduction of this system six months ago and it is working smoothly now. We believe we have found an excellent measure of performance.

On the whole problem of financing of new agents, there has been a paucity of published material on current thinking and practice. Perhaps it is because we have all been scrambling to find some answers. I was delighted to see a recent publication on this topic by LIAMA, file 344, entitled "Agent Financing." The publication is not intended to offer specific methods, but does outline many of the problems, and cannot help but stimulate our thinking. This booklet should be regarded as required reading for anyone interested in actuarial phases of agency compensation.

MR. NORMAN K. MARTIN: State Farm Life is a member of a multiple line organization. The parent company is a casualty company whose chief business is insuring automobiles. All companies in the organization are served by the same agency force. As a consequence of the multiple line selling our agency force spends a minor portion of its time in life insurance work.

Prior to 1961, our commission scale was level for the first three policy years. Compared to the more conventional scales, our scale had the advantages of smaller total commissions on policies that do not persist, and larger total commissions on policies that do persist. It has been our experience that the agents that write the most business also seem to have the better persistency. Thus, our large volume producers were being compensated at an over-all higher rate when renewals were taken into account, which was a reward for the better business and coincidently for the volume of insurance. However, we failed to achieve what would seem to be the major benefit, a reasonably good persistency rate.

The chief disadvantage of this scale was that we are probably the only company which had a level 1st, 2nd and 3rd year commission. This served as a basis for complaint that the agent was not being adequately compensated for his life production. To eliminate this situation, we adopted a

more conventional commission scale at the beginning of 1961. The effect of this change in commission scale cannot be isolated, because a new financial arrangement was also adopted and the number of licensed agents has increased. It is also too early to tell what our persistency experience will be. There was no immediate important change.

At the time the new commission scale was installed, the agency force was given the option of remaining on the older scale until their production fell below a certain point at which time they would be transferred to the new commission scale. We found some verification that the level commission for three years had been a satisfactory commission scale since most of our better agents, from a volume and persistency standpoint, elected to remain on the old scale. However, they represent a very small percentage of the licensed agency force.