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Agency Compensation

A. Have existing methods of compensation for managers proved satisfactory? What recent changes have been made in managers' contracts? Have these been successful? Do they help control replacements and improve persistency?
B. What considerations have led to plans telescoping commissions for agents? What special controls are necessary to maintain quality business? What is the effect on agents' survival rates?

MR. JOHN J. MARCUS: Prudential Insurance Company has recently revised its managers' contracts for both ordinary agency and district agency managers.

Prior to the change, the ordinary agency manager was compensated by (*a*) a base salary determined by executive action; (*b*) $1.00 per $1,000 of net production increase; and (*c*) 5 per cent of first-year commissions paid to agents. Something was wrong with each of these elements. The base salaries, which constituted about one-half the managers' total compensation, were so high that it was difficult to reassign a manager whose performance had deteriorated, and the arbitrary determination of the amount of salary was becoming increasingly difficult to administer. The $1.00 per $1,000 of net increase element produced inequities between new agencies and old ones with a larger volume of lapses. The 5 per cent overriding commission was too small to be effective and did not vary with quality factors.

Under the new contract the base salary constitutes a smaller proportion of the manager's total earnings in order to achieve better motivation and compensation more closely related to sales results. Base salaries are now determined from a schedule based on production in the preceding calendar year, the salaries ranging from $6,000 for production less than $2,750,000 to $12,000 for production of $22,000,000 or more.

The overriding commissions were increased to an average of 13 per cent. This proportion may vary from a minimum of 7 per cent to a maximum of 19 per cent, depending on three quality factors in the agency: (1) the ordinary life new business net lapse rate—plus or minus a maximum of 3 per cent; (2) the ordinary renewal lapse rate—plus or minus a maximum of 1 per cent; and (3) the cost index—plus or minus a maximum of 2 per cent. A similar override applies to health insurance commissions.

The cost index for an agency is the ratio of its actual cost to a standard cost determined by applying standard cost units to such things as the number of policies paid for and the number of premium billings. The weight given to the cost index was dampened because some of the items included, such as rent, are not entirely within the manager's control. Even though the cost index has only a modest effect on the manager's

compensation, its introduction seems to have increased considerably the managers' awareness of their agency expenditures.

Another item in the new contract which has had a favorable reception is a supplemental compensation for manpower development. This item provides monthly payments ranging from $15 to $50 in the year following the calendar year in which each agent in his agency has met certain production levels. In total, this feature should pay out $\frac{3}{4}$ per cent of first-year commissions.

Prior to the change in the district managers' contracts, a district manager's compensation was different for debit life insurance than for regular ordinary insurance. As these two types of insurance became increasingly similar, it became important to devise a compensation system consistent with this similarity. Previously, compensation for debit insurance was based on a percentage of agents' commissions and for regular ordinary insurance on dollars per thousand of net paid-for insurance, with both rates of compensation depending on quality factors. Under the new contract, both debit and ordinary insurance compensation are based on agents' first-year commissions and amounts of net paid-for insurance, varying by quality. Weight is about equal on commissions and insurance paid-for.

The system of base salaries for district managers was continued without change. Compensation for both ordinary and debit health insurance was changed and is now based on first-year commissions, with the factors varying to reflect lapse rates. Previously, lapses were not considered for health insurance. Finally, a rolling quarter system was installed to increase the stability of the managers' incentive payments. Under this system, actual incentive payments are the average of those credited in the previous twelve weeks with an adjustment being made every four weeks.

MR. J. C. ALAN MACDONALD: London Life Insurance Company operates on the branch-office system and its ordinary managers' contract has been in effect since 1936 except for minor modifications.

This contract has proved very successful, particularly from two standpoints:

1. One factor in the contract pays managers for net production (business issued less first- and second-year lapses). The amount of overriding paid for a particular agent depends upon which of four net production classifications the agent belongs to. No overriding is paid for agents in the lowest classification, and the managers are encouraged to raise the sights of their agents. The arrangement has been effective in increasing the average production of the agents.

   The overriding commission is based on volume of insurance and

probably would be more satisfactory if related to the agent's commission or premiums written.

2. A second feature of the contract provides that the manager does not receive any overriding commission for a policy that does not persist for two full years. This feature has been very effective in maintaining a satisfactory conservation rate.

MR. JOHN S. ACHESON: While the life insurance industry has undergone much change and shown much initiative in recent years in administrative procedures and product development, most companies have clung, almost fanatically, to the traditional scales of commissions which are paid to agents for new business.

These traditional scales embody a high first-year commission and nine renewals, with some heaping in the second year. Some companies also pay so-called service fees beyond the tenth year. While nothing has occurred to change our faith in the commission-paying system, changes have occurred, particularly in the career agent field, which demand modification of the incidence of payment of these commissions.

The payment of renewal commissions for nine years or longer has provided income protection in the event of the premature death or disability of an agent. The group coverages and retirement plans provided by most companies today make renewals unnecessary for this purpose.

Like most salesmen, the life insurance agent reaches his full sales capacity early in his career, but, unlike salesmen in other industries, he does not reach his full earning capacity for many years because of our renewal commission system. With the rising living costs which have accompanied the economic growth of the last fifteen years, our industry has been at a disadvantage in competing with other industries for good salesmen. In addition to the recruiting problems it creates, the deferment inherent in our compensation scheme causes many agents who can sell a sufficient volume of life insurance to drift away into other lines of selling.

Some companies have made efforts to cope with these problems of recruiting and survival by (1) increasing commissions (there are competitive and sometimes legal obstacles to this, and over-all commissions are already adequate); (2) heaping most of the renewal commissions into the first two or three renewal years; (3) eliminating service fees in favor of persistency bonuses; (4) actually reducing the commission paying period; (5) adopting agents' training programs; or (6) adopting formal financing plans for new agents.

The financing plans provide a subsidy to the new agent during his first two or three years, and, to receive this subsidy, he must meet a minimum

scheduled performance, period by period, as long as financing is continued. The rate of increase in this performance or validation schedule must be such that his commissions at the end of the financing period are at least as great as his income during the period. If commissions are payable under a long flat scale, the demands of the validation schedule are steep. Many feel that they are unrealistic and, therefore, a waste of men and money. If more men are to validate successfully, it apparently will be necessary to increase the financing period or telescope renewal commissions.

Any change in commission scale which will improve the recruiting and survival rate must be significant but not so extreme as to (*a*) remove all responsibility for quality and service from the agent, (*b*) encourage replacements, (*c*) facilitate proselyting of agents, and (*d*) introduce too much instability into the agent's earnings. We need not go to extremes, however. Telescoping of renewal commissions into four or five years will make validation schedules easier to meet and full earnings capacities easier to attain. At the same time, the agent's stability of income and interest in the quality of his business will remain.

MR. SYDNEY J. R. CHATTEN: I am speaking, by permission, as a visitor and somewhat diffidently because I am not too well aware of the circumstances in which business is done here. Nevertheless, the matter which is under discussion, the telescoping of commissions, is one on which we have an experience of a type so different from yours that I thought a few words on it might be of interest to you.

Our experience is in fact based on a system which very nearly is the one called "the most extreme case." We pay all our commission in the first two years of the policy contract. We pay 70 per cent of it in the first year and 30 per cent in the second year, and we have been doing that for somewhat over thirteen years. Before then we paid it all in the first year, so that we have some experience under the system.

This system accentuates the problem of instability of the agent's income, which, however, the company attempts to mitigate by providing fringe benefits for time lost due to ill-health, for medical expenses, and for retirement. Nevertheless, under this system the agent is subject to greater income fluctuations than would be the case if he had renewal commissions. There is danger, however, in providing too stable an income for agents. Their work cannot be closely supervised, and the financial incentive remains the most effective spur to continued effort. Although a salesman may reach his maximum degree of competence quite early in life, he will in later years have acquired a connection and experience which will enable him to produce more results for a given effort than a younger man

could do. Renewal commissions, which mount up in the agent's later years, may discourage effort in a period in which he should reach his maximum potential.

Agents working under our system are quick to feel economic changes. For thirty years the companies using the system have not had to face a major depression, but I think that, in such a case, management would have to accept the responsibility of maintaining the agents in the field, if only because of the large amount of money that has been invested in the establishment of the field force.

The quality of our business, judged by available information regarding lapses, is apparently about as good as anyone's, in spite of the absence of renewal commissions. Good persistency comes from continually talking about it, warning and, if necessary, terminating those agents who have high lapse rates, and from very strict financial controls on replacements.

MR. GEORGE RYRIE: In my opinion, a major agency problem today is that men in the life insurance business do not believe strongly enough in what they are selling. Until this is corrected, changes in compensation and motivation methods are not likely to accomplish much.