TRANSACTIONS OF SOCIETY OF ACTUARIES
1965 VOL. 17 PT 2. NO. 48

DIGEST OF SMALLER COMPANY FORUM

AGENCY

A. What methods of subsidizing new managers or general agents are being used in scratch agencies and established agencies? What type of performance standards is required in determining when a new man should receive an increase or decrease in compensation or be terminated?
B. Is the manager or general agent required to share in losses on agent financing, and how is his share of the loss determined?
C. What research has been done on the cost of developing new agencies? Have any cost standards been determined?
D. What methods have been found successful by life companies not connected with property companies in developing life business from general insurance firms? What problems have been encountered by life subsidiaries of property companies in attracting life business from brokers of the parent company?

MR. L. JEFFERSON STULCE: At Gulf Life we are making fundamental changes in agency management philosophy. For years our combination field force has represented about 90 per cent of our total sales manpower. We want to expand our Ordinary Sales Division, but we want to find a way to do this within reasonable cost. Expansion efforts so far have been costly.

The following decisions have been made and announced to the field regarding our Ordinary Sales Division:

1. We are changing from a branch office to a general agency set-up.
2. We have strengthened validation requirements, particularly in the early months, and the general agents will share in the financing costs on men who terminate in the first two contract years.
3. The general agent is to assume an increasing share of costs on behalf of agency supervisors, who had previously been brought into and kept in the branch office by the manager without cost to him.
4. The general agent's income will be based almost entirely on renewal premiums, where previously the manager's income was heavily weighted on first-year premiums.
5. We will take a harder look at field operating costs and be less generous with advances.

We start a general agent on a scratch agency at a $12,000 subsidy level. Thereafter we subsidize at such a level as to guarantee $12,000 of annual "base earnings" *if* he meets our general agency validation

standards. Of the thirty-three agents we want him to recruit in his first five years, we hope to have ten still surviving at the end of the agency's fifth contract year. Our primary "performance standard" is the GA validation schedule, measured in terms of annual premium on production. We expect the general agency to develop the following production: 1st year, $18,000 annual premium; 2d year, $34,000; 3d year, $48,000; 4th year, $60,000; 5th year, $70,000; 6th year, $78,000; and so on.

With this incidence of new business, and with good persistency, we can project the GA's "base earnings" until they exceed the $12,000 level. This happens in the 6th contract year with our new contract, according to our projections. In the interim, the GA's subsidy will each year be the difference between $12,000 and the amount of "base earnings" corresponding to our original projections reflecting our assumed production and persistency. If production or persistency is disappointing, his compensation suffers accordingly. On this basis the total subsidy adds up to $45,000 under our new contract.

The general agent can supplement "base earnings" in three ways:

1. Full commissions on all personal production.
2. Additional compensation from doing a good job developing successful career agents. On a scratch agency we pay a manpower allowance totaling 40 per cent of first year commissions earned by agents in their first contract year and 20 per cent in their second year. The 40 per cent factor will grade down by 5 per cent intervals to 20 per cent after six years. Offsetting this is the general agent's share of financing losses on terminated agents.
3. Nonvested renewal commissions on business produced by terminated agents. This income will be insignificant in the first couple of years but would gradually increase. Income from this source does not affect the amount of subsidy; nor does the manpower allowance, financing losses, or personal production.

In connection with over-all expenses we find that in adding together soliciting agents' commissions, costs of financing, general agents' *earned* management compensation, general agents' subsidy, and operating expenses, we get a total expenditure for the first five years of operations (in a scratch agency), which closely approximates the total premium for the five years combined.

At the end of six years, we hope to have a going general agency, with a general agent who is no longer subsidized and who is beginning to earn vested commissions. At this time we would hope to have eleven producing agents, plus a supervisor and the general agent, himself. However, of these eleven subagents, at least six or seven would still be in the financing period, and, of course, we would have made a sizable investment in each of the others. It could hardly be said that we are ready yet to begin to

produce a profit, however. For example, it will take many years of production of good quality business to produce sufficient profits to amortize the investment we have in each financed agent who completes the financing period.

It appears that many companies need to give more thought to the consequences of reducing premium margins at the same time that competition for sales manpower is skyrocketing and agency expansion costs are rising.

MR. ERNEST C. STEELE:* We have two contracts at Appalachian National Life. The essentials of these contracts are as follows:

Agency Manager

A. (1) Compensation. Salary for one year.
Beginning with second year, salary plus renewal override is paid until such time as commissions on personal production plus first-year override equals salary. Then straight commissions are paid according to standard general agent's contract.

	Per Cent
1st year	70 (graded)
2d year	15
3–10 years	5

GA override 30 per cent 1st year (of agent's commission as shown above) and 40 per cent of renewal.
All commissions are fully vested immediately subject to repayment of salary paid during financing period.

(2) Expense Allowance. Company pays agreed upon expenses. Record of expense allowance equal to 25 per cent of agent's annualized commissions on all paid business is kept. When accumulated expense allowance equals total expenses paid by company, then allowance is payable in lieu of company paid expenses.

(3) Performance Standards. Performance is measured by predetermined building plan. Termination or continuance is a matter of judgment on the part of the agency offices.

B. No part of losses is charged to the agency manager.

Personal Producing General Agent

A. (1) Compensation. Income is flat base (250–300) plus commission advance of 55 per cent of annualized first-year commissions. First

* Mr. Steele, not a member of the Society, is president of Appalachian National Life Insurance Company of Knoxville, Tennessee.

two pay periods commission advance is assumed to equal the flat base and is charged off as subsidy. All business paid for during first $1\frac{1}{2}$ months is accumulated and commission advance made on third pay period. Flat advance plus commission advance paid thereafter until debit balance equals zero. To avoid extreme fluctuations, a maximum is imposed and any commission advance in excess of the maximum is carried over into subsequent advance checks; 50 per cent of group commissions are paid and 50 per cent credited to account. All commissions are fully vested subject to repayment of debit balance with interest after termination.

(2) Expense Allowance. Same as Agency Manager.

(3) Validation.

Performance is required as follows:

a) Production

1st quarter, annualized premium equal to 83.3 per cent of initial income. Subsequent quarters, annualized premium equal to 125 per cent of initial income.

b) Schedule of maximum net deficit (debit balance less deferred first-year commission).

End of Month	Deficit	End of Month	Deficit
3	520	30	1090
6	760	36	660
12	1300	42	120
18	1520	45	0
24	1400		

B. No part of losses is chargeable to general agent. GA is responsible for personal debit balance only to the extent of deferred commissions.

The general agent is not responsible for repaying any of the advance except that which comes from his deferred earnings. We at one time made an attempt to collect debit balances and found it to be a fruitless effort, so we redesigned our contract. We have used this, I guess, as a recruiting tool and do not charge back the balance against the man personally, only to the extent of his deferred commissions as they are earned or credited to his account

MR. JAMES M. BATES: At Ohio State Life we have been concerned about the problem of too much emphasis on renewals in the general

agency system. We have found a lack of incentive in general agents who have been with us more than 15 years. They can slack off in their efforts and maintain a level of income.

MR. JAMES M. WOOLERY: At Occidental Life of North Carolina our agent is paid a salary plus a bonus. This bonus is based on the percentage of paid first-year life premiums. It varies from 2 per cent to 5 per cent, based on net gains, and the percentage of bonus earned then is further modified based on the agent's persistency. Under 75 per cent, we do not pay any net gain bonus at all. From 75 to 80 per cent we pay $66\frac{2}{3}$ per cent, and if it is 80 to 90 per cent, we pay 100 per cent. If it is 90 per cent or more, we then pay him 110 per cent.

At the beginning of each year we have a budget item called "Field Acquisition Cost." This must not exceed 110 per cent of the first-year premiums. This field acquisition cost includes first-year commission and bonuses, field salaries, field travel, conventions, field advertising, etc. Therefore we have to ration the number of agencies that we are going to develop within this budget.

PRODUCT

A. What has been the experience under special term policies for high-school and college students as to lapse rates, mortality, acquisition costs, and conversion to permanent plans?

B. What special contracts with flexible premiums have been designed for the H.R. 10 market? What types of plans involving auxiliary funds have been introduced for this market?

C. What has been the experience on business involving bank financing of premiums for medical interns and graduate students? Does this type of business show satisfactory persistency after the financing ceases?

D. What is the actuarial justification for coupon policies? Do any of their attributes or characteristics suggest special legislative or regulatory controls over their sale?

MR. WILLIAM L. FARMER: While Protective Life Insurance Company does not write variable premium plans for the H.R. 10 market, I have given some thought to the subject.

It would seem that flexible premium contracts could fall into one of three basic groups. The first class would be quite similar to the traditional group annuity contract using single premium deferred annuities. Such a contract would give the annuitant the right to pay single premiums from time to time to purchase annuities at rates guaranteed in the contract. The contract would probably specify minimum and maximum premiums which could be paid in a given policy year. If the commissions are the usual high first-year and lower renewal type, there might be one scale of cash values for the initial single premium and a higher scale for subsequent single premiums. Alternatively, a flat commission rate could be used.

The second type of flexible premium contract is one of the traditional level annual premium type with the option from time to time to increase the annual premium, within stated limits. Here the same scale of cash values, measured from the effective date of each increment of annual premium, could probably be used for all such increments. For consistency with individual policy pension trusts, a new first-year commission could be paid on each such increment.

The third type of flexible premium deferred annuity would provide for level annual premiums of the traditional type with the option to pay supplementary single premiums annually to buy additional benefits, subject, of course, to some appropriate limits. Here the contract would

provide one scale of cash values with respect to the level annual premiums and another scale with respect to the single premiums. Standard first-year and renewal commissions would be applicable to the level annual premium, with lower rates for the single premiums.

The chief difficulty with all three of these arrangements is the problem of keeping records of the premiums actually paid and the benefits purchased over the life of the contract. This would seem to be particularly true in the case of a company which has installed a computer and converted its individual policy records to magnetic tape on a consolidated functions system.

Of course, a traditional group deferred annuity contract of the money purchase type could be issued, but this seems a rather expensive procedure for a case covering only a very few lives.

We do have for individual policy pension trusts a series of policies which provide the life insurance benefits and a portion of the retirement income, with the remainder of the retirement income being obtained from conversion at retirement from an auxiliary fund. In our case the auxiliary fund is an undivided amount belonging to the trustee, and to my knowledge we have not used this approach for any money purchase type of plan, whether or not it is an H.R. 10 plan. All the material we have regarding H.R. 10 strongly recommends that money purchase plans be used to avoid the problem of future contributions in excess of the prescribed limits. It would seem also that the auxiliary fund would have to be allocated specifically to individual participants because of the vesting requirements of the law.

MR. HARWOOD ROSSER: I can remember working for a company that sold quite a few coupon policies. While I cannot give you a strictly actuarial justification, one of the reasons for the popularity of these policies, from the field and consumer viewpoint, was their flexibility. For example, drawing upon the coupons in time of financial reverse to pay premiums may be considered superior to creating a policy loan or utilizing the APL provision.

COMPUTERS

A. How long after the installation of a computer do savings in staff begin to appear?

B. Over what period is the cost of a computer amortized in determining costs?

MR. CHARLES T. WHITLEY: While many jobs may be done faster by a modern computer, a savings is not necessarily realized. I advocate the consolidated functions approach, and I feel it is necessary to automate at least an entire function in order to realize any significant savings in staff.

In our one automated department at Security Life and Trust Company, in-force has increased 50 per cent in the last three years, and there has been no increase in staff. When our entire ordinary life business is automated, we expect a reduction in staff of 10 to 20 per cent.

I think it is now possible for us to assume a lifetime of eight years for a computer in determining costs, because the computers now available are built on the building-block process, so that you can purchase a computer which will be adequate to take care of your particular company's needs for at least that period of time by adding additional pieces of peripheral equipment as they are needed. This was not true until the recent family of computers came out.

MR. KARL L. MANCHESTER: There are two areas of potential staff reduction: (1) clerical and (2) supervisory. Planning for a computer reveals clerical staff reduction potentialities without the necessity of installing a computer. Many companies, especially the smaller ones, would be wise to capitalize on this potential and cancel their computer order until the computer manufacturers provide insurance programs as an integral part of computer products. Actual installing of our computer at Southland Life created staff additions, but utilization of it reduced staff considerably over a period of time.

The real worth of a computer lies in reducing the supervisory staff and in company reorganization. Many companies that have consolidated functions have failed to consolidate their organization. Having many departments was desirable prior to the advent of computers, because of the separation of policy maintenance into functions.

MISCELLANEOUS

To what extent have functional cost studies been developed in the smaller companies? What uses have been made of the results?

MR. JOHN K. ROBERTS: We have been developing a cost study of home office expenses at Pan-American Life. All home office expenses are allocated to one of six basic functions: acquisition, maintenance, general insurance, investment, management, and service. They are then subdivided by more specific functions. They are also separated by line of business, and between United States and Latin America.

Our general ledger accounting already charged all expenses to some department of the company, but we established new coding procedures to charge a specific section of a department.

We established a functional code worksheet to be completed by each employee, indicating to the best of his ability the percentage of his time spent in the year on approximately a hundred different functions.

Another step is to determine the number of work units performed in each area so that the expenses of that area can be reduced to an expense per work unit.

We have found the cost data that are available to be useful in several ways: allocation of Exhibit 5 totals between Life, Health, and Investment; allocation by country for internal profit statements; contribution of figures to the LOMA cost study; and establishing expense factors for gross premium tests and calculations.

There are always going to be changes and refinements to be made in your expense analysis program. It is essential to continually review your functional cost breakdown to see what changes in your operation are occurring.

MR. BOB J. BOLIN: We have had to estimate our cost analysis at Southland Life on the basis of our program of scientific budgeting. The entire budget for the company is broken down into departmental budgets.

The increases in expenses led management to inaugurate a "Time in Motion Study" for most departments and for each individual within these departments. The study has been going on for 19 months, and we have reduced personnel from 10 per cent to 50 per cent in the various departments. We reduced the secretarial staff and eliminated receptionists by using a pool of secretaries. Some of the older department managers are having a difficult time adjusting to staff reductions.

Further work by the Actuarial Department will result in using the study in our functional cost analysis for the computation of gross premiums and earnings by line of business.