TRANSACTIONS OF SOCIETY OF ACTUARIES
1974 VOL. 26 PT. 1 NO. 76

CONSUMERISM AND THE COMPENSATION OF THE LIFE INSURANCE AGENT

ANNA MARIA RAPPAPORT

ABSTRACT

The nature of the product, the way it is distributed, the compensation of the agent who sells it, and the way sales and operational expenses are regulated are closely interrelated. Each has an impact on how the life insurance industry deals with its customers, how effectively it serves their needs, and how it will do business in the future.

The purpose of this paper is to examine the job and compensation of the ordinary life insurance agent in relation to expense regulation. The analysis will raise questions about the distribution system, examine to some extent how well the industry responds to customer needs, and consider how the system might be changed.

After defining the scope of the agent's job, the paper will establish some criteria for systems of both agent compensation and expense regulation, so that the relevant issues can be evaluated within an over-all framework. And, since agents' compensation and expense regulation can be understood only within the context of current conditions within and outside the insurance industry, the paper begins with a discussion of these topics.

The consumer is faced with several questions: How much insurance does he need? How much money can he spend for it? How can he use his money best in the order of his priorities? In order to answer the questions, the consumer probably will rely on the advice of an agent. The agent may be influenced by his compensation plan, and that compensation plan is strongly influenced by expense regulation. This paper ties together the three related questions of the consumer's product choice, the agent's compensation, and expense regulation.

The questions raised here are intended to present some challenges to actuaries to evaluate whether the present compensation systems and expense regulatory structures allow companies to meet the needs of life insurance buyers. Further, they offer a challenge to the life insurance industry to see whether it can strengthen its distribution system and do a better job of serving the public.

THIS paper is in five sections, dealing with the following topics: the environment as it affects the ability of the life insurance industry to distribute its products; the ordinary agent's job and the business problem of paying him for it; the ordinary agent's compensation system and issues it raises about dealing with the customer; the regulation of expense and agents' compensation; and summary and conclusions.

I. THE CURRENT ENVIRONMENT

Problems in maintaining the ordinary distribution system, together with the growth of consumerism and the challenges it represents to industry and government, make it necessary to ask some basic questions. Several aspects of the current environment will be discussed in order to define the problem areas and to show why expense regulation is used as a method of protecting the life insurance consumer. These provide a background for considering the issues raised in the paper and include the following topics: (1) some shortcomings of the ordinary life insurance distribution system; (2) reasons why concepts of capitalism and free enterprise do not apply to the life insurance business; (3) the public image of life insurance; (4) the current regulatory environment; and (5) the role of consumerism.

1. The ordinary distribution system is faced with manpower and cost problems. It is extremely difficult to interest qualified people in a career in life insurance selling. A high percentage of the people hired as new agents fail, creating high costs and a poor image of the job.[1] Many policies are sold by agents who then leave the business, causing the policies to become "orphaned," that is, the selling agent is no longer available to service them. This contributes to lapses that are costly to both companies and customers.

The average agent sells about one policy a week and has difficulty earning a living. The Life Insurance Marketing and Research Association (LIMRA) Manpower and Production Survey for 1971 shows that half of the experienced career agents of United States companies earned first-year commissions of $5,439 or less with their primary company, and

[1] Howard D. Allen, in Discussion on "Agent Recruiting and Retention," *TSA*, No. 71 (1973), p. 116: "McConney-Guest Modified illustrates a 16 per cent five-year success rate—but many companies are now experiencing much lower success rates. . . ." The LIMRA 1971 Manpower and Production Survey shows a four-year survival rate for new agents of 13 per cent for United States companies and 10 per cent for Canadian companies.

one-quarter earned first-year commissions of $2,547 or less.[2] (Experienced agents are defined as full-time career agents who have completed at least their fifth year.) For experienced agents, first-year commissions probably represent more than 50 per cent of total income and in many cases 75–80 per cent. The survey shows that in 1971 experienced career agents in the United States sold an average of forty-eight policies per year with their own companies.

2. Theoretically, the operation of free-market forces under capitalism will ensure the success of the well-managed enterprise; theoretically, competition and free choice in the marketplace will protect the customer. It is further assumed that business should be free to operate in this capitalistic society. However, it has long been recognized that the life insurance industry has aspects that require regulation, and the business has been heavily regulated. The nature of participating life insurance makes expense regulation, rather than direct price regulation, a logical method of protecting the consumer. It has also been necessary to regulate nonparticipating life insurance under the same system because it competes with participating insurance in the marketplace.

The position of the policy purchaser is different from that of the consumer who is buying a product from a business of another sort. The price of most products is determined at the time of purchase, and the consumer is not subject to costs based on the future operation of the selling company. In the participating insurance purchase, however—whether the product is sold by a stock or a mutual company—the actual cost of the product over its life will depend on the future costs of operation of the company. In contrast, for a purchase of nonparticipating insurance, the price is guaranteed at issue. However, it is still very difficult for the buyer to evaluate the cost. Purchasers of consumer products are free to make periodic choices based on buying experience and product reputation and performance. But once a purchaser has made an initial decision, he no longer has completely free choice—he may suffer a substantial loss if he chooses to replace his policy. If a policyholder is uninsurable, he may be unable to obtain other coverage, even at a loss. Therefore, in terms of the consumer changing his mind or changing coverage, life insurance is a very special kind of product.

The kinds of controls that competition and the marketplace in a free-enterprise system automatically place on most business, and the conditions that force a business to operate effectively in order to survive,

[2] No corresponding data exist on the earnings of the agents from sources outside their primary company.

do not operate in the same way. Most insurance purchasers buy from the agent who shows them why they need to make the purchase. The agent often has some choice about the company with which he will place the business. Companies try to attract brokered business through commission and price competition and by offering services. If the business is brokered, the agent rather than the purchaser usually chooses the company, so that actual competition tends to be for the agent rather than the buyer. The effect of competition is to push toward two opposite results: to raise selling costs as well as to lower prices. This occurs because both price and commission influence the agent's choice as to where business should be placed.

3. The public views life insurance as a necessity, even though many people do not understand it[3] and are not in a position to make rational choices about what to purchase or when. Despite the fact that agents in the abstract have a poor public image, most people think that *their* agent is doing a good job for them, and they value his services.

As a career, life insurance selling has a poor public image. However, for the families of successful life insurance agents, the image is a very positive one. Sons, nephews, and many others who have had long-term contacts with successful agents become agents.

4. The regulatory environment is complex. The life insurance industry is regulated by the states and to some extent by the federal government. There is substantial cooperation between the state commissioners, but there are also many differences in law and regulatory practice. The federal government is increasingly entering the scene. The Securities and Exchange Commission has been regulating some aspects of variable annuities since their inception. The Hart committee is raising questions with respect to the life insurance industry.[4] The consumerists pose a continuing challenge to regulators.

The need for regulation of life insurance has been well established for many years. The record of the regulatory agencies in overseeing the solvency of companies, the basic honesty of management, and the requirements governing policy provisions has been good. In general, over

[3] E. J. Moorhead, "The Hart Hearings in Perspective," *Best's Review*, January, 1974, p. 16: "First is the massive ignorance of policyholders about their life insurance. It is hard to believe that people know as little about their life insurance property as the surveys show."

[4] *Ibid.*, p. 70. Mr. Moorhead points to five probable thrusts of the Hart hearings: (1) price and quality of our products, (2) freedom of the agent, (3) sales practices, (4) sales interference, and (5) efficiency of state regulation.

the years the public has received the life insurance benefits it has paid for.

Frequently, New York has taken the lead as the strongest state regulatory body. Expenses and agents' compensation are regulated by section 213 and Regulation 49 of the New York Insurance Law. No corresponding regulation exists in other states. The New York law will be dealt with in more detail.

Price and fair value of ordinary life insurance have never been directly regulated. Today, however, some state insurance departments are addressing themselves to this problem by compiling shoppers' guides and issuing disclosure regulations. These guides fail to answer the purchaser's basic questions. The New York law has attempted to deal indirectly with the fair-value problem since 1906. Its method, utilizing a combination of requirements, recognizes the peculiar nature of the insurance business—in particular, the fact that actual cost is dependent on events that occur after the policy is issued.

Mutual companies are required to distribute surplus annually, and there is a limit on total surplus. These two provisions operate to require mutual companies to return most of their earnings to their policyholders. There is also a limit on the amount of new business that may be written, because new business requires an investment in the year in which it is written, and that investment reduces the amount available for policyholders' dividends. The sections of the law that limit expenses and agents' compensation, new business, and surplus operate together to protect the policyholders of mutual companies from extravagant operations, excessive expenditures on new business, and excessive accumulation of surplus. They assure reasonably consistent treatment between stock and mutual companies. Buyers of nonparticipating insurance are in a somewhat different position, since the contract is on a fully guaranteed basis.

The effects of regulation are not uniform. Regulation may be beneficial to the consumer, it may have little effect, or it may be harmful. The same is true of its impact on the industry. Laws often may prevent companies from doing things that would be in the best interests of the public. For example, the nonforfeiture value laws have limited product innovation and design. This paper will further analyze the concept of expense regulation and the current practices of New York State in order to show that certain aspects of this regulation are not serving consumers' interests.

5. Consumerism is a powerful force acting in the current environment. This movement involves a small segment of the public, but it is one that

has a substantial effect on the attitudes and opinions of a very large segment. Consumerism has caused industry and government alike to focus on questions of fair value, rational choice, product performance, and safety. Consumerists challenge the industry to do a better job of serving its customers; they challenge regulators to scrutinize more carefully how well the industry is serving its customers and encourage the public to ask whether it is being served well. In the long term, consumerists may create an environment in which good customer service assumes an increasingly important role in the successful operation of a business enterprise, or, conversely, their efforts may result in overregulation which places business in a stifling environment.

II. THE AGENT'S JOB

This paper raises issues with respect to agents' compensation and expense regulation. Issues relating to compensation can be most meaningfully evaluated by asking a series of questions: What is the agent's job? What does his company want him to do? How is he paid for doing the various things that a company wants him to do? How is his performance measured and evaluated?

In this section of the paper the job of the ordinary agent in the traditional sale situation is defined. The traditional sale is one made to a customer by an agent who has designed a product to meet the customer's needs. Such a sale, involving custom tailoring of the product, may be called the "one-on-one" sale.

The ordinary life agent's job is divided into several parts: finding customers, selling them the product, and providing administration from point of sale to point of policy delivery and service during the life of the policy.

The agent may be completely independent and do business with a number of companies, or he may be affiliated primarily with one company that provides him with a pension, fringe benefits, office space, and secretarial help. The career agent who works full time with one company will do business with other companies when his company cannot provide the needed product or service or when he is faced with competition from a lower-priced product. The experienced agent is usually paid completely on a commission basis. Thus he is substantially independent in the way he conducts his business affairs. Field management attempts to motivate him but cannot tell him what he should do or how or when he should do it. The experienced agent is for all practical purposes his own boss. This independence is considered to be one of the most attractive features of a career as a life insurance agent.

Prospecting Phase

To perform the first part of his job, which is to find potential customers, the agent must identify possible prospects, try to obtain some information about them, and then contact them. The purpose of the contact is to secure an appointment. A method frequently used is to offer some service, such as explaining the prospect's social security benefits. The sale at that point is one of convincing the prospect that the agent has useful ideas. It is not a sale of insurance. Although most people see insurance as a good thing in the abstract, they do not see themselves as needing any "now," and normally they are reluctant to see an agent. The agent must learn to overcome this reluctance and not be discouraged by frequent turndowns. The experienced agent has an easier job of finding customers because his policyholders are aware that insurance must be bought before a problem has occurred (whereas they may seek medical or legal services *after* a problem has occurred), and are good prospects for more insurance. Once they become satisfied customers, they will refer other people to the agent of their choice.

Selling the Need

Once the agent has an appointment with a prospect, he will provide the service he has offered and then attempt to analyze the prospect's situation and identify his needs. The analysis will usually demonstrate a need for additional life insurance.[5] At this point, the agent must sell the need and the specific solution. Although the prospect frequently will not understand the product, he will accept the agent's advice as to what type of policy is preferable—a point that is a source of potential conflict of interest, discussed later.

Once the agent has sold the concept of life insurance and has secured a commitment to buy, a long administrative process begins. First, he must complete an application form with the customer. A substantial amount of information is needed by the insurance company in order to issue the policy.

The agent must make an appointment for the medical examination and follow up to make sure the information is received. He may be expected to go back to his client for further information. The agent also has an obligation to select suitable prospects and see that the company is given true information about them. He may spend many hours developing the policy from point of sale to point of delivery, particularly if the policy is a large one or the purchaser has a long medical

[5] Most of the public is, in fact, underinsured, as was demonstrated by *The Widows Study* (Hartford, Conn.: Life Insurance Agency Management Association, 1971).

history. After the policy is issued, the agent is expected to deliver it and collect the first premium (if he has not already). He will then try to repeat the process by securing the names of new, potential customers.

After the Sale

After the sale, the agent is expected to provide continuing service to the policyholder. This includes both routine and nonroutine functions—assisting the policyholder with a change of address or a policy loan and answering questions about policy provisions and dividends, reviewing beneficiary designations and coverage to make sure that insurance protection is up to date, and servicing death claims.

Traditionally, it is assumed that the selling agent will service a policy during its entire lifetime. In practice this often does not work out because many agents leave the business and many policyholders move. Before the advent of giant computers, many companies kept local records on premium collections and policy status in order to supply the agent with the information he needed to perform service. There are now many ways to store such information and make it available very quickly to servicing agents or personnel.

Service, as a part of the agent's job, has two aspects: it fulfills the obligations of the company to policyholders, and it opens the door to new sales—a way of helping agents make a livelihood. But personal service is time-consuming. Questions are being asked: What service is really needed? Who is best equipped to do it? How should the service obligations of the company and the agent be divided? What is the most profitable way for the agent to spend his time? Who should service the "orphaned" policyholder? Experiments over the next few years will be aimed at (*a*) providing service which is better and performed on a more cost-effective basis and (*b*) improving the productivity of the agent.

The life insurance agent has been taught to be, and is presented to the public as, a professional. This has both advantages and disadvantages. The agent is supposed to represent the interests of both the client and the company, and he should put the interest of the client ahead of his financial interest. He is paid by commissions on what he sells rather than by fees on the work he does. Public opinion probably varies over a spectrum ranging from acceptance of the agent as a professional to belief that the agent is simply a salesman and can be expected to act in his own best interest. Advocates of this concept of professionalism say that it has created an obligation for the life insurance agent to act in the client's interest at point of sale over and above any obligation that normally rests on a salesman. The concept needs to be evaluated further. The agent is paid commissions by the company selling the policy and is not an independent, fee-paid professional. Equating the agent with an independent professional may create obligations that are impossible both for him and for the company.

Evaluating the Job

To gain other perspectives about the agent's job, it is useful to compare life insurance selling with some other types of selling.

LIMRA, in its report *Factors Relating to Salesman Turnover,* discusses the possible impact of the nature of the job on turnover. This report points out that most of the Conference Board companies, which are in other industries, start with a fairly specialized product and a specific territory. They find and train a salesman to fill a specific market. For ordinary life insurance, however, the total market is normally universal. Companies start the agent and usually expect him to define his own product and territory on a trial-and-error basis. This report points out some of the difficulties faced by the ordinary life agent which need not be faced by other types of salesmen. Table 1 shows us some of the differences between life insurance selling and other selling.

In comparing selling jobs, some of the following questions should be considered: At what point is the need for the product created? What is the role of advertising in creating this need and interesting a customer in a particular brand or company? What are the differences between products offered by various companies, and how meaningful are these to customers? Who identifies the potential customers of a company or a particular salesman? How well can the customer understand the use of the product he is buying? What is the role of the salesman in building that understanding? How much service is the salesman expected to provide? How is the salesman compensated? How much of his compensation is salary and how much commission? How much education and training are required to sell the product? What are public attitudes toward the product? How strong is the customer's tie to the salesman as compared with his tie to the company?

Weighing these factors from the agent's viewpoint, life insurance as a field in which to work would score well on several factors: nearly everyone the agent meets or contacts is a potential customer, his customers' ties to him are very strong, and they are not likely to "defect" because their knowledge of and preference for other companies' products is very weak. Life insurance also scores well in that the agent is independent. The type of service he renders to his clients is a source of satisfaction.

Conversely, from the agent's viewpoint, life insurance would score badly on several other factors: the salesman must create his own market

TABLE 1

COMPARISON OF VARIOUS SELLING JOBS

	Life Insurance Agent	Stock Broker	Retail Automobile Salesman	Computer Salesman
Whose interest does he represent?	Seller and purchaser; is expected to be professional	Purchaser; is expected to give appropriate advice	Seller	Seller
Form of compensation	Commission; during training period, salary in lieu of all or part of commission	Salary during training period; draw against commissions with guarantee for a period after training	Salary plus incentives or draw against commissions	Salary plus incentives
How is potential customer identified?	By agent who seeks prospects	By individual broker—mail leads may help	Purchaser comes to seller	By type of business, location
Brand or company identification	Low	Low	High	High
Role of advertising	Creates company image—does not sell product	Creates company image—sells company over competing brokers	Sells product attributes and features	Creates company image
How is purchasers' awareness of need created?	Usually by salesman as part of sales process	In many cases by purchaser prior to contacting broker	By advertising, behavior of peers, etc., prior to time of entering showroom	By awareness of general business practice; by competitive considerations
Salesman's role in establishing need or desire for product	Very strong	Moderate to very strong, depending on customer	Minimal	Moderate
Education and training required to sell product	Very substantial, but agent begins to sell during first month of training period as soon as he is licensed	Very substantial—up to six months of full-time training may be required before any sales can be made	Minimal	Very substantial

and find his own customers, he must sell them a complicated product, his income is made up exclusively of commissions, and he is expected to provide substantial amounts of service and do administrative work. From the point of view of both the agent and the consumer, life insurance selling is unique in that the salesman is expected to be a professional and is expected to represent both the seller and the purchaser.

III. THE AGENT'S COMPENSATION

The present pattern of agents' compensation is under attack from various sources: agents' groups say that commissions are too low, and industry critics say that commissions are too high. Large numbers of agents have substantial difficulty earning a living. Some of them leave the business, and others struggle for long periods without earning adequate compensation. This situation makes it difficult to attract good men to the business.

The job of the ordinary insurance agent has been defined. The objectives that he is expected to attain are less well defined. Clearly he is obligated to produce new business, to try to keep business from lapsing, and to provide service. However, the extent to which he is expected to perform these functions, and what constitutes good performance, are unclear.

Performance is rewarded by compensation and recognition. The rewards for writing new business are great, but those for maintaining good persistency are much smaller. Moreover, the rewards for good service are indirect. They appear as larger renewals which result from better persistency or as new business obtained through repeat business or referrals. The problem is more difficult because service, unlike new business or persistency, cannot be measured directly.

What are the criteria for a compensation system toward which the industry might strive? This section will offer some suggestions against which the current system can be measured.

Ideal System

The prerequisites of an agents' compensation system include the following:

1. A sufficient number of agents who can earn an adequate living must be available to serve the needs of the public.
2. The system is attractive enough to bring new people of good quality into the business.
3. The system provides for reasonable methods of (*a*) getting new agents started and (*b*) helping them make the transition from the training period to being on their own.

4. Payment is reasonable in proportion to the services rendered.
5. The method of payment provides for adequate incentives to the agent so that he will perform the services which the company wishes him to perform.
6. The system provides the industry with a means of delivering the service for which the public is paying.
7. The agent's interest is not in conflict with his client's or his company's.

New York State System

The present system of compensating career agents of companies operating in New York consists of the following components:

1. First-year commissions of 55 per cent on whole life, graded down to substantially lower percentages on term and endowment policies.
2. Renewal commissions that usually represent a front-end heaping of the traditional 5 per cent renewals in years 2–10.
3. Service fees of 2 or 3 per cent after the tenth year and various fringe and security benefits.
4. Full vesting of commissions after ten to fifteen years of service. Partial vesting may begin at an earlier time after the training period is completed.
5. A salary scheme for new agents under which they receive a salary for the first two or three years instead of all or part commissions.

Companies that do not operate in New York State pay higher first-year commissions and may pay bonuses. Some of them offer less in the form of renewals. The system is designed to meet three objectives: to provide adequate compensation for producing new business, to pay enough to attract new men into the business and develop them into career agents, and to provide incentive for agents to keep the business from lapsing and to provide service as needed to policyholders.

But the present system has a number of drawbacks:

1. It is very difficult for new agents to get started. On the average, not more than 15 per cent of the new agents hired become successful agents. Some companies experience higher retention rates and some have lower retention rates, but the total result is disappointing. A substantial number of agents have a very difficult time earning an adequate living.
2. Lapse rates are higher than desirable. First-year lapse rates on ordinary business range from about 7 to 25 per cent. Lapsed policies are costly to the company and the policyholder.
3. Minimum deposit insurance is often sold when term should be sold instead, and, if it lapses soon after issue, at a high cost to the policyholder.
4. The rewards to the agent for selling very large and very small policies are unrealistic relative to the effort required to make the sale. This is a problem the industry has come to grips with in setting commissions for group insurance and single-purchase-payment variable annuities.

5. Vested commissions are paid to agents who no longer have any connection with the company and are no longer providing any service to policyholders.
6. Also, a policyholder does not receive the service he is paying for when his agent leaves the business (unless another agent is assigned to provide this service for him), and his premiums are not reduced accordingly.

Renewal Commissions

At present, agents are paid first-year commissions plus renewal commissions. New York companies usually pay renewal commissions through the tenth policy year and service fees in the following years. Renewal commissions may be vested or nonvested, or, in some companies, agents receive a salary in lieu of most renewal commissions. Renewals can be considered as serving several different purposes: (1) compensation for the original sales, (2) incentive payment for keeping the business on the books, (3) payment for renewal service, and (4) a method of stabilizing earnings over the agent's career.

Since renewal commissions are never contingent on whether the agent actually performs the renewal service, and since they are not large enough to attract the agent's interest, many agents do not perform renewal service. Many agents may feel that renewals are inadequate to compensate them for the time required to perform services. Those that do perform service are often motivated by the fact that they expect to make an additional future sale. Such service may be viewed as a form of prospecting. It is questionable to what extent renewals provide an incentive for agents to work to keep business on the books.

From the policyholder's viewpoint, the premium dollars spent on renewal commissions can be viewed either as deferred payment to the agent for the original sale or as payment for service. But renewal commissions paid over a ten-year period and service fees paid after that are ineffective ways to spend the premium dollar for the following reasons:

1. They do little to provide the agent with the incentive to behave as the companies wish him to.
2. They further exaggerate any inequities in compensation differentials that exist among various levels of sales performance and various policy sizes.
3. They are payment for service that the policyholder may not be receiving.
4. They do little to help the new agent succeed.

Measuring Effects

In order to measure whether renewals are an effective tool in compensating for various persistency levels, first-year and renewal commissions at various persistency levels and at various agent career stages were calculated. The assumptions are shown in Table 2. The results are shown in Tables 3 and 4.

TABLE 2

ASSUMPTIONS USED IN THE PREPARATION OF TABLES 3 AND 4

Production:

Level—$1,000,000 per year

Increasing—$1,000,000 in the first year, increasing 10% per year

Mix of business:

65% whole life at $25 per thousand

35% term at $8 per thousand

Commission rates:

STANDARD		HEAPED	
Years	Rate	Years	Rate
Whole life:		Whole life:	
1	55 %	1	55 %
2–10	5	2	12
11–20	3	3	7
Term:		4–20	3
1	35	Term	
2–10	7½	1	35
11–20	3	2–10	7½
		11–20	3

Termination rates:

Average: Table B from LIAMA Mathematical Tables supplementary to the Reports of the Committee on Agents' Compensation, with a minimum termination rate for term of 12%

High lapse rates: Total termination rates are taken as 150% of Table B total termination rates with a minimum termination rate for term of 15%

Low lapse rates: Total termination rates are taken as 50% of Table B total termination rates with a minimum termination rate for term of 9%

TABLE B: TERMINATION RATES*

Year	Rate	Year	Rate
1	20.4%	11	6.0%
2	12.5	12	5.9
3	10.6	13	5.8
4	9.4	14	5.7
5	8.7	15	5.6
6	8.0	16	5.7
7	7.3	17	5.9
8	6.7	18	6.1
9	6.4	19	6.3
10	6.1	20	6.4

* For years 3 and over for average termination rates, 12% was used for term.

TABLE 3

SUMMARY OF COMPENSATION AND PREMIUMS PER SURVIVING AGENT

(Assumptions Are as Stated in Table 2)

No. of Years in Business	First-Year Premiums	Renewal Premiums	First-Year Commissions	Standard Commissions Scale			Heaped Commissions Scale		
				Renewals	Total Commission	Ratio of Renewals to Total	Renewals	Total Commission	Ratio of Renewals to Total
	Level Production—Average Persistency								
5	$ 19,050	$ 50,944	$ 9,917	$ 2,732	$12,650	21.6%	$ 3,478	$13,396	26.0%
10	19,050	92,276	9,917	4,930	14,847	33.2	4,954	14,871	33.3
20	19,050	141,797	9,917	6,415	16,333	39.3	6,439	16,357	39.4
	Level Production—High Lapse Rates								
5	$ 19,050	$ 40,745	$ 9,917	$ 2,187	$12,104	18.1%	$ 2,873	$12,790	22.5%
10	19,050	67,358	9,917	3,606	13,524	26.7	3,831	13,749	27.9
20	19,050	92,455	9,917	4,359	14,277	30.5	4,584	14,502	31.6
	Level Production—Low Lapse Rates								
5	$ 19,050	$ 62,354	$ 9,917	$ 3,337	$13,255	25.2%	$ 4,126	$14,044	29.4%
10	19,050	124,404	9,917	6,620	16,537	40.0	6,312	16,229	38.9
20	19,050	218,716	9,917	9,449	19,367	48.8	9,141	19,059	48.0
	Increasing Production—Average Persistency								
5	$ 27,891	$ 59,933	$14,520	$ 3,215	$17,735	18.1%	$ 4,288	$18,808	22.8%
10	44,919	147,762	23,385	7,903	31,288	25.3	8,737	32,122	27.2
20	116,506	466,204	60,653	22,986	83,640	27.5	25,150	85,804	29.3
	Increasing Production—High Lapse Rates								
5	$ 27,891	$ 48,280	$14,520	$ 2,591	$17,111	15.1%	$ 3,562	$18,082	19.7%
10	44,919	110,988	23,385	5,947	29,331	20.3	6,935	30,319	22.9
20	116,506	330,891	60,653	16,714	77,368	21.6	19,277	79,930	24.1
	Increasing Production—Low Lapse Rates								
5	$ 27,891	$ 72,874	$14,520	$ 3,901	$18,421	21.2%	$ 5,060	$19,580	25.8%
10	44,919	193,745	23,385	10,326	33,711	30.6	10,843	34,228	31.7
20	116,506	656,861	60,653	31,412	92,066	34.1	32,755	93,408	35.1

The calculations show that an agent with good persistency can earn approximately 5 per cent more than an agent with average persistency in his fifth year as an agent; an agent with poor persistency will earn approximately 5 per cent less than the average agent in his fifth year. If the renewal premiums in force are taken as a measure of the value of the business to the company, the in-force business of the agent with good persistency is worth over 20 per cent more to the company at the end of the agent's fifth contract year, while the in-force business of the agent with poor persistency is worth 20 per cent less than the business

TABLE 4

RELATIVE VALUE OF BUSINESS AND COMPENSATION AT VARIOUS LEVELS OF PERSISTENCY

(Based on Production and Compensation Shown in Table 3)

No. of Years in Business	Production Assumption	Relative Value of Business to Company (Ratio of Renewal Premiums to Renewal Premiums with Average Persistency)	Relative Value of Business to Agent (Relative Compensation = Ratio of Compensation to Compensation with Average Persistency)	
			Standard Commissions	Heaped Commissions
	High Lapse Rates versus Average Lapse Rates			
5	Level	80.0%	95.7%	95.5%
10	Level	73.0	91.1	92.5
20	Level	65.2	87.4	88.7
	Low Lapse Rates versus Average Lapse Rates			
5	Level	122.4%	104.8%	104.8%
10	Level	134.8	111.4	109.1
20	Level	154.2	118.6	116.5
	High Lapse Rates versus Average Lapse Rates			
5	Increasing	80.6%	96.5%	96.1%
10	Increasing	75.1	93.7	94.4
20	Increasing	71.0	92.5	93.2
	Low Lapse Rates versus Average Lapse Rates			
5	Increasing	121.6%	103.9%	104.1%
10	Increasing	131.1	107.7	106.6
20	Increasing	140.9	110.1	108.9

of the agent with average persistency. In other words, the company is hurt four times as much as the agent by bad persistency, and the agent is rewarded only one-fourth as much as the company for good persistency. If it is assumed that business with high lapse rates will continue to have high lapse rates, then using renewal premiums as a measure of value is conservative, since it understates the spread in value. The spread between the differences in compensation to the agent and the value of the business to the company increases with increasing duration. The compensation differential in the fifth year is important from the viewpoint of motivation because at that point the agent is no longer being financed, he has completed his training period, and probably he has developed almost fully his selling habits. The way the policy is sold and the attitudes of the agent in doing business will have a substantial effect on his persistency.

These tables also demonstrate why renewals are not an effective means of helping the agent get started in the business. All initial financing is normally completed by the fifth year. For an agent with level production and average lapse rates, standard renewals in the fifth year are 22 per cent of total compensation. By the tenth year the renewals will be 33 per cent of total compensation. Heaping increases the renewals in the fifth year to 26 per cent of compensation but has no effect on renewals in the tenth year. For an agent with production increasing 10 per cent per year, the corresponding value of standard renewals at year 5 is 18 per cent, and at year 10 it is 25 per cent. Heaped renewals for this agent are worth 22 per cent in year 5 and 27 per cent in year 10. Renewals are costly in terms of value received as compared with dollars paid out.

An examination of data for actual renewal commissions and first-year commissions paid, for various companies, indicates that renewals are a much higher percentage of total commissions than would be expected from the data in Table 3. Table 5 shows, for the year 1972, ten companies' actual first-year and renewal commissions. These data are taken from Schedule Q for the various companies, in order to eliminate any distortion from the effect of reinsurance. The large proportion of renewals can be explained partially in terms of vested renewals which are being paid to terminated agents and renewals to agents who are still active but whose production has dropped. Renewals paid to nonproducers defeat the primary purpose of agent compensation: to pay adequate compensation to the active, producing agents of the company. That portion of the renewal commission dollar which is doing something else is an unprofitable expenditure of money.

TABLE 5

RATIO OF FIRST-YEAR AND RENEWAL COMMISSIONS TO PREMIUMS
AND RATIO OF RENEWAL COMMISSIONS TO TOTAL COMMISSIONS

(Data from 1972 Schedule Q for Various Companies; All Data in $1,000's)

Company	First-Year Premium (1)	Renewal Premium (2)	First-Year Commission (3)	Renewal Commission (4)	Total Commission (5)	Average First-Year Commission Rate [(3)÷(1)] (6)	Average Renewal Commission Rate [(4)÷(2)] (7)	Renewal Commission as a Percentage of Total [(4)÷(5)] (8)
A........	$22,488,528	$201,034,981	$11,809,531	$11,895,023	$23,704,554	52.5%	5.92%	50.2%
B........	9,227,627	88,510,645	4,879,168	3,075,147	7,954,315	52.9	3.47	38.7
C........	7,629,360	66,734,999	3,670,765	2,488,288	6,159,053	48.1	3.73	40.4
D........	20,824,336	134,802,274	9,527,858	9,027,067	18,554,925	45.8	6.70	48.7
E........	5,549,248	29,092,310	2,647,980	1,505,106	4,153,086	47.7	5.17	36.2
F........	32,780,165	255,330,411	15,773,129	18,040,481	33,813,610	48.1	7.07	53.4
G........	12,481,952	101,464,767	6,817,736	6,163,869	12,981,605	54.6	6.07	47.5
H........	19,771,526	170,438,616	9,390,747	10,020,310	19,411,057	47.5	5.88	51.6
I........	16,276,048	97,589,275	8,397,848	4,382,158	12,780,006	51.6	4.49	34.3
J........	38,421,859	295,670,868	18,591,059	20,939,855	39,530,914	48.4	7.08	53.0

Alternate Plan

To overcome these difficulties, agents' compensation might be based on a three-part formula consisting of (1) commissions for the production of new business and perhaps renewals for the second and third policy years; (2) a basic salary; and (3) a bonus or incentive compensation based on performance, to be paid periodically in addition to salary and commissions.

Commissions in this plan would be based on a substantially lower scale than at present. The scale would be designed to minimize the conflict of interest between the customer and the agent. Commissions for term insurance would be paid at the same rate as for whole life. No commissions would be paid on policies lapsing before a full year's premium was paid. The incentive compensation determined by performance would represent a substantial part of income, perhaps as much as 50 per cent. A company would have to determine what it wanted its agents to do and how it would measure whether they were doing it in order to determine the bonus formula. Both persistency and level of production would weigh heavily in the bonus formula.

Salary would be expected to be a relatively large component of compensation for new agents and would gradually decrease in importance over time. The bonus would start at zero and gradually increase with time.

Renewal commissions would be substantially reduced. Studies indicate[6] that discontinuing renewals after the third policy year results in no adverse effect on persistency.

The agent would be eligible for a pension and other employee benefits. The objective would be to use the money paid to the sales force to produce the most effective result. If its effect were to make it easier to recruit and retain good salesmen, this in turn would reduce the cost of doing business and make it possible to pass along the savings to the life insurance customer.

Illustrating the Plan

An illustration of such an alternate agents' compensation plan has been developed with the objective of rewarding production and good persistency. The components are as follows:

1. A salary equal to $7,000 in year 1 and a level amount of $4,000 in all subsequent years.

[6] Richard E. Johnson and E. J. Leverett, Jr., "Life Insurance Commission Schedules: A Tool for Motivation," *Best's Review*, November, 1972.

2. Commissions equal to 20 per cent of first-year premium and 20 per cent of second-year premium. No commissions after the second policy year.
3. Incentive compensation to be paid out monthly as an addition to salary. The incentive compensation amount is determined once a year at the beginning of the year and is based on the experience of the previous year.
4. Incentive compensation after year 1 is equal to the sum of:
   a) $1,000.
   b) $1.00 per $1,000 of new business in excess of $300,000 written during the previous year.
   c) $1.00 per $1,000 of new business in excess of $2,500,000 written during the previous year.
   d) $0.50 per thousand of insurance in force in year 2 and later in excess of $2,000,000.
   e) 10 per cent of net increase in premium income over $10,000 in each of the two previous years.
   f) 1 per cent of renewal premiums in the previous year.
5. Incentive income is to be increased or decreased up to 25 per cent on the basis of persistency experience. In the examples below, it is increased 25 per cent for low lapse rates and decreased 25 per cent for high lapse rates.

An illustrative calculation is shown in Table 10. Compensation has been calculated on the basis of traditional commissions with standard and heaped scales and on the basis of this plan for several combinations of production levels, proportion of term and permanent, and levels of lapse rates.

Tables 6–9 compare compensation under the illustrative plan with compensation under traditional and heaped commissions. These tables also show the differences in compensation between average, high, and low lapse assumptions. The assumptions are the same as those shown in Table 2, except for production and mix of business. Production and mix of business are shown on each of the tables. These examples demonstrate that this type of agents' compensation plan can reflect much more effectively the differences in value to a company of business with average, high, and low persistency. The plan can be varied to increase or decrease the differentials, according to what the company considers important in motivating agents. The purposes of the examples are to demonstrate that it is possible to design such a plan and to point out some of the factors that might be used in it.

Table 6 shows the relative value of commissions and compensation under the illustrative plan for fifth-, tenth-, and twentieth-year agents at various production levels with a fixed business mix of 65 per cent permanent and 35 per cent term. The effect of the illustrative plan is to provide approximately the same compensation as heaped commissions for the agent whose ultimate production level is $1,000,000 and whose lapses are average. For the lower-production agent the compensation under the illustrative plan is somewhat higher because the plan in effect puts a floor on earnings. For the higher-production agent compensation is a little lower. Under the illustrative plan, good persistency is more highly rewarded. For example, the fifth-year $1,000,000 agent with good lapse rates is paid 12 per cent more than the agent with average rates under the illustrative plan, as compared with only 4 per cent more based on heaped commissions. These data differ from those shown in Tables 3 and 4 because of the assumption of increasing production in the agent's first four contract years.

Table 7 shows how the plan provides a reasonable pattern of compensation in the first five years an agent is under contract. The production and mix of business assumptions are the same as for Table 5. The illustrative plan is compared with commissions only, without any training allowances. This table also shows that the effect of persistency will be reflected in the agent's earnings to a much more significant degree and much earlier than under heaped commissions.

Table 8 shows a comparison of heaped commissions and the illustrative plan for fifth-, tenth-, and twentieth-year agents for an ultimate production level of $1,000,000 for various business mixes. For the agent writing 90 per cent term, the illustrative plan provides a tenth-year agent with average lapse rates $10,503, as compared with $6,741 under a heaped commission plan. For the tenth-year agent writing 90 per cent permanent, the illustrative plan provides $16,192, as compared with $18,175 under a commission plan. The compensation is about equal at the level of 65 per cent permanent, with the illustrative plan providing $14,313 as compared with $14,602 under heaped commissions. Table 9 again shows the effect of various business mixes, but in this case production is $1,000,000 in the agent's first year and increases 10 per cent each year.

Table 10 is an example of how the detailed calculation works. This table also provides the data for experimenting with alternative plans and for introducing variations in the illustrative plan.

It is anticipated that the illustrative plan would provide for the termination of an agent who failed to earn $7,500 during any year.

Salary plans have the advantage of improving the image of a job. Studies done by LIMRA[7] and the Conference Board indicate that a higher level of starting salary is usually accompanied by higher reten-

[7] *Factors Related to Salesman Turnover* (Research Report No. 72-11 [Hartford, Conn.: LIMRA, 1972]), p. 2.

TABLE 6

COMPARISON OF COMPENSATION PER PERSISTING AGENT: STANDARD AND HEAPED COMMISSIONS VERSUS ILLUSTRATIVE PLAN

(Production at Various Levels with a Constant Mix of Business of 65 Per Cent Permanent and 35 Per Cent Term)

YEAR OF AGENT'S CAREER	PRODUCTION: FACE AMOUNT OF INSURANCE SOLD								
1	$450,000			$ 600,000			$1,200,000		
2	525,000			700,000			1,400,000		
3	600,000			800,000			1,600,000		
4	675,000			900,000			1,800,000		
5 and over	750,000			1,000,000			2,000,000		
	Standard Commissions	Heaped Commissions	Illustrative Plan	Standard Commissions	Heaped Commissions	Illustrative Plan	Standard Commissions	Heaped Commissions	Illustrative Plan
	Compensation—Average Lapse Rates								
5	$ 9,005	$ 9,563	$10,494	$12,007	$12,751	$12,748	$24,401	$25,503	$23,291
10	10,833	10,952	11,659	14,444	14,602	14,313	28,888	29,204	26,383
20	12,162	12,180	13,119	16,217	16,241	16,259	32,433	32,481	28,817
	Compensation—High Lapse Rates								
5	$ 8,705	$ 9,207	$ 9,806	$11,606	$12,276	$11,566	$23,212	$24,452	$20,192
10	9,956	10,186	10,355	13,274	13,581	12,548	26,549	27,163	21,531
20	10,669	10,838	10,957	14,225	14,450	13,351	28,450	28,900	22,926
	Compensation—Low Lapse Rates								
5	$ 9,335	$ 9,942	$11,288	$12,447	$13,256	$14,242	$24,984	$26,511	$27,070
10	11,933	11,861	13,348	15,911	15,814	17,265	31,821	31,628	33,404
20	14,338	14,107	16,556	19,117	18,809	20,866	38,234	37,618	39,995
	Ratio of Compensation Paid to Agents with High Lapses to Compensation Paid Agents with Average Lapses								
5	96.7%	96.3%	93.4%	96.7%	96.3%	90.7%	96.7%	96.3%	86.7%
10	91.9	93.0	88.8	91.9	93.0	87.7	91.9	93.0	81.6
20	87.7	88.9	83.5	87.7	88.9	82.1	87.7	88.9	79.6
	Ratio of Compensation Paid Agents with Low Lapses to Compensation Paid Agents with Average Lapses								
5	103.7%	104.0%	107.6%	103.7%	104.0%	111.7%	103.7%	104.0%	116.2%
10	110.2	108.3	114.5	110.2	108.3	120.6	110.2	108.3	126.6
20	117.9	115.8	126.2	117.9	115.8	128.3	117.9	115.8	138.8

TABLE 7

COMPARISON OF COMPENSATION PER PERSISTING AGENT: STANDARD AND HEAPED COMMISSION PLANS VERSUS ILLUSTRATIVE PLANS

(All Production is 65 Per Cent Permanent and 35 Per Cent Term; Standard and Heaped Commissions Plans Do Not Include Any New-Agent Financing)

YEAR OF AGENT'S CAREER	PRODUCTION: FACE AMOUNT OF INSURANCE SOLD								
1	$450,000			$ 600,000			$1,200,000		
2	525,000			700,000			1,400,000		
3	600,000			800,000			1,600,000		
4	675,000			900,000			1,800,000		
5 and over	750,000			1,000,000			2,000,000		
	Standard Commissions	Heaped Commissions	Illustrative Plan	Standard Commissions	Heaped Commissions	Illustrative Plan	Standard Commissions	Heaped Commissions	Illustrative Plan
	Compensation—Average Lapse Rates								
1	$4,463	$4,463	$ 8,714	$ 5,950	$ 5,950	$ 9,286	$11,901	$11,901	$11,572
2	5,573	5,980	8,515	7,431	7,974	9,930	14,861	15,948	16,159
3	6,693	7,275	9,171	8,931	9,701	10,905	17,862	19,401	19,110
4	7,842	8,413	9,831	10,456	11,218	11,780	20,912	22,435	20,859
5	9,005	9,563	10,494	12,007	12,751	12,748	24,401	25,503	23,291
	Compensation—High Lapse Rates								
1	$4,463	$4,463	$ 8,714	$ 5,950	$ 5,950	$ 9,286	$11,901	$11,901	$11,572
2	5,526	5,881	8,053	7,368	7,842	9,336	14,736	15,683	14,896
3	6,582	7,079	8,638	8,777	9,439	10,116	17,553	18,878	17,182
4	7,641	8,141	9,222	10,188	10,885	10,787	20,376	21,711	18,476
5	8,705	9,207	9,806	11,606	12,276	11,566	23,212	24,452	20,192
	Compensation—Low Lapse Rates								
1	$4,463	$4,463	$ 8,714	$ 5,950	$ 5,950	$ 9,286	$11,901	$11,901	$11,572
2	5,620	6,080	8,977	7,493	8,106	10,524	14,986	16,212	17,422
3	6,818	7,477	9,750	9,090	9,969	11,771	18,180	19,939	21,167
4	8,056	8,696	10,452	10,742	11,595	12,981	21,483	23,190	23,748
5	9,335	9,942	11,288	12,447	13,256	14,282	24,984	26,511	27,070
	Ratio of Compensation Paid Agents with Low Lapses to Compensation Paid Agents with Average Lapses								
2	99.2%	98.3%	94.5%	99.2%	98.3%	94.0%	99.2%	98.3%	92.2%
3	98.3	97.3	94.2	98.3	97.3	92.7	98.3	97.3	89.9
4	97.4	96.8	93.8	97.4	96.8	91.5	97.4	96.8	88.6
5	96.7	96.3	93.4	96.7	96.3	90.7	96.7	96.3	86.7
	Ratio of Compensation Paid Agents with Low Lapses to Compensation Paid Agents with Average Lapses								
2	100.8%	101.7%	105.4%	100.8%	101.7%	106.0%	100.8%	101.7%	107.8%
3	101.9	102.8	105.9	101.9	102.8	107.9	101.9	102.8	110.8
4	102.7	103.4	106.3	102.7	103.4	110.2	102.7	103.4	113.9
5	103.7	104.0	107.6	103.7	104.0	112.0	103.7	104.0	116.2

COMPARISON OF COMPENSATION PER PERSISTING AGENT: HEAPED COMMISSIONS VERSUS ILLUSTRATIVE PLAN

(Production Is Constant after Fifth Year of Agent's Career, and Mix of Business Varies)

	Mix of Business							
Permanent	10%		50%		65%		90%	
Term	90		50		35		10	
	Production							
	Premium	Face Amount	Premium	Face Amount	Premium	Face Amount	Premium	Face Amount
Year of agent's career:								
1	$ 5,820	$ 600,000	$ 9,900	$ 600,000	$11,430	$ 600,000	$13,980	$ 600,000
2	6,790	700,000	11,550	700,000	13,335	700,000	16,310	700,000
3	7,760	800,000	13,200	800,000	15,240	800,000	18,640	800,000
4	8,730	900,000	14,850	900,000	17,145	900,000	20,790	900,000
5 and over	9,700	1,000,000	16,500	1,000,000	19,050	1,000,000	23,300	1,000,000
	Plan of Compensation							
	Heaped Commissions	Illustrative Plan	Heaped Commissions	Illustrative Plan	Heaped Commissions	Illustrative Plan	Heaped Commissions	Illustrative Plan
	Compensation—Average Lapse Rates							
5	$5,360	$ 9,075	$10,735	$11,536	$12,751	$12,748	$16,111	$14,790
10	6,741	10,503	12,458	13,274	14,602	14,313	18,175	16,192
20	7,446	11,774	13,482	15,035	16,241	16,259	20,238	18,297
	Compensation—High Lapse Rates							
5	$5,095	$ 8,442	$10,318	$10,714	$12,276	$11,566	$15,540	$13,265
10	6,079	9,148	11,535	11,621	13,581	12,548	16,991	14,093
20	6,478	9,698	12,276	12,355	14,450	13,351	18,074	15,011
	Compensation—Low Lapse Rates							
5	$5,621	$ 9,720	$11,173	$12,793	$13,256	$14,242	$16,726	$16,656
10	7,463	12,175	13,537	15,577	15,814	17,265	19,610	20,077
20	8,653	14,783	16,039	19,207	18,809	20,866	23,425	24,008
	Ratio of Compensation Paid Agents with High Lapses to Compensation Paid Agents with Average Lapses							
5	95.1%	93.0%	96.1%	92.9%	96.3%	90.7%	96.5%	89.7%
10	90.2	87.1	92.6	87.5	93.0	87.7	93.5	87.0
20	87.0	82.4	91.1	82.2	88.9	82.1	89.3	82.0
	Ratio of Compensation Paid Agents with Low Lapses to Compensation Paid Agents with Average Lapses							
5	104.9%	107.1%	104.1%	110.9%	104.0%	111.7%	103.8%	112.6%
10	110.7	115.9	108.7	117.3	108.3	120.6	107.9	124.0
20	116.2	125.6	119.0	127.7	115.8	128.3	115.7	131.2

TABLE 9

COMPARISON OF COMPENSATION PER PERSISTING AGENT: HEAPED COMMISSIONS VERSUS ILLUSTRATIVE PLAN

(Production Is $1,000,000 in Year 1, Increasing 10 Per Cent Each Year)

	MIX OF BUSINESS							
Permanent.	10%		50%		65%		90%	
Term.	90		50		35		10	
	Production							
	Premium	Face Amount	Premium	Face Amount	Premium	Face Amount	Premium	Face Amount
Year of agent's career:								
1	$ 9,700	$1,000,000	$ 16,500	$1,000,000	$ 19,050	$1,000,000	$ 23,300	$1,000,000
5	14,202	1,464,000	24,158	2,464,000	27,891	1,464,000	34,113	1,464,000
10	22,872	2,358,000	38,906	2,358,000	44,919	2,358,000	54,940	2,358,000
20	59,323	6,116,000	101,000	6,116,000	116,506	6,116,000	142,498	6,116,000
	Plan of Compensation							
	Heaped Commission	Illustrative Plan	Heaped Commission	Illustrative Plan	Heaped Commission	Illustrative Plan	Heaped Commission	Illustrative Plan
	Compensation—Average Lapse Rates							
5	$ 7,944	$11,326	$ 15,845	$15,865	$ 18,808	$17,669	$ 23,746	$ 20,677
10	14,262	17,665	27,251	25,347	32,122	28,228	40,240	33,029
20	37,910	47,311	72,742	67,646	85,804	75,272	107,574	87,981
	Compensation—High Lapse Rates							
5	$ 7,535	$10,296	$ 15,206	$13,963	$ 18,082	$15,499	$ 22,876	$ 18,059
10	13,132	15,087	25,632	21,201	30,319	23,603	38,132	27,608
20	34,555	37,400	67,555	54,054	79,930	60,300	100,555	70,709
	Compensation—Low Lapse Rates							
5	$ 8,349	$12,527	$ 16,517	$18,250	$ 19,580	$20,400	$ 24,685	$ 23,983
10	15,483	21,389	29,116	31,015	34,228	34,625	42,748	40,642
20	41,777	60,456	79,327	87,074	93,408	97,055	116,877	113,691
	Ratio of Compensation Paid Agents with High Lapses to Compensation Paid Agents with Average Lapses							
5	94.9%	90.9%	96.0%	88.0%	96.1%	87.7%	96.3%	87.3%
10	92.1	85.4	94.1	83.6	94.4	83.6	94.8	83.5
20	91.2	79.1	92.9	79.9	93.2	80.1	93.5	80.4
	Ratio of Compensation Paid Agents with Low Lapses to Compensation Paid Agents with Average Lapses							
5	105.1%	110.6%	104.2%	115.0%	104.1%	115.5%	104.0%	115.9%
10	108.6	121.1	106.8	122.4	106.6	122.7	106.2	123.0
20	110.2	127.8	109.1	128.7	108.9	128.9	108.6	129.2

TABLE 10

EXAMPLE OF ILLUSTRATIVE PLAN CALCULATION:
PRODUCTION $1,000,000 BEGINNING IN YEAR 5*

(Mix of Business: 65 Per Cent Permanent and 35 Per Cent Term)

	AVERAGE LAPSE RATE			HIGH LAPSE RATES			LOW LAPSE RATES		
	Year 5 Agent	Year 10 Agent	Year 20 Agent	Year 5 Agent	Year 10 Agent	Year 20 Agent	Year 5 Agent	Year 10 Agent	Year 20 Agent
Production and in-force:									
1. First-year premiums	$ 19,050	$ 19,050	$ 19,050	$ 19,050	$ 19,050	$ 19,050	$ 19,050	$ 19,050	$ 19,050
2. Second-year premiums	13,647	15,164	15,164	11,899	13,221	13,221	15,396	17,107	17,107
3. Renewal premiums	38,953	84,673	137,922	31,465	62,668	90,732	47,242	112,525	210,390
4. Increase in premium—prior year	11,849	8,281	4,151	9,721	5,342	1,912	14,235	12,417	8,623
5. Increase in premium—second preceding year	11,382	9,008	4,434	9,672	6,060	2,110	13,196	12,983	8,926
6. Amount sold—prior year	900,000	1,000,000	1,000,000	900,000	1,000,000	1,000,000	900,000	1,000,000	1,000,000
7. Renewal in-force—prior year	1,495,903	3,999,084	6,750,685	1,234,442	3,025,199	4,544,235	1,768,752	5,160,846	9,974,883
8. Renewal premiums—prior year	28,520	77,025	134,040	23,516	57,922	89,001	33,886	100,619	202,063

* Production in first four years of career:

YEAR	PRODUCTION		YEAR	PRODUCTION	
	Face Amount	Premium		Face Amount	Premium
1	$600,000	$11,430	3	800,000	15,240
2	700,000	13,335	4	900,000	17,145

TABLE 10—*Continued*

	Average Lapse Rate			High Lapse Rates			Low Lapse Rates		
	Year 5 Agent	Year 10 Agent	Year 20 Agent	Year 5 Agent	Year 10 Agent	Year 20 Agent	Year 5 Agent	Year 10 Agent	Year 20 Agent
Illustrative calculation:									
9. 20% of first-year premium	3,810	3,810	3,810	3,810	3,810	3,810	3,810	3,810	3,810
10. 20% of renewal premium	2,730	3,033	3,033	2,380	2,644	2,644	3,079	3,422	3,421
11. Salary	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000	4,000
Incentive compensation:									
12. $1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
13. $1.00 per $1,000 of prior year new business over $300,000	600	700	700	600	700	700	600	700	700
14. $1.00 per $1,000 of prior year new business over $2,500,000	0	0	0	0	0	0	0	0	0
15. 10% of increase in premium over $10,000 in prior year	185	0	0	0	0	0	424	242	0
16. 10% of increase in premium over $10,000 in second prior year	138	0	0	0	0	0	320	298	0
17. $0.50 per $1,000 of prior year renewal in-force over $2,000,000	0	1,000	2,376	0	513	1,272	0	1,580	3,987
18. 1% of renewal premiums—prior year	285	770	1,340	235	579	890	339	1,006	2,021
19. Total before persistency factor	2,208	3,470	5,416	1,835	2,792	3,862	2,683	4,826	7,708
20. Persistency factor	1.00	1.00	1.00	.75	.75	.75	1.25	1.25	1.25
21. Incentive compensation after persistency factor, item 19 × item 20	2,208	3,470	5,416	1,376	2,094	2,897	3,353	6,033	9,635
22. Total compensation per persisting agent (sum of items 9, 10, 11, and 21)	12,748	14,313	16,259	11,566	12,548	13,351	14,242	17,265	20,866

tion rates. This type of plan would improve earnings stability without permitting undue reliance on past performance. Each year's earnings are, in effect, based mainly on the performance of the current year and the two preceding years. This type of plan should enable companies to recruit and retain high-quality salesmen. The main disadvantage of this type of plan is that it may prove to be expensive if the provisions for cut-off of nonproducers are inadequate.

The illustrative plan is heavily slanted toward increasing the reward for good persistency and charging the agent with the cost of poor persistency. In this way the financial interests of the agent and the company become more similar. The same kind of result with respect to persistency could be accomplished by paying lower first-year and higher renewal commissions. However, such an arrangement would generate other problems which this type of plan tries to resolve. First, this type of plan is designed to cut off the agent who ceases to be productive. Renewals paid to a nonproducing agent do nothing to help the company in the year in which the renewal is paid. Simply paying more in the form of renewals would have the effect of paying more money to people who are no longer current producers. A plan based on some combination of salary, incentive, and commission can be set up so that the new-agent financing is an integral part of the total plan rather than a separate plan. This type of plan can also be designed to make it much easier for the new agent to reach a normal level of compensation relatively early in his career. If renewals which are paid out over a long period of time are a substantial part of the agent's compensation, then the agent is faced with a severe problem at the end of the financing period, and the company must provide more initial financing.

The plan outlined above is an example of how an alternate plan might work. Many other plans are possible. The factors on which compensation should be based are determined by desired performance, which a company can define in any way that it wishes. If the company developed a way of measuring service, then this might be a factor. The Institute of Life Insurance has pointed to the life-cycle client account as the way insurance may be sold in the future. The number of accounts serviced might be a factor in the compensation base. Net changes in performance as well as the actual performance levels might be used as factors in the compensation formula. An actual plan would have to consider other products which a company offered.

Alternatives might also reflect some grading by policy size. This would work best if the unit were policyholder rather than policy sold. The effect of a grading by size might be to introduce a minimum payment per life sold, or it might be to reduce the payment for amounts over stated limits. Repeat business might be given extra credit because of its good experience.

The company's objectives with respect to growth in premium income might also be considered as a basis for compensation. The present compensation plans reward production far out of proportion to persistency. The illustrative plan places a heavier reward on good persistency. Both plans, however, reward the high-producing agent with high lapses to a greater extent than the low producer. The following question can be posed: Agent A and Agent B both have $1,000,000 of premium income in force, but if Agent A had double the new business, and double the lapses, who would be the more valuable agent? Clearly Agent A was ahead in compensation, all contests, and so on. Agent A also contributed twice as much new-business expense and has twice as many policyholders who very likely suffered some sort of loss when their insurance lapsed. Agent B in fact contributed more to the profits of the company and did a better job for policyholders. A second illustrative plan would be simply to pay the agent a percentage of the growth in premium income. Furthermore, a bonus could be added as the growth in income approached the new-business premium written. This bonus could be a sliding scale based on years in the business or size of the book in force, so that all agents who had better than average experience would be rewarded and agents with poorer than average experience would be charged. Such a system might very well make it impossible for agents with poor persistency to earn a living. This could have the effect of substantially increasing the quality of the business and of lowering the cost of insurance but of cutting down the volume of quickly terminated business which is written.

The design of an actual plan should be based on the type of field force, type of market, type of product, and objectives of the company.

IV. THE REGULATION OF EXPENSE AND AGENTS' COMPENSATION

It is felt by regulators that the free-enterprise system is not adequate by itself to control the fair value of life insurance through competition and the profit motive. To correct this deficiency, New York State regulates fair value through a combination of methods: (1) regulating expenses, (2) regulating surplus and dividends, and (3) limiting new business. The impact of New York regulation extends to companies doing business in other states only, in that they must try to be competitive with New York companies. The purpose of regulating the expenses of insurance companies is to maintain their solvency and, indirectly, to hold down costs. (Direct regulation of price is impractical because of the nature of participating insurance. Direct regulation of cost would be virtually impossible, since there is no agreed method of measuring what cost is.) Expense regulation protects companies from ruinous and excessive competition. Beyond that, however, the primary purpose of regulation is to protect the public. Therefore, emphasis in this discussion will be on establishing criteria for a system of expense regulation that will achieve that objective. Then the operation of the present system will be analyzed with respect to these criteria.

Criteria of Regulation

What should a system of expense regulation be expected to accomplish? The criteria that follow provide a framework against which the present system can be measured. From this evaluation it can be determined either that the present system is functioning well, that it should be modified, or that an entirely new system should be devised.

1. Expense regulation should protect the consumer. This can be achieved in several ways. Selling charges should not be excessive or favor one product over another. The policyholder should not have to pay a share of excessive operating costs, either at the time he makes the purchase or in later policy years. He should get a fair value for his money.
2. The law should prevent extravagant company operations and help to protect company solvency.
3. Regulation should provide adequate margins for maintaining a sales organization and compensating salesmen adequately in order to make it feasible for them to cover various segments of the marketplace; that is, it should provide margins that permit adequate compensation for selling to lower-income customers and a reasonable spread of compensation as between products. Every product should be self-supporting.
4. Regulation should be equitable in the way it affects various types of companies with various types of distribution outlets and jurisdictions.
5. Interference with company operations should be kept at the lowest level consistent with effective regulation.
6. Administering the law should not be an onerous burden for either companies or regulators.
7. The law should not discourage innovation in marketing methods or agent compensation.
8. The law should prevent ruinous competition for agents.
9. The law should provide adequate margins for establishing new companies and new agencies within existing companies.

Adequate Margins

The criterion that regulation should provide adequate margins for maintaining a sales organization requires further elaboration. The sales organization should be able to reach as broad a segment of the public as possible. But attaining the lowest possible selling expense will not necessarily achieve this objective or be in the public interest. For example, if no commission or salary in lieu of commission could be paid, the only insurance that would be sold would be an over-the-counter product such as is now being sold in savings banks and by mail. While this type of product could be sold cheaply, it would leave the vast majority of people without private insurance protection. It would clearly be against the public interest to limit expenses so that only this type of product could be sold. Thus the object of regulation should be to ensure that margins are adequate to cover selling expenses to all segments of the public who need coverage. That includes low-income families. There should be adequate allowances for a product and marketing scheme that can reach this segment of the population. This does not imply that a marketing plan that is appropriate for selling a $100,000 policy is also appropriate for selling one of $5,000. Rather, strategies for selling both ends of the market have a place. If the law makes it uneconomical to reach one of the segments, then that segment of the public is being denied proper insurance protection.

Current System in New York

As was pointed out earlier, the free-enterprise system does not function to control the fair value of life insurance through competition and the profit motive. To correct this deficiency, New York regulates fair value through a combination of methods: regulating expenses, surplus, and dividends and limiting new businesses. The system of expense regulation is based on section 213 of the New York Insurance Law—the major regulatory device—and Regulation 49 of the New York Insurance Department, which limits reimbursement of expenses to general agents. Section 213 requires all policies to be self-supporting. The premium rates plus the interest earnings on the policy funds must be adequate for the payment of all benefits and expenses. Section 213 also provides for three over-all expense limits: a first-year field expense limit, a total field expense limit, and a total expense limit. It also sets maximum first-year and renewal commissions scales payable to soliciting agents.

These limits set forth in section 213 are calculated according to relatively complex formulas that have been revised and updated from time to time but that basically reflect the theoretical considerations that went into the law as far back as 1905 and the Armstrong investigation. Revisions normally occur when the law interferes with the operations of companies and are usually arrived at by negotiation and compromise. The effect of the formulas is to provide lower maximum commission limits on term insurance and endowments than on whole life.

Questioning the Approach

A number of forces operating in the 1970's indicate that a fresh look is in order. Consumerism puts the spotlight on regulation and asks how well it is working. Agents' groups are asking for higher limits and higher commissions because, as has been noted, they are having a hard time earning a living. New agents in particular are having difficulty in getting started in the business.

In other sectors, first-year commissions are being questioned as being too high, and people are speculating whether agents are doing the job they are being paid to do. Since the effect of the commission scale is to pay the agent differently for various types of advice, his interest may be opposed to that of his client.

Another problem is that, with substantial inflation, the cost of doing business is continuously rising.

While the New York law applies to the operations in all states of companies licensed in New York, not all companies are licensed in New York. Companies not licensed in New York are not subject to section 213 and can pay substantially higher new-business commissions to agents than can New York companies. But total selling cost includes a number of elements other than commissions. So it is not clear that non–New York companies necessarily have higher total distribution costs. Still, non–New York companies with New York subsidiaries would seem to have an unfair advantage over New York–licensed companies.

Faults of Present Structure

To repeat, the present system effectively has limited agents' commissions of companies operating in New York and has served to limit their total expenses of doing business. The fact that many companies have chosen not to operate in New York or to do so through a subsidiary would indicate that the law has indeed been effective in limiting agents' compensation and costs of the distribution system and the total company. A number of other problems relating to expenses exist in the present structure:

1. *There are different limits for term and permanent insurance.*—The low allowances available to pay term commissions in calculating the first-year

field expense limit under section 213 of the New York law create a situation substantially favoring the sale of permanent insurance, despite the fact that the law should not favor one product over another. This problem could be remedied by modifying the calculation of the first-year field expense limit.

2. *There are different limits for fixed-dollar and variable annuities.*—The SEC controls sales loads on variable annuities, and the New York Insurance Law controls commissions on fixed-dollar annuities.

3. *Inequities exist between New York companies, non–New York companies, and non–New York companies with New York subsidiaries.*—This is not a problem stemming from the New York law, and therefore it cannot be remedied by the New York Insurance Department. A uniform national system is needed to remedy these inequities. If the schedules showing compliance with the expense regulation statutes are to be included in the NAIC Convention Blank, there should be a practical method of handling such a system. Such additional material on expenses as a comparison of actual with expected expenses on some standard basis could be disclosed. Information about a company's performance relative to expense standards would be of interest to policyholders buying participating insurance. The NAIC should assume a position of leadership in working toward a uniform, national system of expense regulation. In the meantime, New York should try to correct problems that exist within the present law.

4. *New York Regulation 49, covering expense reimbursement to general agencies, is cumbersome, is expensive to administer, and fails to encourage efficiency in general agency operation.*—Section 213 covers companies operating on the general-agency and the branch-office system. Commission limits and first-year field and total field expense limits apply to both types of companies. In addition, there is a separate regulation, Regulation 49, which applies only to general-agency companies.

Regulation 49 permits the companies to reimburse the general agent for expenses. The amounts are to be for actual expenses incurred and are in addition to the general-agent commissions provided for by the law. There is a wide variety of types of general-agency shops, ranging from career full-time agents to personal producing general agents and brokerage shops. In the case of the career companies, the general agent must have a means of developing and financing agents. The personal producing general agent needs money to pay his office and operating expenses, and the brokerage general agent has expenses incurred in trying to develop and service the business. These types of operation are very different, and it is difficult to set standards that can apply fairly to all three. The situation is complicated further because companies that do not operate in New York pay higher commissions, but they may expect agents to pay more of their own expenses out of the higher commissions.

The purpose of Regulation 49 has been to prevent the companies from using the reimbursement of expenses to general agents as additional compensation. However, Regulation 49 is ineffective in preventing expense reimbursement from being treated as a de facto part of general-agency compensation. One proposal has been made that vouchering requirements in Regulation 49 should be replaced by an over-all limit on new-business compensation paid to a general agent which would include all commissions and a reasonable expense allowance. The New York Insurance Department in a "clarification" of Regulation 49 set an over-all limit on first-year commissions plus total expense reimbursements of 96 per cent of first-year premiums but did not remove the requirement of vouchering of actual expenses. Such a limit presents difficulties to career companies unless a special additional provision is made for new-agency financing, and the clarification does mention the possibility of exceptions for new agencies. A total limit without a reimbursement requirement realistically could limit total costs and would encourage the general agent to operate more efficiently. If an over-all allowance is not acceptable as a substitute for expense reimbursements, then a method should be worked out to allow an accountant's statement of expenses in lieu of vouchers. Using vouchers to verify the legitimacy of general-agency expenses puts an onerous administrative burden on the general agent, the company, and the insurance department.

5. *The present system operates inequitably between general-agency and branch-office companies.*—General-agency companies are restricted more severely than branch-office companies. Although the field expense limit is the same for both, there is more specific regulation of general agencies. The general agent's commission is limited, and expense reimbursement is subject to Regulation 49. The branch-office companies can pay whatever they wish as managers' salaries and branch-office expenses as long as they comply with the over-all limits.

6. *The law penalizes the company that chooses to finance new general agents by using advances rather than outright financing payments.*—It is conservative to finance through advances, since the company then has the right to recover the money. Advances are charged against the *first-year limit,* but outright financing is charged only against the total *field expense limit.*

7. *Individual insurance compensation normally is not graded by policy size.*—This is a significant problem for the public if it means that the small-sale end of the market cannot be serviced. There is precedent in the handling of group insurance for grading the commission paid according to the size of the premium. Premium rates for individual insurance have been graded by policy size for a number of years.

8. *Vested and nonvested renewals continue to go to the agent whether he is performing service or not.*—The buyer pays a price that provides for field force compensation which assumes that service will be provided at time of sale and for the life of the insurance contract. The buyer always pays for the service; often, in fact, he does not get it. Vesting of renewal commissions is against the buyer's interest and should be prohibited.

9. *In setting a pattern of commissions that has become a frequently used*

formula, the law has discouraged experimentation.—Companies operating in New York usually pay the maximum or almost the maximum commissions permitted by law. Scales follow very similar patterns. The law permits some experimentation, but as a practical matter very few innovations have been tried.

10. *The structure of section 213, operating together with the federal tax laws, has encouraged the growth and frequent misuse of minimum deposit insurance.*—Minimum deposit insurance is any plan in which the insured systematically borrows the increase in cash value to pay part of the premium. If the borrowing plan is arranged to comply with the requirements of the Internal Revenue Service, then the interest paid by the policyholder on the policy loan is deductible for federal income tax purposes. Such plans do not develop any substantial cash values, since they are usually fully borrowed against and, in fact, they are often merchandised as a substitute for term insurance. A minimum deposit policy may or may not be better than term insurance, depending on individual circumstances. In many cases, however, term is substantially cheaper, and the cost differential may be greatest in the early policy years. The agent frequently will not even mention the alternative of buying term because of the enormous difference in his compensation for selling the two products. The commission structure, which provides for a first-year commission on the ordinary life premium and commissions on the full premium (not the premium less the policy loan), is the primary motivating force behind the misuse of minimum deposit insurance. Although many high early-cash-value plans have commission rates lower than the 55 per cent common on ordinary life, the rates are still usually higher than term rates. The misuse of minimum deposit insurance is detrimental not only to the policyholder who should have been sold term but also to other policyholders of the company if the plan is a participating one. The policy loan interest rate is less than the company could earn if it invested the money in securities, and the lapse rates on minimum deposit are much higher than on other business. The use of minimum deposit tends to raise the cost of insurance for all of the company's other participating policyholders.

V. SUMMARY AND CONCLUSIONS

Product choice is a key consumer concern at the time of purchase. The consumer is often strongly influenced in his choice by his agent's advice. But the agent is paid vastly different compensation for selling permanent and term policies (even if the premium amounts are similar). So the commission scale, affecting what agents want to sell, tends to influence product choice. The pattern of commission scales follows the maximum allowances available for commissions under section 213 of the New York Insurance Law. Therefore, the law also contributes to the product-choice problem.

Agent compensation is a key factor influencing agent behavior. The present system provides strong incentives for production but very weak incentives for persistency. From the consumer's viewpoint, the system is weak at those points where the policyholder dollar is spent ineffectively. From the company's viewpoint, the system makes it difficult to build and rebuild its agency force in the current environment.

Renewal commissions, in their present form, represent an ineffective expenditure of the policyholder dollar. The present system is tied closely to the maximum legal commission limits and to the pattern provided for by law. The system and the law are so closely related that they must be considered together if a new system which will overcome the present deficiencies is to be designed. In this paper, problems in the agent compensation system and the law have been identified, and criteria for revising both have been established. An alternate system has been designed to meet the objectives outlined, and examples have been provided to show how the system will operate. But this new system is only one of the many possible objectively oriented agent compensation plans. Thus this particular design is intended not to be a unique solution but rather to demonstrate that solutions exist.

Many readers will disagree with the author's criteria for expense regulation and agent compensation. Many others will have additional ideas as to solutions to the problems outlined. It is hoped that this paper will be the beginning of research and dialogue on the many points raised.

DISCUSSION OF PRECEDING PAPER

FRANK ZARET:

Anna Rappaport has put together a most interesting and provocative paper on a topic of widespread interest. Consumerism is cropping up everywhere, and life insurance operations, including agents' compensation plans, are not likely to escape their ultimate share of criticism. Thoughts on various points raised by Mrs. Rappaport follow.

Policyholder Service

In trying to determine an appropriate basis for service payments to agents, the first and most basic question I would ask is, What do we mean by service?

There are two separate classes of service to which reference is normally made, but they tend to become intertwined in discussions and their differences are blurred. The first I would call client-initiated service, and the second agent- (or company-) initiated service.

In the first instance—client-initiated service—as its name implies, the policyholder asks for certain activities to be performed, such as an address change, a beneficiary change, a dividend explanation, a policy loan, a cash surrender, or some other service. Such service represents a company obligation to the policyholder on account of that policy. The policyholder who wants this service usually can manage to find the right place to go to accomplish his ends. He can write to the home office or telephone a local agency office if he does not know who is his personal representative. I doubt that an agent would refuse to aid a policyholder making a specific request even if the agent were not assigned that policyholder's case (there are, I suppose, always exceptions).

The second type of service, which is agent-initiated, usually involves a call on a client by the agent to review the client's current insurance program or to update coverage. In its purest sense, this would be more in the nature of prospecting than of true service.

Contacts to be initiated by the agents with their clients seem to me to be what we really mean by agent service; they make up the activity that motivates agents to perform. Communication or contact between the agent and the client is the essence of the service that should be given all policyholders. This communication need not come from the original writing agent but can come from any sales representative who has the particular policyholder in his care.

Paying a special fee of some form to compensate agents for client-initiated requests has drawbacks. If the payment were on an item-by-item basis, the administrative problems could be massive and the system could lead to abuse. In my opinion it would be neither appropriate nor worthwhile to pay directly for such activity. Payment for agent- (or company-) initiated service, which is more a form of prospecting, should be included as part of the over-all selling compensation. Periodic communication with existing policyholders is perhaps the best source of new business for agents. It is important, therefore, for the sales force to appreciate that agent-initiated service contacts are one of the best means of increasing new business sales and additional compensation. Moreover, little would seem to be gained by paying special fees for this type of service.

Sound management and adequate training are a necessity in motivating the sales force to act in their client's best interests and, at the same time, achieve company objectives. Compensation systems alone cannot do the job of motivating the sales force.

Consumerism

Consumerism, as related to the life insurance industry, now appears to have concentrated its impact on the new applicant for insurance. Fair, accurate, and illuminating cost comparison methods are being sought to aid the potential new customer in making a sound decision on a life insurance purchase. However, we should not forget that there also is an existing body of policyholders who must be treated as fairly as possible. These existing policyholders constitute a far larger total than the new applicants for insurance (and a good portion of these new applicants are already existing policyholders). To the extent that expenses increase in a mutual company, existing policyholders must bear the burden. High agent turnover and attendant training allowance costs to maintain a sales force can raise expenses substantially for existing policyholders. Adequate production levels by those in whom the company has invested training allowances and management time are a necessity in order to continue to spread such costs over as wide a base of policyholders as possible.

There is a body of opinion which feels that agents of any company should have unrestricted freedom to place business wherever they choose for the benefit of their clients. Others feel that agents affiliated with a company should at least give their company the first chance at business, inasmuch as the company has spent time and money training and developing the producers. This raises an interesting consumerism dilemma. On the one hand, the agent should seek to obtain the best deal for his new-applicant client. On the other hand, the new applicant becomes an existing policyholder as soon as a policy is issued, and it is then most beneficial for him to have his agent continue to place business in the same company. If the agent trained by one company continually places business elsewhere, existing policyholders of his company can complain that money invested in that agent is not being used effectively for the existing policyholder's benefit. It would be less costly and of more benefit to existing policyholders to stop training allowance programs—and there would be logic in their stance. Of course, this would severely strain the underlying fabric of our current agency system.

Attempts to appease consumerist demands in one area can conflict sharply with aims in another area. Proper consideration must be given to all sides of the consumerism picture—to the new applicant as well as the existing policyholder.

Persistency

There is one specific section in Mrs. Rappaport's paper on which my interpretation is somewhat different from hers. In Section III, headed "Agent's Compensation, Measuring Effects," it is indicated that persistency, good or bad, has a greater impact on a company than it has on the agent. The comparison made to prove this point does not appear wholly consistent. One should not measure the effect of persistency by comparing an agent's total income, which contains first-year commissions as well as other items besides renewal commissions, with the renewal premiums. It would appear more reasonable to compare the renewal commissions an agent receives with the renewal premiums. In Mrs. Rappaport's hypothetical plan, the impacts of good or bad persistency on renewal premiums are in line with the renewal commissions. The variation is about 20 per cent up or down for both. Although an agent's income should have some variation by persistency, to vary the total income in about the same proportion as the renewal premium in force would be too drastic.

An additional impact of persistency in many companies can be found in the first-year commissions. In her hypothetical compensation plan Mrs. Rappaport shows income variations by persistency that are caused by differences in renewal commissions only. As a practical matter, first-year commissions also will vary with persistency, as will first-year premiums, and the amount of variation will, to a great extent, depend on the modal mix of business.

Compensation Plans

Mrs. Rappaport suggests a hypothetical compensation plan which places great stress on persistency. Plans of this nature are currently in existence in the industry. At the Metropolitan we introduced recently a new compensation plan for sales representatives which embodies many features called for by Mrs. Rappaport. The persistency elements in our contract have a strong effect on total compensation.

In brief, our compensation plan for life insurance policies consists of four major elements: first-year commissions, renewal commissions, quality business payments, and career incentive payments. We also have a training allowance plan for new appointees and several minor compensation elements, but these will not be touched on here.

First-year commissions on our life insurance policies are normal, graded down from a high of 55 per cent. A significant feature of this commission scale is the less-than-proportionate amount of commissions granted if less than thirteen months' premiums are paid on a policy. For example, if a policy lapses with only one-half of the first year's premium received, only 30 per cent of the full first-year commission is payable. Only 90 per cent of the full first-year commission is payable when the policy lapses with exactly one year's (not thirteen months') premium paid.

Renewal commissions on life insurance run for three years and are level at 11 per cent. These are paid only to the agent who personally wrote the business. Lapses take a substantial toll of renewal commissions.

Quality business payments are made over and above the life renewal commissions. These are made to the writing agent only and are a percentage of the renewal commissions. The percentage is a varying one, dependent on both the relative production of the individual agent in relation to a company average and the persistency of the agent's personal business within the first four policy years. On the average, an additional 25 per cent of the renewal commissions is provided by the quality business payments; these payments can go as high as two-thirds of the renewal commissions. It is noteworthy that, if the persistency or production levels drop below certain minimums, the agent will receive no quality business payments. There is a sharp drop (no gradual tapering) in the quality business table, and, for salesmen who fail to maintain minimum persistency or production records, this can result in a significant reduction in compensation.

Our career incentive payments are a form of service commissions on life business more than four years old. Here again, the percentage applicable to renewal premiums in the fifth and later years is dependent on the agent's production as compared to a norm and his length of service. No career incentive payments are made if production falls below a certain level. The applicable percentage averages about $1\frac{1}{2}$ per cent but can go as high as 3 per cent. Career incentive payments are made only on business produced personally by the sales representative and are not true service commissions.

Our current compensation plan for sales representatives was developed with the thought that persistency is determined mainly at the time of sale. For this reason renewals, quality business payments, and career incentive payments are made only on personally produced business. We refer to the current plan as one based on a "writing agent only" concept.

The plan is aimed at the production and retention of quality business and is geared to men who stay with the company. Payments designated specifically for service have been omitted deliberately from this compensation plan. This, of course, means that no compensation is provided on orphaned business. Although nothing is paid on such business it is assigned to sales representatives for servicing. Our philosophy is that such business, when assigned to a sales representative, is an excellent potential source of new business, which is justification enough for a man to want to have it in his account.

It may be of interest to indicate the relative levels of compensation in our plan under several of the assumptions of production and persistency given by Mrs. Rappaport. No attempt has been made to develop the figures in the accompanying tabulation exactly according to Mrs. Rappa-

Year of Agent's Career	First-Year Commissions	Renewals, Quality Business Payments, and Career Incentive Payments	Total Compensation	Compensation Ratios*
		Average Lapse Rates		
5	$8,640	$ 6,579	$15,219	100%
10	8,640	7,928	16,568	100
15	8,640	10,712	19,352	100
		High Lapse Rates		
5	$7,971	$ 3,864	$11,835	78%
10	7,971	4,826	12,797	77
15	7,971	6,666	14,637	76
		Low Lapse Rates		
5	$9,288	$ 8,593	$17,881	117%
10	9,288	10,357	19,645	119
15	9,288	14,220	23,508	121

* Relates total compensation where lapses are high or low to average lapse situation.

port's assumptions. Comparisons should be viewed in terms of how persistency affects the total compensation rather than in terms of absolute amounts involved.

Our assumptions involve a level production volume of $1 million per year with the product mix that exists in our company. The high, average, and low lapse rates used correspond quite closely with Mrs. Rappaport's assumptions for the first policy year and are somewhat more favorable beyond that.

As can be seen, lapses have a significant impact on total compensation. Because we write so high a proportion of monthly business, about 50 per cent, our first-year commissions are affected significantly by variations in persistency. Renewal compensation items are even more severely affected by poor persistency. Strong indications exist that since the introduction of our new compensation plan, which stresses persistency so heavily, we have had and are still experiencing a substantial improvement in early lapse rates.

ALBERT E. EASTON:

This paper presents a timely and careful review of an area in which the life insurance industry may be vulnerable to attack. The summary of deficiencies and inequities in the present operation of the New York Insurance Law should prove particularly useful. There are several specifics, however, on which my point of view differs from that of the author.

First of all, I believe there is cause for concern arising from the repeated inferences, both in this paper and elsewhere, that the agent is somehow obligated to provide "service" long after the sale on the policies that he has sold. Certainly the insurer has an obligation to provide such service, but I cannot agree with the rationale that it must be done through the agent. No other industry expects its salesmen to double as servicemen and technicians.

The normal agent's contract authorizes him to do three things: submit applications, deliver policies, and collect the initial premium thereon. In no way is he authorized to do such things as secure policy loans for the insured, let alone to answer questions about policy provisions and dividends, which he probably is not qualified to do. Consumers are likely to be much better served if such service becomes the function of someone other than the agent, who is not trained, compensated, or generally even authorized to perform this kind of policyowner service.

I do not mean to imply that the agent should be prohibited from contact with the insured or from discussion of the policy after issue. To many agents such contact or discussion may be a valid way of establishing a reputation or of obtaining leads for new sales. But it should be viewed as such, and not as a substitute for a solid service organization. If the company's service organization on this level is solid, there is really no such thing as an "orphaned" policyholder.

Second, I cannot agree that term insurance is discriminated against by the New York law to the extent implied in this paper. As indicated in Mr. Linton's paper (*TASA*, Vol. XXX), the present limitation on term insurance was introduced into the law for the purpose of "removing the incentive to write this form of insurance for the purposes of obtaining margins to be expended upon other forms of policies." Since the allowances calculated as a percentage of premiums are not the only allowances in the first-year field expense limit, merely comparing $37\frac{1}{2}$ per cent to 55 per cent does not tell the full story. In fact, allowing for an average whole life premium of $25 per thousand, one may quickly calculate that a term premium of approximately $4.50 produces exactly the same margins per dollar of premium, even with a 55 per cent commission. This amount is not an unreasonable average term premium for the types of renewable and decreasing term now most commonly sold, as can be proved by extracting data from Schedule Q and the policy exhibit of companies that offer low-premium term insurance.

An argument can be made, therefore, that a substantial increase in the percentage of premium allowance for term insurance under the New York law would have the effect of tipping the scales *in favor* of term insurance to the detriment of whole life insurance.

The New York law is not the sole reason for the lower commissions generally paid on term insurance, and there are New York-licensed companies with term commissions as high as 50 per cent. Moreover, even if identical commissions were payable, there probably would not be much effect on the agent's natural preference for whole life insurance.

Finally, I am among those whom the author anticipated would disagree with her criteria for agent compensation. The salary scheme outlined as a possible alternative compensation basis might be attractive for hiring and training new agents but could not possibly be successful as an over-all agent compensation scheme. The $1 million producer assumed to be the "top producer" would not even qualify for the top producers' clubs in many companies today. The real producers generally are in the range of somewhere between $2 million and $5 million or even higher in many companies, and their compensation under the current scheme is well above the level they would receive under the alternative compensation scheme. The problem is that the company using the alternative compensation scheme would quickly lose its most successful producers to a company which continued to pay 55 per cent first-year commissions. In fact, if one were to trace the history of the development of the high first-year commission, it would probably develop that it arose from a desire of companies to attract large producers by a more attractive compensation scheme.

If the interests of the consumer were at stake, there might be a stronger argument for a more level compensation scheme, but the consumer's interests (i.e., in the event of early policy termination) are already protected quite adequately by the Standard Nonforfeiture Law. As the paper correctly points out, however, it would be the insurers, not the consumers, who would gain most from the alternative scheme, and I suggest that their interests in this matter are already quite well balanced by the existing compensation scheme against their interest in obtaining the service of the large producer.

PETER M. TOMPA:

The author should be complimented on a major contribution to a subject that has not had an airing on the pages of the *Transactions*—except for some excellent informal discussion which appeared in 1971—since the late Allen Mayerson reported in 1956 on section 213 of the New York Insurance Law. This is a shortcoming of our literature. Someone not familiar with the matter could deduce that actuaries are not really interested in the subject. Some people in the past have raised the question whether actuaries have a proper place in the designing of field compensation programs—a question answered by the author with a resounding yes—or whether such activities belong properly to the agency officers, with the actuary playing a minor advisory role.

The main idea of the paper, a compensation plan based on salaries, is contemplated in section 213 (subsection 4, final two sentences, and subsection 8, last paragraph). In the past, resourceful actuaries have developed several plans, some of them short-lived, others of permanent value.

The only plan I know of that relies entirely on salaries, to the complete exclusion of commissions, is the one developed by the Guardian Life Insurance Company in 1943. It is still in force, after several modifications, and the salaried producers under this plan, called "field representatives," were responsible in 1973 for about 40 per cent of the new life insurance premiums produced for the company.

To describe the field representatives' plan in a few words, each cash life insurance premium received by the company is translated, by means of a factor depending on the plan of insurance, into a piece of life production credit. The field representative's life compensation for an employment year is the sum of three items: the first depends on the life production credit of the current employment year, the second on the total life production credit of all preceding employment years, and the third on the life production credit of the immediately preceding employment year; this third part is called "seniority adjustment" and is payable only after the tenth employment year and only if the producer is at least aged 45.

The second item mentioned above, the one based on the total life production credit of all preceding employment years, is calculated not on the portion of the past production remaining in force (which would make it comparable to a renewal commission) but on the entire past production. However, a persistency factor is applied based on the ratio of actual premiums in force to expected premiums in force; this factor produces a considerably higher reward for good persisters and a considerably larger penalty for poor persisters than the traditional commission method. This is in line with the author's recommendations.

To the life compensation thus determined, a corresponding compensation for health and group production is added, to produce the field representative's schedule earnings. If schedule earnings exceed the salary paid, there is an incentive compensation payable, and this results in a salary increase for the next employment year. If schedule earnings fall below salary, there is no penalty, but the salary for the next employment year is decreased. The general agent shares with the company in any losses resulting from such excess salary payments emerging at the end of an employment year or upon termination of a field representative's contract.

The factors for the translation of life production credits into life compensation are determined to satisfy the equivalence criteria of section 213 and to ensure a moderately increasing income for a production pattern as illustrated in the author's Tables 5 and 6.

The accompanying tabulation compares the results of the field repre-

Year	Average Lapse Rate		High Lapse Rate		Low Lapse Rate	
	Field Representatives' Plan	Author's Illustrative Plan	Field Representatives' Plan	Author's Illustrative Plan	Field Representatives' Plan	Author's Illustrative Plan
1	$ 8,148	$ 9,286	$ 8,148	$ 9,286	$ 8,148	$ 9,286
2	9,393	9,930	9,393	9,336	9,467	10,524
3	10,470	10,905	10,220	10,116	10,887	11,771
4	11,451	11,780	10,910	10,787	12,433	12,981
5	12,326	12,748	11,613	11,566	13,799	14,242
10	13,322	14,313	11,685	12,548	16,594	17,265
20	15,354	16,259	10,468	13,351	21,327	20,866

sentatives' plan's life compensation portion with those of Tables 5 and 6. For this purpose I used only the middle line of the author's three production assumptions. This comparison merits some comments.

1. The results achieved by the author's illustrative plan are generally higher than, but comparable to, those of the field representatives' plan.
2. The results achieved by the two plans are close enough to consider them about equivalent. I found it amazing that two plans that are entirely different in concept and execution should produce results that are not too far apart.
3. The author's designation of Table B termination rates as "average" does not correspond to our experience. Business produced under the field representatives' plan exhibits termination rates approaching 125-150 per cent of Table A termination rates. Certainly a representative producing business with termination rates of 150 per cent of Table B rates (i.e., 300 per cent of Table A rates) should not remain a career underwriter for a considerable period of time. Our earnings scale produces a decreasing pattern after the tenth year for such a producer. This philosophy corresponds to the author's remarks that a plan should be heavily slanted toward charging the agent with the cost of poor persistency. The field representatives' plan goes much further in this respect than the illustrative plan of the paper.
4. I suspect that the illustrative plan may be approvable under section 213 only if part of the compensation within the first few years is declared as training allowance under subsection 13. This is not the case for the field representatives' plan. It is, of course, possible that a proper mixture of assumptions as to production pattern, plan mix, and persistency will produce results which are acceptable under subsection 4 as the equivalent of commissions. Under the field representatives' plan, the heavy part of compensation based on the total life production credit of previous years and its forfeiture upon termination (since the plan is completely nonvested) produces acceptable results under subsection 4 if the total compensation of a cohort of field representatives hired at the same time is examined.

JOSEPH R. BRZEZINSKI:

One of the traits of the actuarial profession that I have become aware of in my experiences at the Life Insurance Marketing and Research Association (LIMRA) is that most actuaries harbor some favorite compensation scheme that would be just "ideal" for the life insurance salesman. Consequently, I expect that Mrs. Rappaport's paper is likely to serve as a convenient rallying point for restatement of these ideas concerning the compensation of life insurance agents.

However, lest we sell the current system short, let us remember that, despite all the shortcomings that have been brought out in the paper, the current system has some tremendous advantages that cannot be ignored.

Despite the difficulty in interesting qualified people in a career in life insurance sales (this difficulty may actually be a difficulty in recognizing qualified people), the industry continues to be able to find increasing numbers each year. Recruitment of new agents in the United States in 1974 is about 12 per cent greater than in 1973. (I would not presume to say how qualified the agents are.) A number of other indicators, such as production and policy size, have also exhibited large increases.

Although the current system of compensation can be characterized as brutally competitive, this competitiveness also serves as an impersonal and effective means of selecting (or rather postselecting) the most effective sales personnel, which in turn reduces the companies' cost of selling insurance and helps to keep the cost of insurance low for consumers.[1] That is, the heavy performance orientation works in such a way that better agents succeed while less productive agents must seek other employment.

The compensation system ranks among the most important reasons behind the relatively high significance of life insurance protection in the United States and Canada as compared with other economically developed countries in the world today. The current system of marketing life insurance is being studied and to some extent emulated in many other countries in the world. A small index of this interest may be the dramatic expansion over the past few years of LIMRA's international education programs for marketing.

Although agent turnover often has been pointed to as a source of additional lapsation, LIMRA and other studies have indicated that in most cases the business of a terminated agent exhibited poor persistency long before the agent left the company. It is quite possible, therefore, that one of the reasons the agent left the company was that he could not sell quality business rather than that the business had poor persistency because the agent left the business. Here again, the current system appears to be working to "postselect" agents who are not qualified.

The competitiveness of the current system also has been a source of innovation and evolution in the development of means to increase the productivity of agents. For instance, agents have had to evolve more effective and productive methods of prospecting than Mrs. Rappaport indicated in her paper. The system she described (the "one-on-one" sale) is now being supplemented, and to some extent replaced, by prospecting methods that emphasize much greater exposure to potential policyholders—mass-marketing approaches, development of salary-savings outlets, development of "nests" and "centers of influence," and so forth.

[1] It should be pointed out that much of this saving may be lost in the heavy expenditures incurred for recruiting and training potential terminators.

The current system is not defined as clearly as the paper indicates. Even in New York, the system is much more varied than is evident from the paper. Although first-year commissions are pretty much as stated, renewal scales vary considerably and usually represent something much greater than a front-end heaping (considering only persistency) of the traditional 5 per cent renewals in years 2–10. An "average" renewal scale would be 10 per cent in year 2; 9 per cent in year 3; 7 per cent in year 4; 5 per cent in year 5; 4 per cent in years 6, 7, and 8; and 3 per cent in years 9 and 10. This scale is much higher than is indicated as "heaped" in the paper.

A major subsystem of the current system covers methods of bringing new agents into the business, an area in which I have had some personal experience. LIMRA currently is in the final stages of preparing a working paper on financing agents which explores the subject in much greater depth than the few sentences in this paper. (One advantage of Mrs. Rappaport's proposal that should be mentioned is that it integrates the compensation of the trainee agent with what he receives after he becomes established.)

The objectives of the current system are, and have been, to provide adequate and stable income for producing new business, to reward good persistency, and only somewhat incidentally to provide extensive service to policyholders. In many ways the compensation system is paying the agents for the job that companies want done in just about the desired order of company preference.

Mrs. Rappaport's preoccupation with making the compensation system much more responsive to persistency appears on the surface to have considerable merit. Her projections to illustrate the point, however, are biased in favor of her own arguments by the assumption that all business is written on an annual basis and that a measure of value of business to a company is premiums collected. If we consider the effects of actual modal mix associated with persistency, we find that the relative differences in value of persistency to agent and to company are nearly halved. The value of business to a company is not directly related to premium, and the paper would have been much more effective if premiums less dividends or some measure based upon asset shares had been used instead. These points are minor, however, and do not alter the basic fact which Anna presents, that is, that "persistency is worth more to the company than to the agent." The basic question still is, "Is there a need to make the relative values more nearly equal?" I prefer not to argue this philosophical question. However, if the answer is yes, then the current system has managed to work quite well with the right kind of persistency bonus. It has even worked too well in some companies where the introduction of a persistency bonus has resulted in making the persistent business less valuable to the company in some cases than business with lower persistency.

The interest in making the "rewards to the agent for selling very large and very small policies realistic relative to the effort required for the sale" bears similar scrutiny. The implication is that the agent has a relatively easy job of selling the large policy. With large policies the agent is very likely to spend much more time and effort in selling than he does with smaller policies. Such cases are much more likely to involve competition with other agents and insurers, so that the agent's probability of closing the sale may be much smaller than for a small policy. To some extent, therefore, it can be argued that the agent does earn what he is paid on a large policy. The same rate of compensation for small and large policies under the current system serves to minimize some effects of commission competition on large policies and the brokering of business to other companies. The production bonuses that presently are being utilized in the current system also would appear to be an effective and flexible means of equalizing rewards of selling small and large policies. Both the current system (with bonuses) and the proposed system would give more than proportionate increases in income on the marginal increases in production.

Overall, it does not appear that a really strong case has been made against the current system and for an alternate system. The present compensation system has grown up as the result of certain environmental forces—economic, social, and regulatory. The compensation system by itself cannot be changed drastically unless a management system is developed that can evaluate performance more satisfactorily than do the current production measures now in effect. Furthermore, the extent to which the proposed plan really constitutes an alternate system is questionable. The relative difference between the totals produced by the various compensation methods is small, and the relative impact of the components has not been measured. Variations in compensation within the current system utilizing persistency and production bonuses are likely to be considerably greater than the illustrations shown in the paper.

Despite the shortcomings of her paper that I have indicated above, Mrs. Rappaport deserves considerable praise and congratulations for beginning to fill the void in published information that exists currently in the compensation of life insurance agents. The subject matter is extremely difficult to handle in such a paper. It is truly unfortunate that it is easier to find fault than to be able to agree with all statements and arguments in the paper, and I hope that Anna and other actuaries will continue and expand the dialogue and research into methods of improving the effectiveness of the sales compensation system for life insurance.

NICHOLAS BAUER:

To say that the present paper is timely and topical is to damn it with faint praise. The system of distribution of the individual life insurance product and the method and level of compensation of the agent are coming under increasing questioning and scrutiny from various quarters. The clamor is increasing. In times like these the insurance industry must be careful not only that the distribution system is fair and proper but that it *looks* fair and proper and that it can be defended as such in various public forums.

The author provides a thorough review of the problems that have plagued compensation systems in the past. She then describes what an ideal system ought to do and proposes one that might satisfy the stipulated criteria. Before commenting on the proposed formula itself, I would like to underline one of the problems which, I think, though mentioned, is not sufficiently emphasized. Inflation may be one of the worst enemies that the distribution system faces. As inflation increases, an increasingly large proportion of the premium dollar must be devoted to the financing of acquisition costs in general and commissions and like expenses in particular. For example, in the case of one Canadian company the present value of the first-year commission and bonus formula (agent and manager) under an ordinary life plan amounts to approximately 11 per cent of the present value of premiums if we assume no inflation and a 4 per cent rate of interest, but 17 per cent of the present value of premiums if we assume a 6–7 per cent rate of inflation and a 10 per cent rate of interest. Therefore, the protective value of each dollar of premium declines. The higher the inflation, the greater the proportion of premium dollars that is needed to defray initial expenses. Since the client senses this, insurance products become harder to market.

No amount of redesigning of the compensation system will solve the inflation dilemma (except, of course, a level commission system, which is utopic). Solutions might be true indexed products or a totally different distribution system.

Turning now to the compensation formula proposed in the paper, the following comments might be relevant:

1. A substantial base salary has appeal from the agent's point of view because it ensures a measure of stability in his income. The danger is that a substantial salary might permit borderline and failing agents to survive longer than under the commission and financing system, thereby increasing the

over-all cost of the distribution system to the company. This is particularly evident from an inspection of the author's Table 7, which discloses, in the case of low production, compensation levels under the proposed plan considerably in excess of those under present systems. On the other hand, if a strict validation schedule is attached to the present plan, then in fact the departure from current practices is not as radical as it would seem at first blush.

2. The idea of not paying first-year commissions unless the policy survives the full first year is excellent, since it directly reflects the fact that the policy has been of no value to either the company or the client. The idea of paying the same rate of commissions regardless of the plan is also attractive, although I wonder whether it could be carried through in the case of pure savings plans. The required loading on these might turn out to be excessive.
3. The incentive portion of the proposed system is, I think, its weakest point. In my view, it is made up of too many small, diverse pieces. The result is that the agent will probably fail to grasp what he is being compensated for and will regard the incentive compensation as simply additional revenue for work he is already encouraged to do by the other elements of the compensation formula. In particular, I find it paradoxical that the author states that the agent has little influence on the persistency of business after its second year, a point I agree with, and then proposes to build part of the incentive system on in-force and increase in in-force. Perhaps a more effective incentive system would be based on business persisting to the end of the second year and graded by persistency. Incidentally, the author does not propose a suitable measure of persistency in her paper, and I hope she will remedy this in her answers in the discussion.
4. A technical problem that would arise with respect to the author's proposed compensation system would be that premiums for term plans, particularly of the shorter durations, might become uncompetitive.

Consumerists and regulatory authorities are both questioning the professional qualifications of life insurance agents. Would it be possible to gear compensation to some extent to professional qualifications? An example might be to increase commissions and/or incentive compensation by a modest percentage if the agent completes his L.U.A.T.C. or C.L.U. courses.

I wonder to what extent the agent can be expected to provide service to the policyholder. This sort of activity is only indirectly remunerative, insofar as it may result in new sales. The case presented by the author is convincing that service commissions do not do the trick, since these commissions are payable whether service was actually provided or not. Perhaps routine service ought to be regarded as not the function of the agent at all, thus obviating the need for any compensation past the first few years. The money so saved could be devoted to creating a service organization for the company on a salaried basis, whose exclusive responsibility would be the servicing of the existing business in force. Of course, should a need for additional insurance be identified in the course of such servicing, then the agent could be called in to handle it.

Finally, unless a number of the major companies moved in the direction of a salary-based compensation system at the same time, any one company adopting such a system could become particularly vulnerable to losing its leading agents to other companies with incentive-only systems because of the higher earnings available thereunder.

I would like to echo the author's hope that this paper serves as a catalyst for much-needed dialogue on the subject of agent compensation.

PETER L. HUTCHINGS:

One of the many valuable insights in this paper is the relating of field compensation practices to the lack of effective price competition in life insurance. Today's agent has an excellent understanding of his commission agreement; today's customer has, at best, an imperfect understanding of his insurance product. Companies compete for agents and let the agents compete for customers. In the past this imbalance led to abuse, and abuse led to section 213. As the paper suggests, no such regulation would be needed if the product were less confusing.

Consider those products which, by their nature, are "self-disclosing." These products are so simple that any informed consumer can understand their price without needing an advanced degree. Three examples are yearly renewable term, immediate annuities, and mutual funds. By and large, these kinds of products have the following characteristics: (1) very low commissions for agents, (2) very low (and/or negative) profits for companies, and (3) very low spread between cheapest and most expensive product.

For an interesting example of the relationship of price disclosure to commission level, compare the treatment of flat extras for substandard cases with class extras. The easiest life insurance price to understand is an extra of $5 per thousand—ask any private pilot! On the other hand, substandard class 2 whole life is at least as confusing as regular old whole life. It is not uncommon for flat extras to carry low marginal commissions while class 2 extras are on a full-commission basis.

Very few New York companies would run a section 213 risk by selling their yearly renewable term with a 50 per cent commission (since this test is aggregate in nature). Excellent arguments can be made for adopting such an approach to partially equalize the agent's incentive. However, relatively few companies have taken this approach, presumably because the market will not tolerate such a load.

Conversely, one might well be able legally to pay graded first-year commissions on whole life face amounts in excess of $100,000; however, the agents would never accept it, and the agent marketplace (unlike the whole life marketplace) really works. The group insurance commission scale tapers off because the marketplace (being "self-disclosing") will not tolerate anything else.

The future of an agent's compensation may be influenced more by the profitability of his products than by any other factor, including disclosure. A time may well come when unfavorable expense trends will overtake favorable investment trends and the life insurance business will have meaningful profit problems.

Any health insurer can testify that a well-deserved rate increase causes client unhappiness, while failure to implement a well-deserved decrease causes many fewer problems. The life business has diverted what could have been further price reductions into field expense increases and has suffered relatively little as a result. If and when life profit trends go the other way, management will pick agency reduction over dividend or earnings reduction and the average new salesman will need many more in-laws to validate his financing plan.

Wall Street once had the richest salesmen in the country; when the going got tough, the product price went up and the salesman's percentage went down. Thousands of stockbrokers have new careers as a result. Casualty insurers cut back their commissions when profits were bad, and, when the cycle reversed, they did not typically raise them again.

The life insurance business has already seen this sort of thing in isolated areas. Consider for a moment minimum deposit, high early-cash-value products. Many of these products pay less than maximum commissions, primarily because of profit problems. As the spread between marginal portfolio rates and policy loan rates increased, fewer actuaries were willing to assume that their high-loan product had the same net interest rate as their low-loan product. Something had to give, and the "something" was (in part) commissions.

Perhaps a better example of the commission-profitability link is apparent in individual health insurance. In the mid-1960's many companies paid about the same first-year commissions on major medical and loss of time. By now, the profit squeeze on major medical has led to much-reduced commissions while the loss-of-time commissions are unaffected.

WILBUR M. BOLTON:

Opinions offered in this discussion are strictly my own and are in no sense those of my employer (which happens to be a non–New York company with a New York–domiciled relative).

The author of the paper has made a worthwhile contribution in opening up discussions on agent compensation, particularly the extent to which the typical present pattern of compensation, largely stemming from restrictions in the New York law, fails to pay the agent for doing what the company wants him to do.

The author makes the definite point that existing scales of first-year commission percentages may create a conflict of interest for the agent (in advising his prospect) between permanent insurance and term insurance, particularly in a situation where the prospect's needs and resources indicate that some form of term insurance is more suitable. In the cases where minimum deposit insurance is sold, when it is not suitable the resulting high lapse rates point out a second conflict of interest, this time a conflict between the interest of the company in persistent business and the agent's (apparent) interest in the first-year commission.

These dilemma situations can be minimized (in the absence of arbitrary legal restrictions) by using an idea implicit in John M. Bragg's paper "Prices and Profits" (*TSA*, *XX*, 44). Bragg discusses agent compensation in terms of game theory, in essence a three-person game (among the company, the agent, and the prospect), and notes that, in a three-person-game situation, it is not unusual for two persons to form a coalition "against" the third. For a coalition to endure, the interests of the partners must harmonize.

In a rational scheme of agent compensation, the agent, while seeking to maximize his commissions, would also be maximizing the profits (present-value basis) for a stock company. In a plan of insurance designed for minimum deposit situations, higher renewal lapse rates are expected than for other permanent sales; consequently, a smaller present value of future profits to the company should be anticipated. Therefore, commission scales applicable to such a minimum deposit situation should be reduced in proportion to the anticipated reduction in future profits to the company.

On a different point, how do you compensate an agent properly for giving "good service" to existing policyholders, either his own or those of another agent? Agent compensation is almost invariably a function of measurable quantities. All of us can measure sales; most of us can measure persistency (or renewal premium) and profit (or contribution to surplus). If we want our agents to provide a higher quality of service to existing policyholders, we will have to determine some way of measuring the quality of service provided, distinct from persistency, in order to base compensation, at least in part, on "service to existing insureds." I hope that others discussing Mrs. Rappaport's paper will address this point.

Mrs. Rappaport's paper also points out the relative failure of ordinary commission scales to vary agent compensation in proportion to effort, between very small and very large sales. To a limited extent, some companies may be doing this; for example, several companies whose rate structure includes a policy fee have long-payment life "specials" with a \$25,000 or larger minimum. The higher-minimum specials, in some cases, pay 5–10 per cent smaller first-year commission than the smaller-size long-payment life running mate. For the smallest policies, industrial insurance always has had a relatively high collection and service fee built into the renewal premium rate structure.

I am disappointed by the omission of a bibliography giving credit to earlier actuarial work on agents' compensation; specifically, the major revisions by several New York–licensed companies in the 1940's and 1950's, away from the historic renewal commission pattern of nine vested 5 per cent's, toward higher, nonvested renewals in early policy years, were based on the landmark work of E. M. McConney and R. C. Guest (*TASA*, Vols. XLIII and XLVI), which was the actuarial basis for the LIAMA Mathematical Tables to which she refers. Also, astonishingly, the Table B termination rates in this paper appear, without proper attribution, on the fiftieth anniversary of an original publication by M. A. Linton (*RAIA*, XIII, 287), usually referred to as "Linton B." I would also hope that further mathematical models of lapses which may be used in serious work toward revision of the New York law will take advantage of refinements developed by E. J. Moorhead (*TSA*, XII, 545–63) particularly for fractional premium business. Moorhead's Table S lapse rates should be preferred to Linton B for current work.

My criticisms, which are minor, should not detract from the real service Mrs. Rappaport has performed in opening up for general discussion the agents' compensation area as viewed by consumers. On a quantitative basis, it will be very difficult even in a single company to agree on a "fair" level of income to an agent or even a "realistic" amount of work, per agent, balanced between sales and service. Different companies may well arrive at varying answers, depending on the characteristics of their principal markets, and in spite of the increasing likelihood of full-disclosure requirements applicable to the agent's commissions.

JAY M. JAFFE:

I read Mrs. Rappaport's paper with great enjoyment. It describes effectively the problem of finding a suitable scheme of compensation and motivation for the agency distribution system. The difficulty lies in developing a scheme that will serve the mutual interest of the public, agents, and insurance companies.

Two other compensation schemes might be considered for additional solutions to the problem. First, the industry could eliminate commissions entirely, and the professional agent could be compensated by fee income for services rendered. Second, a system could be developed that would recognize the profitability of the product written and compensate the agent in this relative manner.

Because there is no single answer to the problem, companies undoubtedly will use an amalgamation of various methods in compensating and motivating agents. At this time the important point is that companies should recognize the need to re-evaluate their position in light of the changing insurance environment.

NATHAN H. EPSTEIN:

Although no one enjoys a good mathematical exposition more than I do, it is interesting to note that there is often an inverse relationship between the amount of mathematics in a paper and the paper's significance. The more formulas, equations, and derivations, the less the significance. Mrs. Rappaport's paper, in which the mathematics has been kept to a minimum, ranks very high in significance. Hopefully, it will start a new trend within the Society, where too often members feel that a paper must contain formulas and proofs before it is worthy of being put into the *Transactions.* As a result, many "gut" issues are not discussed.

Mrs. Rappaport's analysis of the agent's job led me to consider the question, Who should pay the agent? The consumer, the company, or both? The consumer pays the doctor for his health needs. He pays the lawyer for his legal needs. He pays the accountant for his financial needs. Why should he not pay the agent for his insurance needs?

The consumer does not pay the color TV salesman for his color TV needs or the car salesman for his car needs, but he does pay the color TV repairman for his TV repair needs and he does pay the auto mechanic for his car repair needs. It seems that the consumer does not pay the salesman of goods, but he does pay the provider of services. He pays the doctor for the visit and the prescription, but he pays only the druggist for the quantity of pills he buys. Is the agent the doctor or the druggist? Is the policy a prescription, or is it a pill?

A doctor is a professional. He is entitled to a fee for his time. He has spent many years acquiring specialized knowledge. And, as a professional he does not go after customers. (Note the hallmarks of a professional—specialized know-how and *no selling!*) An agent has specialized knowledge, but he certainly does sell. So perhaps he is only a semiprofessional. But wait a minute. Let us re-examine the sacred cow—the professional. I cannot quarrel with the need for specialized knowledge. Let us, however, look at the "no sell" aspect. Imagine the following phone conversation:

N. E.: Hello!
M. W.: Mr. Epstein, I'm Marc Welby and I'd like to discuss some matters of vital concern to you and your family. Do you have a minute?
N. E.: Sure, go ahead!
M. W.: As you know, heart disease is a major cause of death and disability in this country. There are many new techniques to diagnose and treat heart disease. I'd like an appointment with you to check you over.
N. E.: Well, I get enough medical exams as it is.
M. W.: Well, when was your last one?
N. E.: Oh, about three years ago.
M. W.: You should be checked over at least once a year.
N. E.: Well, my brother-in-law is a doctor and he handles all my medical needs. You may have heard of him, Joe Gannon at the Medical Center.
M. W.: Oh, yes, a fine doctor. However, I do specialize in heart disease, especially early diagnosis.
N. E.: Well, you do have a point. Let me see, I have some time next Wednesday.
M. W.: Fine, about 3:00 P.M.
N. E.: Good.
M. W.: My secretary, Consuela, will send you an appointment reminder with our address, along with a short medical questionnaire. See you then.
N. E.: Right. Good night.
M. W.: Good night.
[*Click*]
M. W. (*to himself*): Only nineteen more calls to go.

Now who can quantify the number of people whose lives would be saved or prolonged if there was less professionalism and more concern with saving lives? And who can quantify the added grief and financial strain on untold numbers of widows and orphans if life insurance agents were more professional?

Let us use the medical analogy. First, the agent practices "preventive medicine." He reaches the patient before there is a problem, not after. He then makes a house call, examines the patient, and writes out a prescription. He then goes to the "drugstore," has the prescription filled, and brings the pills back to the patient. He has an arrangement with the drugstore to give him a call if the patient does not renew his prescription. If the patient does not renew, he calls him and reminds him of the importance of taking his medicine.

Thus the agent conceptually does perform more service for the consumer than the doctor does. But, as Mrs. Rappaport points out, "equating the agent with an independent professional may create obligations that are impossible both for him and for the company." So let's not equate—let's approximate. As mathematicians we have other symbols besides that of equality: We have $\risingdotseq$. We have $\approx$. We have $>$. We have $<$. The point is that conceptually there is a place for a consumer-paid fee element in a theory of agent compensation.

Now let us turn our imagination toward the company. A company without consumers is not a company. Hence all companies pay someone for bringing them consumers. They pay jobbers, wholesalers, retailers, salesmen, dealers, and agents. They hire public relations firms, ad agencies, and market researchers. They put out catalogues, flyers, and brochures. They give away freebies. Companies will go to extreme lengths to get consumers because, if they do not, they will not survive.

The consumers, however, are not the company. Assets used to provide goods or services for one set of consumers can be used to provide goods and services for another set of consumers. Assets used to produce color TV's for a set of a million consumers can be used to provide electronic equipment for a set of a single consumer—Uncle Sam. Assets used to provide food for the baby set can be used to provide food for the canine set. Companies are consumer set—independent to a greater or lesser degree, even if they are not consumer-independent.

A life insurance company is different. Here the consumers are also the company. For what is a life insurance company, if not a pool of human lives? Every consumer performs a double function, the general business function and the pool-building function. Hence the agent who brings the consumer to the company performs a greater service to the life company than the color TV salesman does for his manufacturing company.

Edward A. Rieder, in his paper "A Method for Grading Commission Scales by Plan and Age at Issue" (*RAIA*, XXIX, 251), attempts to develop a theoretical basis for commissions from a company viewpoint. His thesis is that the commission should be a function of both the protection value and the investment value of the policy. To expand on this, we can say that the protection value of the policy is the pooling element and the investment value is the business element.

We thus have three elements in our agent compensation theory: (1) a consumer-paid fee element, (2) a company-paid pooling element, and (3) a company-paid business element. Much work has to be done to arrive at an equitable balance between the three elements as well as an operational payment procedure combining the three elements.

However, even under today's most prevalent payment scheme—commissions only—we can view the commission as combining these elements. Part of the commission is a consumer-paid fee, with the company acting as merely the conduit. Part of the commission is a company-paid yearly pool fee. And part of the commission is a company-paid business-building element.

Mrs. Rappaport's paper, however, goes beyond "consumerism and the compensation of the life insurance agent." She asks, in her Section IV ("Criteria of Regulation"), what a system of expense regulation should be expected to accomplish (expense regulation, not just agent compensation!). Indeed, this part of the paper could be entitled "Consumerism and the Expenses of the Life Insurance Company."

Mrs. Rappaport's first criterion is that the consumer should get fair value for his dollar. How can we determine fair value? Let us look at company expenses, excluding agent compensation. What we have left can be divided into two parts: direct policyholder-generated expense and indirect policyholder-generated expense. Direct policyholder-generated expense is that part of a company's costs which are incurred in handling the policyholder and are not incurred when the policyholder is no longer with the company. One tool for determining direct policyholder-generated expense is what I call "transaction analysis." Transaction analysis accomplishes the following:

1. Identification of transactions between policyholders and company.
2. Classification of those transactions into two subgroups:
   a) Policyholder-initiated (e.g., loan request).
   b) Company-initiated (e.g., billing).
3. Analysis of the transactions to determine
   a) Need-to-do basis (e.g., contractual or noncontractual).
   b) Key determinants (whether product-determined, age at issue-determined, duration-determined, attained age-determined, or policy size-determined). For example, policy loans are product and duration-determined.
   c) Frequency (e.g., frequency of policy loan requests by duration, size of policy, age at issue, and other factors).
   d) Cost per transaction.

Transaction analysis thus gives us a true cost picture of various transactions such as change of address, change of beneficiary, dividend option changes, loan requests, mode changes, and policy provision inquiries. It provides a means for keeping each policy type self-supporting and independent, since the expense factor for each policy type varies greatly according to the future transactions that will occur over the policy's lifetime. For example, a participating twenty-payment life policy will generate a far different transaction pattern from a nonparticipating five-year renewable and convertible policy. The results of transaction analysis can be used in pricing, planning, expense budgeting, and methods and procedures review.

A useful tool in analyzing indirect policyholder-generated expense is "zero-base budgeting." Zero-base budgeting was developed and applied at Texas Instruments by Peter A. Phyrr. It is a tool for resource allocation and is projective in nature rather than historic. The term "zero base" means that each year the company looks at each program, function, and department as if it were brand new. The company then asks, Is this a necessary program, a necessary function, a necessary department? What would happen if we didn't have it? It forces a company to justify annually the existence of every expenditure it makes.

For a life insurance company this is most useful in scrutinizing indirect policyholder-generated expense, although every operation of the company should come under its scrutiny. In answering the question, Why are we spending this money? zero-base budgeting identifies the spending stimuli for the various indirect policyholder-generated expenses. A pattern I found is as follows:

A. Legal/regulatory stimulus
   1. Record-keeping
   2. Rate filing
   3. Financial reporting
   4. Tax filing
   5. Certain personnel practices
   6. Safety regulations
B. Going- and growing-concern stimulus
   1. Product research and development
   2. Market research
   3. Marketing research
   4. Personnel and employee benefits
C. Executive ego-engendered extravagance stimulus

I refrain from providing examples for Category C, since I do not want to guide anyone's thinking. A note of caution is necessary, however: Before presenting his conclusions on this category to the other executives of the company, the actuary would be well advised to have made arrangements for suitable alternative employment.

After a good, hard analysis of these two areas of expense—direct and indirect policyholder-engendered—we actuaries are going to have to come up with a viable theory and a pragmatic plan for allocating these expenses. As a rudimentary beginning, I feel that direct policyholder-engendered expenses broken down by transaction analysis can be incorporated directly into an expanded Anderson-type pricing arrangement. As for the indirect policyholder-engendered expenses, certain items can be allocated to the policyholders on some policy function basis. Other items should be charged directly to a fund developed out of the investment earnings of the company's capital and a clearly quantified portion of company surplus.

After we put our own house in order, we will be able to confront consumerism, GAAP, regulators, and anyone or anything else from the position of strength that only rationality and integrity can confer. I hope that Mrs. Rappaport's call for research and dialogue will be heeded by all of us. We actuaries owe her a debt for reminding us of our high calling.

DONALD F. CLEMENT:

I found Anna Maria Rappaport's paper quite stimulating. The paper is highlighted by a perceptive, yet concise, evaluation of current environmental forces, and an ambitious attempt to define the agent's job, to compare it with other sales jobs, and to define the criteria of an ideal compensation system. Her comments regarding renewal commissions and the accompanying numerical demonstrations have considerable impact.

While I found myself in agreement with Mrs. Rappaport in most major respects, there are several observations that I would like to make, particularly with regard to the "alternate plan." Therefore, I am accepting her challenge to further dialogue on this subject. In commenting on the alternate plan as presented in the paper, I understand that it was meant only as an illustration of a possible compensation pattern, and is not proposed as an ideal pattern.

Under the alternate plan, commissions for term insurance would be paid at the same rate as for whole life. If the objective is to neutralize any incentive for the agent to sell whole life instead of term, I do not believe this would be accomplished if the same rate were paid for both plans. The incentive remains clearly on whole life, or more generally, on the higher-premium forms. Only a constant-dollar commission, regardless of plan, would neutralize plan incentives (however, this could not be justified economically). This is not to say, however, that the incentives should not be on the higher-premium forms, since, from the company's point of view, there is generally greater opportunity for profit under these arrangements.

It would be my opinion that incentive compensation, relating directly to performance, would be a good deal greater than 50 per cent of total compensation for the mature agent; however, I would expect it to be a good deal less than 50 per cent for the new agent—otherwise, I do not see how any plan would solve the problems identified.

Regarding the point in favor of a reduction of renewal commissions if we remove the obligation from the agents to service business, then we need to fill the void with someone else—perhaps a salaried sales service representative, either in the field or in the home office. I do agree that current renewal commissions do not tend to furnish proper incentives to the agent to service his business, and relatively few agents are providing the kind of service that the industry would like to see provided.

I do not think that a salary equal to $7,000 in the first year and $4,000 in other years is attractive enough psychologically to provide a positive incentive. It probably would have no value to the successful mature agent, and it certainly would not be reassuring to the person contemplating a sales career. Similarly, commissions of 20 per cent of first-year premium would not, in themselves, furnish very much incentive, considering the fact of current commission levels. It has been my experience that it is exceedingly difficult to reduce commissions even if compensation is offered in other forms. Considering this, I wonder why there should be a 20 per cent second-year commission if first-year commissions are paid only on full payment of the premium, as proposed. It would seem more in the right direction, practically, to offer something like 40 per cent the first year and 5–10 per cent the second year.

Why is the $1,000 considered incentive compensation (refer to item 4[*a*] under "Illustrating the Plan" [p. 548])? Is this not the same as a salary of $8,000 in the first year? I am concerned about the incentive compensation expressed per $1,000 of volume. This type of compensation puts direct incentive on the sale of term insurance. In fact, in situations where we have observed compensation formulas relating to volume, the resulting compensation was so high in the term insurance pricing structure that the result was either to erode profit margins considerably or to cause the company to be priced out of the term market. Use of a "floor" of production as given, puts further pressure on the volume sale (term). So, while the high-volume producers of term may receive incentive, there is little incentive in this arrangement for most producers.

The "10 per cent of net increase in premium income over $10,000 in each of the two previous years," while at least based on premium, would seem to be too complicated in practice to provide the agent with direct incentive. In addition, hasn't the paper concluded that renewals are ineffective? If so, why do the 1 per cent renewals appear in the alternate plan?

Overall, this plan impresses me as being too complicated, with the sources of compensation so varied as to obscure the functions/performance standard desired of the agent, and each component alone gives either no incentive or the wrong incentive. An alternative to the plan illustrated might be to provide a production and persistency bonus based on percentage of premium or percentage of commissions, in addition to a somewhat lower than traditional basic commission pattern. The combined persistency and production bonus could range as high as 100 per cent better than the average payout for the top production and persistency bracket to as little as 20 per cent of the average payout on the lower end. Such a scheme would very powerfully compensate the agents producing more and better-quality business, while at the same time discouraging the large number of marginal agents who are a drag to so many insurance companies. I am not at all convinced that a 25 per cent increase or decrease based on persistency experience, as illustrated in the sample in the paper, gives any significant incentive. I think that this is demonstrated by the numerical illustrations.

Another point which in my opinion, was left out in defining the alternate plan, is that compensation has in the past, and probably should continue in the future, to recognize the value of the business to the company. In other words, if one product makes a greater profit contribution than another, it would seem to me that a company would wish to recognize this in terms of its incentives to its agents. If we take this thought and apply it in defining compensation structure from a profit contribution viewpoint, a strong case can be made for significant and increasing renewals, as opposed to high first-year commissions (if this were practical).

Aside from the points regarding the alternate plan, I have several more observations. Mrs. Rappaport states that the object of regulations should be to ensure that margins are adequate to cover selling expenses to all segments of the public who need coverage. This includes low-income families. I tend to disagree on this point. I wonder whether the free enterprise system, specifically the life insurance industry, can provide an answer to the low-income market. Market forces, if permitted to operate freely, as they have essentially in the past, would not solve the primary need of the low-income family, which is protection. I see no way that the sale of protection to this market can be accomplished effectively, since it is a fact, I believe, that the desire of this market appears to be for the higher-premium, savings element type of plan. Thus, marketing the "proper" insurance for the low-income group would involve strong social motivation which would override considerations of profit. For that reason, I am inclined to feel that the answer for this market lies in the social insurance area—for example, higher limits on insurance provided under social security. I believe that Mrs. Rappaport's point can be made validly, however, for the middle- to lower-middle-income market, which can be, yet is not currently being, adequately serviced by the industry.

While non-New York companies with New York subsidiaries may have a sales advantage over New York-licensed companies in the short term with regard to section 213, I see this issue as much more complicated than one involving only section 213. New York-licensed companies, because they include the largest and oldest companies, would tend to have a larger surplus base from which to operate and from which to finance new business. It would seem to me that the generally smaller and more recently organized non-New York companies need all the help they can get to compete in the insurance market. Overall, considering the strength of the distribution systems involved as well as the surplus base with which to conduct operations, it seems clear to me that the New York-licensed company on the whole has a much stronger advantage in sales than the non-New York company. (I do recognize that there are many exceptions.)

Along the same lines, while a uniform national system of expense regulation appears to be an equitable objective to those who have concluded that expense regulation is necessary today, I think that the issues are more complicated then just sales costs. One example is the higher reinsurance costs that the smaller company must absorb. It seems to me that if the free enterprise system is to work in the insurance business, any regulation should recognize the need for equity between small and large companies, non-New York and New York companies, and so on. Such a regulatory system might be quite complicated and perhaps impossible. However, it troubles me that there exist in one area inequities which, if "solved," might create inequities at least as large in another area. Much care must be taken, in dealing with regulatory approaches to any issue of inequity, to see that the "total picture" is considered.

Regarding the comments on the "faults of the present structure," I am not sure that it is not logical for state insurance laws to favor the sale of permanent insurance. If each state benefits from the investment of insurance company assets in that state, and if the public at large benefits from the higher premium taxes paid on permanent insurance, then why is it not to the states' good to encourage permanent insurance sales? Granted, strictly from (an insured or prospective insured) consumer point of view, the laws should not favor one product over another. However, I would think that the states could not be criticized as anticonsumerist if they felt more secure with their citizens' permanent insurance as opposed to term.

Mrs. Rappaport is to be congratulated on an excellent paper. The various criteria given, as well as the other points made, should be very thought-provoking for those involved in this area.

AUTHOR'S REVIEW OF DISCUSSION

ANNA MARIA RAPPAPORT:

I was pleased to receive the many comments and suggestions in the discussions. The discussions raise a number of unanswered questions, and I hope that there will be further dialogue on these questions and on those raised by the paper.

Frank Zaret and Peter Tompa describe two plans of compensation which are quite different from the conventional system in common use. Both plans provide for greater incentives for persistency than the conventional plan. Both of them have prepared calculations comparing the results on different persistency levels. The descriptions of these plans and the calculations add greatly to the value of the paper and provide examples of how companies have translated their objectives into compensation plans.

Mr. Zaret raises the question of the interest of the consumer as it relates to the right of the agent to place business in various companies. The apparent best interest of the customer prior to time of purchase may be the opposite of the apparent best interest of the customer after time of purchase, when he has become a policyholder. Further discussion of this issue is needed.

Several of the discussants raise the issue of service. The distinction between policyholder-initiated and company-initiated service is raised. Albert Easton points out that the agent is authorized to submit applications, deliver policies, and collect the initial premium thereon.

The obligation of the company to provide service is well recognized, but the positions of companies with regard to the agent's role in the provision of that service vary substantially. Some companies expect the agent to provide all service, and others expect the agent only to do that which he feels will lead to additional sales.

Joe Brzezinski defends the operation of the present system and points out some of the modifications that have taken place in that system to help agents to do a better job. He points to mass marketing and salary allotment. These types of marketing are often accompanied by special products, price structures, distribution systems, and compensation arrangements that are specially designed for the particular markets. It is beyond the scope of this work to describe such programs in detail. He points to the success of companies in hiring larger numbers of agents but does not give us any data on earnings or productivity.

Mr. Brzezinski points out some of the modifications in existing compensation arrangements, including variations in heaping, production, and persistency bonuses. He also points out the need to refine the model to account for modal distribution of business.

Nicholas Bauer points out the impact of inflation on agents' compensation costs as a percentage of premium.

Peter Hutchings relates the questions of price competition, agents' compensation, and product complexity. These issues deserve further study.

Wilbur Bolton points out that a rational scheme of compensation will maximize profits at the same time that it maximizes agents' earnings. Jay Jaffee suggests relating compensation to profitability.

Nathan Epstein raises a question as to who should pay the agent. He also proposes a theory of compensation. He gives us some valuable new tools for dealing with expenses. All of the issues are very important and merit more research and discussion.

There have been several suggested improvements in the incentive compensation system. Mr. Bauer points out that there may be too many pieces, and he comments on some of the pieces. In general, the simpler the plan which will accomplish an objective, the better the plan. The alternate plan is illustrative only, and any given company would have to design its own plan. The following are the important steps in the design of a plan:

1. Decide what the job of the agent is to be. This includes providing the support services so that the agent will not be expected to do those things which are not his/her job.
2. Set an acceptable level of performance and standards of measurement to determine that the performance objective is being met.
3. Set objectives. What is important?
4. Determine a reasonable level of compensation for adequate performance.
5. Determine a method of compensation which will provide the desired compensation level for adequate performance and which will provide incentives related to the objectives chosen.
6. Evaluate performance once the plan is in operation, and fine-tune.

The question of how to measure persistency was raised. There are many different methods, and most companies have a method which is already being used by their agency departments. The methods being used currently can be used for purposes of an incentive-oriented compensation plan.

Donald Clement raises questions as to what public policy would be in the best interest of consumers. He asks whether encouraging permanent insurance over term might not be in the public interest. This point is definitely worth further discussion. Mr. Clement and Mr. Bauer both point out that the compensation formula is too complex. Mr. Clement comments on the various parts of the compensation formula in the alternate plan, but in doing so he has failed to consider the compensation as a whole.

The work underlying this paper began many years ago. Doing the research, writing the paper, and experiencing the response to it have been very gratifying. I wish to express my appreciation to all the people who helped and encouraged me all along the way.