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Session 69OF
Agent Compensation and Expense Issues

Track: Financial Reporting

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Summary: As life insurance companies have focused more on managing expenses and increasing the efficiency of their operations, much attention has been given to the structure of agent compensation. New designs have emerged with the intent of retaining and attracting the better performing agents and aligning incentives with desired behaviors, while placing the insurer in an acceptable financial position. Attendees gain an understanding of industry trends around agent compensation.

MR. JOHN F. BEVACQUA: Welcome to the session on agent compensation and expense issues. My name is John Bevacqua. We have some individuals with some very good perspectives from different vantage points.

The first is Michael Herman. Mike is a senior manager with Deloitte & Touche, out of their New York City office. He is the leader of the sales force effectiveness initiative within Deloitte & Touche, working in their human resource strategies group. He is focusing on the financial services industry sector (FSI) and is focused around areas of distribution strategy through incentive compensation and administration.

The second speaker is Steeve Jean. Steeve is a senior consulting actuary with Ernst & Young in Philadelphia. Steeve has over 10 years of experience in the life insurance industry, and his primary areas of expertise are financial reporting and financial modeling.

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Last but not least is Gaetan Nicolas. Gaetan is an FSA and FCIA. He is the vice president of field compensation for MetLife and works out of their Boston office.

I think we'll first start off with Mike. Mike is going to be bringing a fairly broad FSI perspective to the agent compensation issue, and he'll benchmark some of the challenges that the life industry has relative to other sectors of the financial services industry. He'll give us a good perspective on some of those broader challenges.

MR. MICHAEL HERMAN: I'm going to take a 30,000-foot view what's going on in the marketplace and how it's affecting the life industry, especially around the compensation issues that are related to the life industry. If you look at what's going on in the industry, there really are four critical perspectives or issues that are affecting sales compensation.

One of them is attraction-retention. You may have heard this also referred as the war for talent.

Another one is convergence. How does that really affect compensation? The captured sales force–agent sales force dispersion is the differentiation in pay between captured sales force reps and agent reps. Last is that compensation cost to sales are skyrocketing, from a profit and loss (P&L) impact. The cost of paying reps is taking a larger toll on organizations than it has in the past.

There are key business focuses that are facing off against some of these issues. One is reducing the prominence of special deals to reps. We'll go into these in a little bit more detail. Another focus is improving the internal learning and development capabilities at insurance firms. One of the things that we see driving a lot of the attraction-retention issues, or turnover issues, is antiquated learning and development policies and programs at insurance firms.

Another one is developing a common platform across distribution networks. If we have multiple products or even if we have similar firms but different market segments, how do we really ensure that the platform we're dealing with is level set? It's understood across the business units, it still reflects those individual units, but it's also not as difficult to administer as it is presently.

Another focus is enhancing the productivity and cost effectiveness of distribution. This really is a key outcome of an effective incentive compensation plan. How do we ensure that we're really incenting the right behaviors as well as disincenting the wrong behaviors?

And, finally, that just goes to improving the link between pay and performance. Some of the work we've done in the past has shown that there is a high amount of overpaying for what a lot of firms would consider not acceptable levels of performance commensurate with that level of pay.

I'm going to touch on these broad subjects briefly. The first one is special deals. For those of you who are not really in the know on what's going on with the special deals, it's basically a war for talent for agents, or even captured sales force reps, depending on the firm. A lot of firms are really out there to purchase their distribution because they're not effectively training and developing younger folks or new people to become productive reps. A lot of firms are going out there and buying experienced reps.

This is something that is becoming prevalent in the insurance industry and, if we take a look back at the predecessor, it's rampant in the brokerage industry. As you see these worlds merge, you'll see that this will take probably an even further step up in the forefront. These deals basically pay people guaranteed contracts up front or on a guaranteed dollar basis, as well as give them little perks, like management credits for managing people and allowing all of the products, the credits for the products, even across different services or different product lines, to be credited toward bonuses, sales conferences, and so forth.

It often leads to a very high-cost infrastructure, which many times is not recaptured by the firm. That's due to some of the issues around the psychograph of people who tend to jump a lot from firm to firm; they tend to do it for a reason.

If you look at special deals, they have historically done very little to improve performance of the sales force. The cost of a sale, as I mentioned, is increasing. It also starts to develop an "us versus them" mentality. If half of your sales force is externally brought in, and they're all on these special deals and the other half you've developed internally, sometimes what happens is you get your reps that have been developed internally, saying, "Well, these guys are paid a lot and they're not really doing a lot more than I am. That's pretty much unfair. What can you do for me? How are you going to pay off my loyalty?"

Sometimes, it can put the firm in an uncomfortable position, especially on the management side. Again, it's not a fix for the challenges around learning and development opportunities at insurance firms that are traditionally antiquated. The firms in the new higher orientation programs are trying to figure out how to get an inexperienced person up to speed and effective in the marketplace. Getting those people to demonstrate the right behaviors we're looking for them to demonstrate has been a challenge.

If you're known as a firm that writes a lot of checks, you're viewed as an ATM machine. There really is not that much affiliation. What I mean by affiliation is pride in the brand value of these reps, where they are less loyal to the firm and more loyal to the bank. We've done a lot of studies on the return on investment on these deals, and they're quite low.

Additionally, for those who have a back office purview of the industry, these plans are very difficult to administer because no two plans are alike, and they have to be

hard coded into each compensation system. What that basically means is it's a lot of work. And the cost of it is tremendous.

Some of the insurance firms that you'll see out there have fairly significant back office operations, not just for their special deals that are out there, but also for their compensation plans. My last point on the special deals is really the legal issues, which may follow in parallel. What happens is that a lot of the deals that are given out there are usually forgivable loans, which basically means you don't have to give back these moneys over a certain period of time.

If people leave before then, it usually leads to a little bit of a legal issue as to how much the person pays back to the firm for what's been given out. So these are really some of the fun things that are associated with special deals. I think the industry is really careful and a little bit afraid of the trend that's going on right now around purchasing talent.

What are some of the best practices at reducing a firm's dependence on external talent? One is identifying a core set of agents or even managers, depending on how your organization is aligned.? Companies need to understand the economics behind how long it takes to get a return on investment.

The assumptions on how long it takes depend on the type of people you're bringing in. How long does it take to ramp up your employees? Companies need to understand their business well enough to say, "If we're offering these checks out there, are we going to be able to recapture it?" And what's driving it? Is that internal or is that external?

Companies need to understand what we call the value proposition for the target agents. The value proposition is a human resources word that asks, basically, what makes people happy? For some folks it's directly financial; just the give me the money. For some people, it's affiliation, which means, "I'm selling a brand and that brand is bringing money to my account by bringing customers in."

By really understanding what the value proposition is of the folks you're trying to bring in or you're trying to associate yourselves with, it's going to allow you to offset your comp programs, as well as some of your other non-dollar compensation programs to offset against it.

It's important that when you develop your pay programs, develop them to have an acceptable P&L impact. It's important to really understand the return ratio on the investment dollars in compensation, as well as developing the best in-class training. How do you really get your people up to speed? It's important to start affecting the variables, which would affect the cost of compensation due to special deals.

Companies should limit the flavors of recruiting packages. Instead of having a new package for everyone, have two or three flavors. Just the ease of administration

would help. Companies should leverage sales plans, which we'll talk a little bit more about in detail later on.

That's the first issue. The second issue is around the convergence issue in the industry. Everyone—brokerage, banking, investment management, insurance—is trying to figure out what their grocery store is going to look like and what's in each aisle. There have really been some interesting effects of that. The critical one is, if you're going to sell different products based upon different pricing schemes, how do you have a common compensation platform?

If you're a rep and you're selling insurance, you're selling brokerage, and you're selling some banking, you would have a compensation set of booklets six feet high because you would have different plans for each different product and service.

Right now, the big thing is the gross-to-net issue. A lot of firms are looking at the brokerage model as the flavor of the day, for a couple reasons. One is the clarity in the plans, and two, it's very, very clear from a P&L impact. A firm can line item across each business and understand the returns as well as the costs associated with compensation.

If you're cross-selling, and you have these comp plans in place, how much are you really focusing or trying to motivate people to cross sell? Everyone always talks about how they have to cross rep a book of business with all those other fine products and services that they have. But we've found that there is there is a certain amount of business that people actually cross sell because people tend to stay in their comfort zone. So, how do you really affect it? Well, it goes back to the whole sourcing issue and the training and development issue.

You need to know what the real expectations are, and what the administrative costs are going to be. If you're at a firm with four broker dealers (BDs) or four distributions, in order to really cross sell, the administration of tracking those transactions across the organizations is quite challenging. But that gets to the systems and efficiencies that support it.

Right now, while the gross-to-net issue is very prevalent, a lot of the high-end insurance brokers or agents think they can actually negotiate better deals with the broker dealer than they can get through a common platform. It's actually true, and that's a challenge that still needs to be addressed in the industry. Another issue is revenue credit. How do you get revenue credit, especially if you're working in teams across different products? How does that translate into compensation? And how does that ensure that we have the right calculations for the return on the investment in the calculation?

It then gets to the shared services versus a profit center for clearing. If you're an agency sales force, you have a broker dealer you're usually putting your transactions through. Is that a firm business or is that more of a firm service? And

how does that affect compensation?

The third broad topic I'm going to talk about is the dispersion currently going on between the compensation opportunities and payouts for captured sales forces versus agent sales forces. This is actually a really unique dynamic because 'the pay dispersion—the actual compensation earned between captured sales force reps, as well as agents for firms that have both—is getting wider and wider. That's forcing a lot of captured reps to say, "Why do I need to be a link with an organization, when I can be my own business? I can go negotiate the best prices, different products, special deals, and so forth."

The leverage on the pay opportunities is a lot better for the agents. You're seeing a lot of people move over to the agent business. The agent business has turned into a spreadsheet business, where people don't have the affiliation they used to have with firms. It's more about the best deals and pricing. Now you have a captured sales force moving toward an agent sales force, which is not loyal.

This really is showing some vulnerability to insurance companies around revenues because of it. So, this is a big issue coming up in the future in the industry.

How do we take focus away from the agents and potentially put focus in house and develop a captured sales force that's going to get those financial returns that we're looking for? One approach is revamping the comp plans to make them more similar to those of an agent, but still having acceptable P&L impact.

What I mean by leverage is that for the people who really are going to perform well, let's pay them; for the people who are not, let's send a clear performance message. Traditionally, you talk about performance management outside of financial services. It's really around setting expectations with a manager, feedback, and so forth.

In sales, it's really not that. It's, "If you don't sell, you don't make money." And if you don't make money, you look for another job. I know that sounds really cold, but that's the message that pay is supposed to send for individuals. There needs to be a better message sent for it. In the not-for-profit in house, there is a lesson that can be learned from the brokerage industry. The lesson is that when you have a proprietary trading desk or a broker dealer internally, it is a conflict of interest.

Externally, the clients may not be getting the best prices. How do we make these areas of the business a service center rather than a profit center, as well as an effective sourcing training and compensation for the managers? A lot of people look at agents, they look at the sales force, and they tend to not think about the managers. But if you look at the three, the number one factor of agent or sales force dissatisfaction, is the manager. It's the person who is going to teach you how to make you know a million dollars or the person who is going to tell you how to market your book. That's the number one area of dissatisfaction.

The second one is tools and processes. If you can't spend eight hours a day selling, you're going to be unhappy. If you're spending half your time reconciling tickets and reconciling statements, you're not allowed to spend a lot of time selling. With the competitive pressure of the market as it is now, you're going to be very unhappy.

We usually try to say those two things get you on the ledge of the window. Compensation is the wind that blows you over because then you start saying, "I can get another pay package elsewhere that's fairly similar, but my job is better, and I really like my manager."

Here is where we start talking about the pay-for-performance curve. What we're really doing is increasing the opportunity for the higher-end performers and decreasing it for the low-end performers. As long as the delta, or the change in the slope, is greater for the folks that are on the way down than on the way up, you actually can increase your average productivity by decreasing your cost of sales.

We've been seeing that there's just too much overpaying for underperformers in insurance. You don't have to increase the leverage that much for the high performers to wind up having a return to the business or a reduction in your actual compensation cost of sales. We've seen this at work with a couple of firms. These are direct impacts to the bottom line to the organization.

There are some other interesting side effects. It really does improve targeting of desired behaviors. To say, "Sell a lot, we'll pay you a lot," is a very strong message to salespeople.

You want to reduce the compensation cost of sales, through that reduction in the efficient frontier at the low end of production. It enables compensation to be your performance management tool. In a really tough or litigious society around hiring and firing, we think that comp should do the job of reducing the prominence of those conversations. The difference is between someone saying to himself or herself, "I just can't make a living here. I'm not producing. Maybe this is not the right industry for me," versus the conversation where someone comes in and says, "You're not doing a good job. We think it's time to move on." There are potential implications that are associated with that conversation.

Additionally, we see improvement in average productivity of your sales force. If your low-end performers realize that this is not the place for them, and the high-end people realize that this is a place where they can earn a lot of money, your average productivity goes up. While that is just what you see, that actually has a lot of value externally. When you have reps saying, "Our average productivity at our organization is X," and your top performer starts saying, "Here's a place where I can earn a lot of money," it's really a small industry in a way. People really know where the opportunities are, who has the best pricing, and who has the best

products.

Compensation is one of those critical conversations where they say, "I can make a lot of money at this place." That's a very important message you want to have at an organization. Of course, there would have to be the proper economics that support it from a firm perspective, but it's a very important message.

It improves the affiliation of current top performers. The best thing you want is a sales force of happy top agents or top reps because that speaks volumes for the organization. It's its own marketing tool.

It develops your brand externally for top talent. As I mentioned, they'll say, "This is a place I can really earn some good money if I work hard."

MR. GAETAN NICOLAS: One of the things I would like to do is go step by step back to the basics. We will go back to the special deals a bit later on. I will cover some background information and then we will talk about some numbers. Then we can explain why what's happening is taking place right now. If you go after experienced reps, there's a reason for it. If you go after financial planners, there's a reason for it.

Incentive compensation is fairly straight forward. We want to attract, we want to retain, and we want to increase the sales and the quality. Some companies lately have been doing things to improve financials, like charging more expense to the rep, making sure we get the right incentive there. Some use compliance for people who have a good record—they get some bonuses from the managing director. And there are some companies that do increase activities.

But the basic always goes back to attract, retain and increase sales.The definition of incentive compensation includes cash compensation, which includes financing, commissions, fees, salaries and bonuses. As for the fees, there could be all kind of fees for activities taking place: planning fees, enroller fees, finder's fees for some cases, or any advisory fee if you sell rep product.

The definition also includes fringe benefits. Those packages can be worth a lot of money in total. The definition includes recognition that cannot be understated. And, finally, it includes stock option plans. We'll talk about some of the accounting there.

On the background side, if you think about it, life was good a few years ago. We had one life company and one main distribution system. We tried to sell a little bit to brokerages or other distributions, but the main focus was on one carrier agency or one brokerage. No one tried to develop multiple brokerages or multiple distribution systems all at once. The manufacturing organization and the distribution organization worked very closely together, and you'd look at your numbers together.

What we would sell is mainly two products, probably 80 percent or 90 percent of the sales would be life and annuities. The Life Insurance Marketing and Research Association (LIMRA) is telling us right now that the production from carrier agents is going down. The production mainly comes from independent producers, which indicates that the evolution from carrier agents to independent producers is continuing.

As for recruiting, there are about seven or eight companies in the United States doing the bulk of the recruiting right now. The industry has dropped to about half of where we were; it's very difficult to get the life insurance industry working without the recruiting. If you look at the earnings, they are up and progressing slowly, but at a nice pace.

One of the main issues that we're facing—and we've been facing it for 20 years—is retention. I think 15 percent or 16percent over four years is really what you can expect in an average carrier. I've read about some people being in the 30s, but they are very rare. When we go to numbers, we will see the impact of low versus high and why it's so important to try to improve the model that we have right now.

As far as I'm concerned, demutualization should not have too much impact. If you are a mutual or stock company, you should look at your bottom line; it should be managed very efficiently. But demutualization has forced people to try to get their return faster. We're being rushed now. I think it's probably outdated. We need to improve it, but I hope that we won't forget that we need to invest.

Where I am we have a bank and the Financial Modernization Act hasn't had a significant impact yet. But I believe it will come. It goes to us re-engineering all of our compensation systems toward more like the gross dealer concession. I guess we're learning quite a bit from the security industry on fees of doing transactions.

MetLife is essentially developing four main distribution systems, all at once: carrier managerial, general agency, brokerage insurance and wirehouses and banks. The carrier managerial companies are like the MetLife traditional sales force. The general agency would be like the New England sales force. The brokerage would be more like General American, and the wirehouse and banks are like MetLife investors.

If you look on the managerial side of the general agency (GA), what's happening is that the carrier managerial is trying to become as efficient financially as the GA, doing more and more like the GA would do. But I see also that the GA has lost a lot of control in their reps in trying to promote proprietary products, products from the firm. They're trying to regain it, so the GA seems to be going toward the carrier.

And the carrier managerial is going more like the GA from a financial management viewpoint. If you're thinking of your business as life and annuities, things are changing and they're changing fast. The number of products that are coming at us

is just incredible. We get producers that specialize in each of those. And if you're thinking about the financial planning platform, more and more of those products will be needed. If you're relying on margins from your life products, and allowing all the other products to be sold on an incremental basis, which I've seen a lot of companies do, over time this will create a significant problem. It is something that needs to be looked at right now.

We need the margins on all the products. There are more and more products from other firms that are available to those sales forces. I call them non-proprietary products. But at the same time, you have other insurance products that can be made available also to that sales force.

If you try to recruit people these days or make the distribution company financially sound, and you have a lot of those non-proprietary products, it is challenging. Just the administration of these non-prop products is challenging. The most efficient that we've heard about is 12 percent of the gross dealer concession. If you're spending 12 percent or 13 percent from the start, and you're not recognizing it in your compensation to the agent or you're treating those sales as incremental sales, that could be a major issue, mainly if you're going to the financial planning platform or non-proprietary mutual fund. Non-prop mutual funds are a very big part of the market.

There is increased interest in the industry in the fee-based financial planning platform. We should all be doing the financial planning. I think it's a very interesting platform. It's probably the one that will allow us to do more sales per customer. It can attract people, and it looks more attractive than a normal carrier agent. Maybe that's the way to change.

The financial planning platform encouraged new recruits to sell the financial plans. Right now we are not convinced yet that the sales will come if we do the training. If you allow people to have fees from the plans as a source of income, that may decrease the sales that you would normally get from your other products.

There's also a tendency for people to be happy with a certain level of income. When they've achieved that certain level of income, their interest in selling more may decrease.

Recruiting experienced reps with special deals is controversial. If someone had asked me in 1998 if recruiting experienced reps could be successful, I would have said I have strong doubts about it. If you recruit people from another company and mainly the motivation is money, there's a big chance that a few years later that person would move again for money.

But right now, I have to admit that my opinion is changing. If I look at the experience of recruiting established agents, the costs are way better than trying to recruit new people. There is a lower cost. Now, I don't know what that means for all

of us, going after the others' reps. But so far, the cost of those programs are cheaper than recruiting new reps. And I think that means is the war is just starting. I think everyone will be focused on improving their recruiting program for established agents.

The one other thing I see is a trend toward moving from smaller to larger offices, which creates an impact. There is more joint work and more mentoring. We're hopeful that going to that kind of a program will improve retention quite a bit.

The sharing of compensation with product specialists is another development. In the past, if you had a rep, he would work his business and the last thing he would do is share with anybody. At least, that has been my experience, but right now I see a change in that attitude. As we move to the larger firm, and as more products are available, I see more cooperation and more people working together.

Another development is alliances with professional organizations. Our alliances are not in place yet, but some of our subsidiaries have programs, like the CPA program, which is another trend.

MR. STEEVE JEAN: We're going to look at the financial impact of agent production and retention from the distribution system perspective. The manufacturer is going to pay the distribution system for selling the products, and the distribution system is going to pay the agents and managers.

In Table 1, the distribution system recruits a new agent, a low producer who produces only $25,000 first-year commissions. If we have low retention of 15 percent, the present value of distribution revenues from the manufacturer is a little over $100,000. The distribution margin—what's left after you pay the agent and managers on a fully allocated basis—is going to exceed the revenues that you got from the manufacturer for selling the products.

Table 1

4. Value of an additional agent

$25,000 Producer (FYC)

	Retention	
	Low	High
PV of distribution revenues	$107,000	$296,000
Distribution margin		
Fully allocated	-12%	6%
Incremental basis	14%	24%

Assume that we were able to increase retention to 30 or 35 percent. On a fully allocated basis, the distribution margin would be 6 percent, which means that 94 percent of the revenues you got from your manufacturer are begin passed on to the agent and the managers. On an incremental basis, since you're growing your sales force, you're going to look at a margin of 14 percent to 24 percent, depending on the retention level.

Table 2 looks at a mid-level producer with $50,000 in first-year commissions. Even on low retention, you can, at least, break even if you have a fully allocated basis and low retention. And then you get significant margin for high retention on an incremental basis of 18 percent.

Table 2

4. Value of an additional agent

$50,000 Producer (FYC)

	Retention	
	Low	**High**
PV of distribution revenues	**$217,000**	**$598,000**
Distribution margin		
Fully allocated	**2%**	**9%**
Incremental basis	**14%**	**18%**

Table 3 looks at a high producer with $125,000 in first-year commissions. Even on a fully allocated basis, the distribution margin actually goes down a little bit, which means for a very high producer there is more being passed on to the agent and managers than for a mid-level producer. Although on a percentage basis you're probably keeping less distribution margin for the high producer, on a dollar basis you're still making more money with the high producer.

Table 3

4. Value of an additional agent

$125,000 Producer (FYC)

	Retention	
	Low	**High**
PV of distribution revenues	**$542,000**	**$1,499,000**
Distribution margin		
Fully allocated	**2%**	**3%**
Incremental basis	**10%**	**11%**

From the manufacturer's standpoint, we looked at an example of selling universal life on a fully loaded ROE, a GAAP ROE of 10 percent (Table 4). In the example we considered issue expenses as being overhead and 20 percent of your underwriting expenses being overhead. If you can eliminate some overhead, on an incremental basis your GAAP ROE goes up to 17 percent from 10 percent.

Table 4

5. Financial impact for insurance company--US GAAP

- **Fully loaded ROE: 10%**
- **Incremental ROE:**
  - **•Issue & U/W (20% OH) 17%**
  - **•Maintenance (20% OH) 18%**
  - **•Distribution (20% OH) 22%**

If we assume that maintenance expenses are 20 percent of overhead, we get another 1 percent, so that was a small gain there. From a distribution standpoint, if you're able to expand your existing distribution channel, eliminate some overhead, and in this case, we assume 20 percent of the distribution revenues were overhead, we would increase the GAAP ROE to 22 percent.

Just to summarize, we said that of the incremental gains, 55 percent would come from issue and underwriting, 10 percent from maintenance, and there's a 35 percent increase in GAAP ROE, which would come from expanding your distribution channel and eliminating the overhead associated with it (in other words, keeping the same overhead).

When you look at the value of an additional million dollars of additional life premiums on a fully allocated basis, the present value of GAAP profits run between $150,000 to $300,000. On an incremental basis, those values almost double, from $150,000 to $300,000 on the low end and from $300,000 to half a million dollars on the high end. Those numbers show the value of expanding and increasing your distribution channels and sales, while simultaneously reducing your fixed costs and your overhead.

MR. NICOLAS: A lot of companies right now are splitting the cost for distribution away from manufacturing or they make special entities for distribution. They're breaking them apart. The number from distribution may not always look the best, but I think you have to look at it together. We have to run the distribution efficiently, but if you don't look at it together, distribution and manufacturing, it's

possible that the wrong decision will be made.

Among some other things that we have seen happening lately for carrier agencies, which are normally non-vested on the managerial side, more and more are people now offering succession planning. That could be a substantial increase in costs, particularly if you cannot benefit from the orphan business.

The granting of stock options is an issue since we demutualized. Our interpretation of the stock option accounting is that if it's a common law employee receiving the stock option, there' s no expense issue.

But if you have a statutory employee, or a broker or an independent contractor receiving the same stock option, it has to be expensed. I think there's some advantage to the common law system right now, to common law employees. There are additional benefits, like split dollar-type of arrangements for the independent producer.

I see more and more people offering deferred comp as a way to golden handcuff to stop other people from recruiting reps, that is the independent producer..

MR. BEVACQUA: We'll open the floor up to any questions you might have.

MR. MICHAEL LESAR: Can you talk about trends you've seen in terms of increasing or decreasing compensation for agent quality in term of things like mortality, persistency and placement ratio?

MR. NICOLAS: One of the things we did in terms of quality of business, meaning persistence on the life side, was change the way we pay the persistency bonus. If you look at the way we've implemented it in the carrier side, it almost makes a level comp system. But it's challenging with some people right now. They see the money, then they don't see it.

In terms of expense management, we have put in place a process to charge expenses to all the reps. People who produce at the lower level have a choice: produce a bit more, or at the end of the day you pay us to stay with us. It's that simple.

In terms of mortality, we have not put anything in place. Some of the companies with high producers have captives for share of the gains, but we do not have it. I don't see the trend toward the mortality right now. I see the trends more toward paying people trailers for assets, which means doing everything possible to avoid, when someone leaves the business, having the business leave with them. They're doing anything to protect the asset side of the business.

MR. HERMAN: Issues such as mortality tend to be more effectively offset in governance issues or in management issues, such as to how you manage the

business. It's not as much of a business result, which is where people tend to focus instead of compensation. One of the critical things that people are looking for is now that almost everyone is selling or potentially selling the same products, it's about retaining the assets that you have in-house, retaining the policies you have in-force, and so forth.

Persistency is playing a greater role in-house, and even from a brokerage side people are now looking more toward paying on assets that are retained in-house.

MR. JEAN: That would probably bring you to compensating for value instead of compensating for revenues. If you want to pay compensation based on value of the policy or value of a sale, then you would factor in things such as mortality, lapses and the agent's experience for his block of business.

MR. PAUL LAPORTE: In 1998, New York modernized its section 42-28 law, which governs expense and compensation. What effects in compensation, if any, have you seen as a result?

MR. NICOLAS: I think 42-28 has allowed way more flexibility right now in recruiting. They allowed the salary plan and that by itself provides a lot more flexibility. I do not think under the past law that you would have had that much activity from your base company on recruiting experienced agents. But right now, under the salary plan in the new law, companies are able to compensate people for services that they provide that are not sales. If some of those reps are doing management functions, we are allowed to pay them for those management functions.

FROM THE FLOOR: Gaetan, you brought up the issue of demutualization. I'm curious in terms of the impact on that event in terms of retaining and attracting agents and to the extent that was a cultural issue for some producers. Many agents from mutual companies are raised to believe that mutual companies have a better product and a better approach in terms of servicing their customers. Have you had any issues at MetLife that were important to recognize and are related to that event?

MR. NICOLAS: We didn't really have any issues with the demutualization. The unfortunate part was that we demutualized at the same time that we introduced a new compensation plan. The requirements were a lot tougher than before, and people have blamed those changes on the demutualization. But the changes were required of us as a mutual or as a stock company. So, people blamed it on demutualization. Right now, there are requests from independent producers to get more and more stocks or stock options. But, as of now, this has not been a significant issue.

MS. KRISTAL HANBROOK: You talked about trail commissions and paying for assets under management. I see it typically in the variable product lines. Are you

seeing it trending over to UL and Single Premium Deferred Annuities (SPDAs), and are there difficulties you see with it trending over to those product lines?

MR. NICOLAS: At MetLife, the idea is to get some concession from the reps on some other issues. We are paying trails on traditional life insurance, like on whole life. So all products right now have a tendency for trails. In fact, there's someone in the room here who managed the system, and there is, I think,16 million policies on which we compute trails every quarter. So it's a lot of work. Today, would we put trails on whole life under normal situations? I don't think it's a requirement. I think it does put some challenge in the pricing.

It's a costly concession. There is some advantage. One of the things is every quarter we know how much asset each rep manages, so there are some positives on it.

MR. BEVACQUA: I think a lot of firms are starting to talk about this issue because they're really starting to understand the importance of maintaining their books of business, due to the competitiveness of the market. We've talked to some firms who are even thinking about reducing the up-front compensation a little bit and putting a little more prominence on the back end. They're considering having people really build a perpetuity or an annuity business based upon managing their book.

It also really depends upon how you structure your sales force and the behaviors you want people to demonstrate and target, as well as what your customers look like. By understanding all three of those variables, you're then going to come up with the questions: What's the right type of plan. Where do I really need to put the foot on the accelerator? Where do I need to decelerate?

But on balance, the issues around focusing people on retaining their books of business will be stronger going forward. A lot of people are very interested in this topic because there is an economic impact, which a lot of firms haven't modeled, about losing business and bringing business back in. It's actually a fairly significant impact, so firms will move toward it, I think.

MS. TERESA CARNAZZO: I have a question about leveraging sales compensation to benefit the higher producers. The risk that we've seen is that your concentration of production will be more heavily in the high-end producers and therefore your compensation is at a higher level on average than expected. Do you have any comments on that?

MR. HERMAN: I think that's a good problem, if you have the returns on your business calculated well, especially if your fixed costs are set. Then, the amount that you're paying out increases as you produce more. The way you have to set your plans is that the slope of what you're bringing in is greater than the slope of what you're paying out.

If, at your target levels of compensation, you have an ROI of let's say 15 percent or 20 percent, you can actually increase that by paying out more to higher producers by how you set those targets. I think that's a good problem to have. When I say changing the leverage of the curve, I don't mean break the bank and give everyone everything, but give them that little incentive or that little bit of a carrot. The way you can look at it is that you're still dangling a carrot in front of them, but you're just making sure that the carrot is not as big as it was before.

MR. BEVACQUA: I just want to make one note on a very good point that Gaetan brought up. We talk about the move from transactional model to advice models. The one thing we have to realize is that those two people who offset that could be quite different. So the person who's a transactional person, potentially is going to have some challenges moving over toward an advice model. It's a different skill set that you're looking for in people, and we've found that it's been a big challenge. In moving toward an advice model, the reps that are there have been career transactional reps. And it's a whole new set of behaviors, it's a whole new set of a way of doing business, and it's really a leap of faith that it's going to work.

In the brokerage industry, for instance, Prudential started doing fee-based pricing. The percentage of people who were actually using it were not as great as they had thought. The same was true at Merrill. And so that jump toward the transactional advice model is going to require a lot of work around training, recruiting, learning, development and financial planning.