TRANSACTIONS OF SOCIETY OF ACTUARIES
1950 VOL. 2 NO. 2

SECTION 213—EXPENSE LIMITATION

In the current study of Section 213, what problems are involved, and along what lines does the greatest promise of satisfactory solutions lie?

MR. G. D. McKINNEY opened the discussion with a statement in which he conceded that the technical problems involved in the current study of Section 213 are very large. He had been attempting to draft a revision of certain parts of the law on behalf of the National Association of Life Underwriters and was therefore fully aware of the difficulties involved in drafting a sound revision in understandable language. Rather than talk on these technical problems, he devoted his discussion to what he termed the human problem, the position of a life insurance agent under Section 213. He stressed that in view of the human element involved and the importance of the compensation section of the law, facts rather than impressions should be brought to the forefront before a sound revision can be made on a realistic basis.

He thought that too many people make the broad statement that "agents are writing more business than ever before—they are better off than ever before." By developing the answers to two subsidiary questions he attempted to show that this statement is not by any means necessarily true. The first of these subsidiary questions dealt with the average premium on the business written. He stated that since the average premium on Ordinary business had decreased from $29.20 per $1,000 in 1944 and 1945 to $24.10 per $1,000 in 1948, the agent had to write 20% more business in 1948 to attain the same volume of first year premiums as during 1944 and 1945.

The second question dealt with the agent's true income after recognition of his expenses. He indicated that the National Association of Life Underwriters is presently accumulating facts with respect to agents' business expenses and that a limited sample of their questionnaires indicates an average business expense in 1949 of 29% of the agent's gross income, as against 22% in 1944.

Mr. McKinney illustrated the effect of the foregoing average premium and business expense figures by using, as an example, the quarter million dollar producer, the man claimed to be the backbone of the insurance business. Assuming that the total compensation of an agent would approximate 80% of the first year's premium, he then averred that the net income of the quarter million dollar producer in 1944, after expenses,

would have been $4,570, as against $3,420 in 1949. He pointed out that during the same period the cost of living index had gone up over 40 points.

MR. E. M. McCONNEY then rose to discuss some of the main problems that are involved in the revision of Section 213, as he saw them. After listing the need for simplification as the first problem, he then pointed out that in view of the variety of commission schedules and plans of security benefits for agents now in effect it is almost impossible to include compensation of the soliciting agent as part of an over-all expense limitation section.

The other problems listed by Mr. McConney dealt with the type of limits. He indicated that he favored one limit for field expenses and another for the total of the controllable expenses in the Home Office and field. Under both of these limitations, commissions to the soliciting agent would be excluded. The limit factors should be the same regardless of whether you operate on the general agency or the salaried agency manager basis since the policyholder is interested in the efficient operation of the field services and it makes little difference to him what system is used. Mr. McConney also felt that we need factors in Section 213 upon which a budget can be based. For that purpose it would help a great deal if we do take out the soliciting agents' compensation, including the cost of their social benefits.

With respect to the question of agents' compensation, he indicated that one of the difficulties encountered in any attempt to arrive at some definite information as to the actual earnings of a representative group of individual agents is the fact that they place surplus business elsewhere and some write accident and health, etc. Therefore you cannot obtain any real information about their income, and about their expenses. He also stated that he had a deep-rooted objection to averages and therefore would not like to see any available data on agents' compensation expressed in that form.

MR. C. F. B. RICHARDSON then discussed two aspects of Section 213 not mentioned by previous speakers. The first was the deficiency of the present law in providing adequate margins for financing new agents. At present, broadly speaking, a financing plan must be designed so as not to exceed the amounts permitted to be paid to an established agent. The result is that when an agent leaves the financing plan, say after two years, and goes under a straight commission contract, he does not get any renewals since they have all been mortgaged to pay out salaries or advances. Therefore, in effect, the agent has to start all over again at the end of two years.

He indicated that this financing problem, that is, the inadequate financing help to agents under the existing law, may be contributing to the high termination rates of new agents. In this connection, he pointed out that 50% of the new agents leave the business at the end of the first year. Other businesses do have financing plans to start their new salesmen, and unless we can compete with industry on equal terms, we simply shall not get the quality of men that we need in this business.

The solution Mr. Richardson suggested would be to permit, under Section 213, within proper limits, training allowances for new agents in excess of the first year commissions and renewal commissions allowable to the established agent. He suggested further that these allowances should not reduce commissions available to established men, and that they should be controlled as part of the general agency operating expenses. It would be advisable to frame the limit for this purpose so that the company doing a sound job in building a sales organization would get a more liberal limit than one which is doing a poor job.

The second problem raised by Mr. Richardson dealt with the valuation of agents' compensation plans involving nonvested commissions. The present law had no standard valuation for that purpose and it might be argued that the company should use its own experience, if it has experience. To do that would mean that the company with the worst experience as to termination rates could pay the highest scale of commissions, which is obviously unfair. This indicated the need for a standard valuation basis under the New York Law for the valuation of agency contracts for the purpose of having them qualified under Section 213.