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DIGEST OF INFORMAL DISCUSSION

AGENTS' COMPENSATION

A. Assuming passage of legislation defining agents' Social Security status as advocated to the Senate Finance Committee in February by Chairman Linton of a committee representing the life insurance companies, what would be the effect on compensation? What modifications in the scale of compensation would be warranted to integrate an agent's retirement program with Social Security benefits? Would this necessitate adjustment of brokerage scales? Would the incidence of expense conflict with assumptions in current gross premiums?

B. What recent developments have taken place with respect to retirement plans for field forces?

C. Can compensation modifications based on persistency rating, volume of business produced, policy size, or length of service produce satisfactory results?

MR. E. J. MOORHEAD said, in discussing section A, that the status referred to is that anyone in the capacity of "full-time life insurance salesman" shall be included under Social Security as though he were an employee. This definition is to be supplemented by a detailed statement, but no statement can eliminate all the difficulties of classification. He expressed the opinion that the effect on agents' cash compensation will be slight since the practice has been to add retirement benefits without modifying cash compensation except when the opportunity is taken to adjust commission rates that had been abnormally high or when required by Section 213 of the New York law.

In integrating existing retirement programs with Social Security benefits, he continued, there are the problems of producing equitable contributions and benefits at the lower and higher income brackets and of insuring that deferred compensation will not prevent the agent from drawing benefits. This trail has been blazed by a few companies. He guessed that there would be no immediate adjustment of brokerage scales since the present development is evolutionary rather than final.

In regard to the effect on gross premiums, he felt that the particular way chosen to express the problem may be dangerous since agents should not be allowed to harbor the notion that gross premiums contain a specific loading for compensation. This may have an unfortunate effect in specific instances such as in the case of premiums waived on account of disability.

Changing conditions, he continued, produce various increases and decreases in expense. In deciding the effect of this Social Security development, we should have in mind the tax rate, the part absorbed in the contribution the company might otherwise make into a retirement plan, the presumed advantages of including agents under Social Security, and the extra record keeping.

In regard to section C, he referred to the discussion at the 1947 meeting of the Institute. At that time, he had expressed doubts that results could be as satisfactory in practice as many believed and as theory might suggest. He had wondered if the other steps taken to improve persistency, agent survivorship or policy size might not be more responsible for the improvements observed. Existing incentives to write business that will produce a first year commission are very strong and, for that reason, he felt that incentive compensation to the manager is much more potent than incentive compensation to the agent.

MR. G. D. McKINNEY stated that the effect of the pending Social Security legislation on agents' compensation will soon be a current problem and that the business must base its actions on facts and a sound approach to the attitude of agents. He viewed it as very fortunate that the current recommendations of the Senate Finance Committee follow closely the recommendations of the National Association of Life Underwriters and the company groups which appeared before it. He cited the interpretation given to the extension of coverage to the full-time life insurance agent by the Committee. In brief, life insurance agents will be covered either as employees or independent contractors. Part-time agents, brokers who do not solicit business primarily for one life insurance company, and agents whose primary business is general insurance will not be treated as employees for purposes of the act.

The first step, he said, in determining the effect on a company of having its agents covered under Social Security would seem to be to determine the cost of the program. This information is available in the 1948 report of the Life Insurance Agency Management Association, "Social Security and the Insurance Agent" (File 051), which summarizes information from eight companies who have qualified their full-time Ordinary agents under OASI for purposes of benefits and taxes. In brief, there are four types of expense in which the company may become involved. These include tort liability, unemployment compensation, workmen's compensation and OASI tax. These four give a total cost to the company, assuming all agents are subject to unemployment and workmen's compensation, of between $86.94 and $94.44. Only twelve jurisdictions, however, require agents to be covered for unemployment insurance and only a limited number re-

quire workmen's compensation with the result that these estimates are high. The NALU is opposed to bringing agents under unemployment compensation and this is one of the major costs averaging $34.71 each year per agent.

There is reason to suspect that the average premium on business written has declined and that, in a number of cases, the average commission on this premium has also declined. In addition, there is the well-known fact that agents' business expenses have been increasing. In view of these trends and the very minimum costs involved in bringing agents under Social Security, he suggested that under no circumstances should agents' compensation be adjusted downward.

He pointed out that there is a limited tendency to adjust retirement plans for Social Security benefits and referred to statistics appearing in an article on "Pension Funds for Agents" (*Life Association News*, February 1949, page 529) showing the percentage of average earnings payable as a pension at age 65 under the retirement plans of 40 companies. For agents entering the business at age 45, 34 showed pensions of 24.4% or less. Before deciding that agents' pensions should be reduced, he observed, a decision should be made to determine whether or not pension plans for agents are realistic. He suggested that the company might ask itself: (1) Is our company's plan for agents as favorable as that for home office employees, and (2) Would our company be willing to recommend a similar plan for a similar business to whom we were selling a pension trust or a group annuity? He concluded by saying that the business as a whole should welcome Social Security coverage for its agents and should not use the extension of that coverage as a means of avoiding the obligation of the business to the men who have made it, and who will continue to make it, great and prosperous.

MR. A. L. JOYCE said that the inclusion of full-time life insurance salesmen in the status of employees presents many problems to a life insurance company, although as yet the total cost of the various items is not excessive.

Some of the matters which one company felt that it had to provide for are as follows:

1. Withholding under the Federal Income Tax Law from the commission payments, based on the net amount expected to be received by the agent after deduction for business expenses.
2. Withholding under the OASI program, as well as the payment of the employer's share of the tax.
3. Withholding for the payment of certain city taxes such as in the case of Columbus, Philadelphia, St. Louis, and Toledo.

4. Withholding for certain state income taxes such as in the case of Delaware.
5. Providing for workmen's compensation coverage.
6. Withholding and payment of the company's share for disability benefits as provided in certain states.
7. The payment of an unemployment tax where a state does not definitely exclude salesmen. Of course, under the present federal law salesmen are excluded.
8. The purchase of a contract which will cover the company in the event of liability for the acts of one of its employees.

The total cost of these benefits increases the effective compensation to an agent but he did not believe that they are as yet of sufficient importance to warrant any modification in the compensation program. Their pension plan has not been changed nor was it felt desirable to attempt to integrate it with Social Security benefits. He did not believe that the incidence of expense caused by these items would seriously affect expense assumptions in rate structure. About all that could be said is that margins are decreased slightly.

MR. G. G. MYER stated, in respect to section B, that one of the most impelling reasons for the Confederation Life's new agents' contract was to make the retirement provisions more adequate. The new contract gives lower first year commission and continuous renewals. At age 65 then future renewals are commuted and paid as a pension with a 10-year guarantee. In addition to this a pension fund was set up, to which the agent contributes 10% of renewals and the Company a like amount. Provision is made for a reduction of the grants by the amount of taxes payable for Social Security purposes.

In respect to section C, Mr. Myer described the quality production bonus contained in the new contract. The rate of bonus is graded by gross volume and first and second year lapses, and varies from $1 to $10 per $1,000 of the difference ("net volume"). It has had a good effect, he said, in making the field force conservation-minded as lapses have a much more powerful effect on the bonus than does the gross volume. It also exerts restraint on overselling. He reported that his company's relative lapse rate has improved slightly and he expected that the improvement will be even more marked as the agents become more familiar with the bonus. The new contract also contains a small bonus per $1,000 graded by size of contract. It is difficult to evaluate the effect of such incentives, he concluded, but the Company is satisfied that they are of real use in raising the sights of the agents.

MR. HAROLD A. GROUT, in respect to section B, described the John Hancock's recently adopted plan for retirement allowances to general agents. Requirements for qualification are a written contract under which business is solicited exclusively for the company; completion prior to retirement of twenty years of service with the company; retirement in good standing at age 65 or later; and continued cooperation with his successor and the company.

He reported that the amount payable in any year is the excess, if any, of $3,000 over the sum of any personal and overriding commissions, the primary benefits under the Federal Social Security Act or any similar Federal or State act, and any benefits under a Federal or State unemployment, workmen's compensation, or disability act. Allowances are paid in monthly installments and any necessary adjustment in the estimated amount is made at the end of the year.

To avoid a heavy tax burden on the general agents (who do not have an employee status with the company) at the retirement date, the plan is noncontributory and retirement allowance payments are authorized by the company one year at a time. The plan is a temporary expedient to be used until such time as the employee status and tax situation may be changed. It has been approved for a two year period by the Massachusetts insurance commissioner and has also been submitted to the New York Insurance Department. He stated that this temporary plan has been well accepted by the general agents.

MR. THOMAS IRVINE presented a statistical review of the agents' retirement plan practices of 71 United States and 18 Canadian companies. Of the 71 United States companies, 51 have plans; this is a higher proportion than may be expected of the country at large since the larger companies are more heavily represented. Of the 51 plans, 43 are contributory while 8 are not contributory. Ten years ago, on the other hand, only one out of four of the Agency Management Association's 98 United States member companies had plans and these were split evenly between contributory and noncontributory. The swing toward pension plans is still going on. Among the 71 companies, 7 added plans during the past three years, 5 contributory and 2 noncontributory, while 1 changed from a contributory to a noncontributory basis and 2 changed existing plans to integrate them with Social Security.

Among the 43 contributory plans, he continued, all but 8 express the agents' contributions as a percentage of total income. These are about evenly divided between 3, 4 and 5 percent, although a few chose other percentages. Of the remaining 8 companies, 7 have formulas such as 15 cents per thousand in force. Ten of the companies also permit additional volun-

tary contributions. Of the 43 companies, 30 matched the agents' regular contribution, while among the remaining 13 practice varies considerably. In 18 of the plans, the agent does not acquire any vested right in the company's contributions on termination, but most of the 18 are somewhat more liberal in the event of death or disability. Among the remaining 25 plans, there is little uniformity—vesting may begin immediately or after 5, 10, 15 or 20 years' service and build up to 100 percent immediately or after 5, 10 or 15 years' additional service. A few also have an attained age requirement for vesting.

Among the 18 Canadian companies, 17 have plans, 8 of which are contributory. Unlike the United States, retirement programs were also in vogue ten years ago at which time 15 of the Association's 18 Canadian member companies had plans, but only 1 of the 15 was contributory. Three changes from a noncontributory to a contributory basis have taken place during the past 3 years.

MR. A. W. LEWIS stated that last year Pacific Mutual established a retirement plan for agents. The plan is a money-purchase group annuity under which participating agents contribute 3% of their earnings for the previous year (subject to certain limitations), which amount is matched by the Company. Agents may make additional contributions to purchase annuities at slightly above net rates, but these are not matched by the Company, and although they may be withdrawn they may not thereafter be repaid.

An agents' retirement and insurance plan account was also set up independent of the group annuity contract and of certain group insurance contracts previously made effective for agents. This fund is credited each year with a percentage of first year premiums, and company contributions to the group contracts are paid from this fund. As this fund accumulates a surplus, benefits provided under one or more of the group contracts are to be liberalized.

MR. A. R. POYNTZ discussed the recent changes in the Imperial's pension plan for agents. The old plan was noncontributory while the new plan is contributory. The company contributes 8 percent of total earnings, which is about equivalent to the over-all cost under the old plan. The agent may contribute from 4 to 8 percent. The company contributions are vested in the agent in the event of death and are completely vested after 20 years' service in the event of termination other than death.

MR. C. F. B. RICHARDSON, in regard to section C, expressed belief that quality of business can be improved by the inclusion of incentives in the compensation plan. In the Mutual Life, he said, a monthly income is payable approximately during the fourth, ninth and fourteenth policy

years depending on the number of applications written, average size of policy, mode of payment of first premium, placement efficiency, and average production of the two years preceding payment of the income. The first year commission on policies of less than $1,500 is also 5 percent less than the regular scale. This has resulted in a marked decrease in $1,000 policies. While these features have made the agents more conscious of quality factors, there is still a wide variation in persistency between agents.

Incentives, he said, can also be introduced in the plans for compensating supervisory personnel. In his company's recently revised compensation plans for managers and assistant managers, the part of the compensation which depends on volume is computed on first year commissions paid to agents. This rewards a manager for high quality business and directly reflects first year lapse rates on fractional premium business. His company has also found that a production expense factor in the manager's compensation is effective in controlling expenses. The present formula, he said, includes both a penalty for the agencies above the average and a substantial reward for those below. It is difficult, he continued, to design an expense factor which will not encourage the manager to liquidate the agency, but he felt that his company had found a solution by tying it in with the proportion of new business obtained from new agents.

MR. JOHN R. LARUS stated that the Phoenix Mutual's compensation plan has long been based on persistency, volume and size of policy. The 6-year persistency of an agent's production for any year determines his subsequent renewal rate on that year's business. The number of renewals paid is dependent on the volume of business produced, and the first commission is graded according to policy size. The first provision, he pointed out, focuses the attention of the agent on his lapse rate. Persistency ratings are used solely as a guide, but nevertheless agents hesitate to write poor business because of the effect on renewal compensation.

His company's experience, he warned, indicates the importance of wording contracts so that incentives are in the form of bonuses rather than penalties. He also stated that his company had found it advisable to simplify the contract at the expense of technical accuracy in the interest of understanding by the agent. When a contract is too complicated, the home office is kept on the defensive and must carry on a continuous program of explanation and education.

He expressed the opinion that it is impossible to assess with any accuracy the effect of such incentives, but felt that his company had succeeded in making the agents more conscious of the vital points.

MR. G. E. CANNON discussed the Standard's experience with a plan

of compensation which depends partly on persistency rating and volume. The company, he said, had three objectives in adopting its incentive contract: (1) to attract and hold career agents by paying higher compensation for quality business, (2) to improve the persistency of business by paying higher commissions at the time the business is sold for business showing an aptitude for persistency, and (3) to encourage a larger volume of business from agents writing quality business by paying an additional reward for volume production of quality business.

The old contract provided 60 percent graded, the new contract 70 percent graded for business with a quality rating of 85 and higher down to a minimum of 50 percent graded for business with a quality rating of 65 and under. Justification for this differential was proved mathematically.

The success with attracting career agents attributable to the change in contract, he said, had been difficult to measure. A contract has only a a limited value in attracting agents but it has a bearing in convincing managers and general agents that career agents are the ones they are seeking. At this point, he cited figures showing the company's recruiting and termination experience during 1949 and 1950. He also cited figures showing the effect of the change in compensation on the first year commissions. Examining the 1942 production of three agents who typified the producers of high quality, medium quality and low quality business, the changes in first year commissions if payment had been under the new contract would have been +12.7 percent, −.2 percent, and −15.8 percent, respectively. The 1942 production of 65 agents of all classes was also examined. Among these, 27 would have shown an increase in first year commissions and 38 a decrease, the net effect being a small increase. Twenty-one of the 27 (78 percent) and only 13 of the 38 (34 percent) have remained with the company until today or until their death. These figures show that the incentive form of contract has been an important factor in retaining agents who write the better class of business.

The development of a persistency consciousness on the part of the company's agents, he said, has been a very satisfactory result of the adoption of the incentive contract.

The third objective, he continued, has also met with some success. The impetus has been more apparent in the efforts of the managers and general agents. Their contracts provide for an annual reward when volume and persistency meet certain standards. This and other incentives have focused their attention on promoting production with quality.

MR. R. E. SHALEN called attention to the provision in the New York law prohibiting payment of additional amounts on account of volume of business produced. He also warned that basing compensation factors on

policy size, length of service, or persistency may have an embarrassing effect on expense margins under the New York law in the event that experience differs from that anticipated.

MR. W. J. LOGIE stated that the system of remuneration adopted by the Empire Life in their efforts toward improved persistency of business depends only on the first year commission earned by the agent and on his lapse index. By earning a sufficient amount of first year commission and having at the same time a sufficiently low lapse index, an agent can gain additional remuneration of 50% of his first year commission. This figure of 50% is graded down fairly gently as the amount of commission earned during the year decreases, but rather sharply as the lapse index increases. For new agents a modified basis is used which merges with the regular schedule after two years.

The progress of the lapse index of an agent, old or new, can be considered in deciding whether to retain or terminate the agent's services. The agent is constantly reminded that to him his lapse index means money and that the low premium plans, attractive as are the sums insured thereunder, do not provide much of a living. Although this system of remuneration has not been in effect long enough to produce extensive experience data, the short experience has been sufficient to convince them that persistency and production statistics have great effect when used as a basis of remuneration.