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AGENCY PROBLEMS

A. What is the actuary's role in developing modern methods for financing field men? Can the actuary best perform this function as an agency executive or as an actuary outside the agency department?

B. What standards are there to guide a company in determining the limits of field expense that may be paid in addition to regular commissions?

C. Is it desirable to market both life insurance and casualty insurance through the same agent? Does this practice introduce additional problems or diminish existing problems in financing (*a*) new agents and (*b*) established agents?

MR. DONALD M. ELLIS stated that the actuary should play an important role in the development of any financing plan. Liberal financing levels are required to meet the competition of other industries and the cost of a poorly conceived plan can easily get out of line. At best, the cost will be substantial and should be related to the margins available under the premium and dividend formula. For companies licensed in New York, a financing plan must meet the requirements of Section 213.

He said that for 25 years the Canada Life has had an actuary attached to the agency department. He is physically located in the agency department and carries the title of assistant actuary. While still considered an actuarial officer, he is responsible to the agency vice president for direction and instruction. Such a man must be carefully selected and should use tact and discretion in order to be effective. It is felt that this actuary must be located in the agency department and active in their activities to fully understand the agency problems and objectives. Being a junior officer dealing with senior agency officials, his actuarial department connection is continued for what support it offers. If he finds conditions which require alteration or correction, he should press for the necessary changes through agency channels and consult with the chief actuary only on matters of fundamental importance and with the agreement of the agency officers.

Mr. Ellis further stated that clearly defined field expense standards are invaluable in agency administration but that great care must be used in the initial selection of such standards as they are difficult to change after once adopted. A company should examine its own history of field expenses, relating such expenses to new sum insured or new premiums or a combination of both. It could then study the comparative costs of its individual agencies and compare the results with those of other companies. Such comparative data can be found in the LIAMA Research Report on first year and renewal costs. The company should then set standards based upon its objectives, using these cost figures as guides. If the prime

objective is low net cost, field costs must be kept low. If rapid growth is sought, it may be desirable to permit somewhat higher field costs. The resulting standards must then be checked against the limitation of Section 213 for New York companies.

Mr. Ellis revealed that the Canada Life established branch office standards many years ago on the basis of $6 per $1,000 for new business expenses and 45 cents per $1,000 of premium paying business for renewal expenses. These standards apply to branch offices supervised by salaried managers and include rent, office expenses, salaries of staff and supervisor (but not manager's salary), cost of agents' financing, and all other expenses under the control of the manager.

A great deal has happened since these standards were set. Salaries and many other expenses have more than doubled. The average size policy has had a similar increase, and the average branch production has increased substantially while the average premium per $1,000 has declined. Premium rates have recently been reduced and volume discounts introduced. Mr. Ellis believed the original standards are still valid in spite of all the changes but felt it is due more to good luck than to good management.

MR. LALANDER S. NORMAN voiced the opinion that the effectiveness of the actuary and the extent to which his advice is sought and recommendations followed depend on the authority he earns by working as an understanding team member and not upon his position in the organization chart.

The actuary's specific role in developing modern financing methods may well begin with spotting the need for a change. Such a need may show itself in an analysis of company results. Weakness in financing methods should be suspected if company statistics reveal mounting debit balances, heavy agent turnover, increasing lapse rates, low average premium, unusual premium mode distribution, inadequate growth of production, or continuing high acquisition costs.

Mr. Norman stated that the actuary has the responsibility for maintaining a proper balance in three major areas. First, a reasonable and realistic balance must be maintained between the sums invested in agency expansion and the margins available from existing business. Such sums include the subsidies involved in agent financing and should relate to the proper growth rate. Secondly, the correct financing of field men must result in a reasonable balance between the advances, allowance, or salary paid to an agent and the ultimate value of his production. This involves equity. The third and most difficult balance to appraise by actuarial methods is the balance between the incentive offered by the financing

plan and the safeguards against loss. A basis that would eliminate all possibility of loss might eliminate all probability of progress.

Mr. Norman felt that the actuary's detached viewpoint might be of special help in preventing some principles from being overlooked when designing a financing plan. Competitors' plans are an excellent source of ideas but must be altered and adapted to the particular company. Liberal training allowances should not be superimposed upon a liberal commission scale or liberal participation in financing loss upon a liberal override commission and allowances scale to general agents.

The actuary should guard against a plan that attracts men by high advances but should strive for a plan that attracts men on the basis of the commission earnings potential. The subsidy of a successful agent should not be measured by the extent of loss on failures. The chief rewards to the successful agent should be his arrival at the point where he can reap the full benefit of his commission earnings.

Mr. Norman said that the American United uses a salary plan for new agents, the continuation of which requires validation according to a schedule based on earned commissions and lives written and also study and sales activity reports. After the second quarter the agent may draw, in addition to his salary, one-half the excess of earned commission credits over and above his validation needs plus any quality bonus credits earned. Only a relatively moderate training allowance is granted at the end of the financing period as a liberal compensation scale is used for career agents.

Before adopting a new financing method, the actuary should apply the scheme to hypothetical conditions and to actual histories of successful and unsuccessful agents. Such demonstrations offer an effective means of selling the new plan to the field men. Any new plan should also include a system to evaluate the results.

Mr. Norman said that the American United's plan, now two years old, has resulted in decreasing agent's debit balances and in reducing lapse rates. The company's new business is increasing at a very satisfactory rate.

MR. MANUEL GELLES pointed out that there is no substitute for the personal supervision and training of new agents and that a good financing plan only supplements these activities. The actuary should help design the plan and the rules of its operation, set standards of performance, and keep management informed of the results.

The New York Life's financing plan is a two-year plan and incorporates validation standards. They use three criteria for measuring recruiting performance: (1) the ratio of recruits actually hired to the quota assigned;

(2) agent survival rates for critical periods such as 3, 6, 12, and 24 months; and (3) the ratio of net credit balance in the new agent's account to his monthly salary. These criteria can easily be obtained and are gathered on a companywide and geographical basis.

Mr. Gelles gave warning of the fallacy of comparing various agents' survival rates unless the data are based upon a common definition of what level of production qualifies the new man for continuance.

The cost of a financing plan or the alteration of an existing plan should be compared with the benefits expected to be derived from the plan or change. The primary benefit is quality production from an increased number of successful agents. The evaluation of these benefits sets a monetary limit on the costs of plan; but such limits must, of necessity, be flexible.

Mr. Gelles defined the actuary's responsibility as setting of limits on costs and the defining of the goals to be reached in order to justify such costs.

MR. ROBERT H. JORDAN suggested that standards under section B could be derived by computing asset shares under varying assumptions as to field expenses and comparing these asset shares with the cash values. This would provide rough limits as a guide to management.

Mr. Jordan said that the Life Insurance Company of North America, still in its formative stages and having a somewhat unique distribution system, has been vitally interested in setting standards for field expenses. They used figures from Schedule Q of various companies to estimate what these companies spent on field acquisition costs. The results on general agency companies were understated since vested renewal compensation is payable to the general agents. In the case of branch office companies, a considerable amount of renewal expense could be shown in lines 51 and 52 of Schedule Q and appropriate adjustments were required. Because of the approximate nature of their approach, the field acquisition costs were expressed as a percentage of first year premiums.

The results obtained ranged from a low of 30 percent for a general agency company to a high of 94 percent for a branch office company. The net result of the study indicated that acquisition expenses on the average are from 45 percent to 50 percent of first year premiums.

As an independent check on the results from Schedule Q and to provide a check on asset share expense assumptions, they also studied the total general expenses of other companies for Ordinary Life Insurance, Total and Permanent Disability, and Accidental Death Benefits as shown on line 23, columns 3, 4, and 5 of page 5 of the annual statement. The purpose was to derive a set of expense rates which, when applied to the appropriate

base figures such as number of policies, insurance in force, etc., would reproduce fairly closely the actual expenses of the companies studied. This approach is similar to one employed by Mr. Pedoe in his paper, "The Trend of Life Insurance Companies' Expenses," *TSA* IV.

The results, while very approximate and unrefined, do provide a means of measuring expenses of one company with those of another and the progress of expenses for a company from year to year. The accompanying table gives the formula they derived from this study. The ratios of actual expenses to formula expenses ranged from 63 percent to 154 percent. If certain companies with unusual characteristics are excluded, the range becomes 73 percent to 123 percent.

Considering the first year expense per $1,000 and the percentage of premium expense to represent acquisition costs they arrived at an acquisition expense of 45 percent, assuming a $20 per $1,000 average premium.

	Per Policy	Per $1,000	Percentage of Premium
First Year.....	$25	$5	20%
Renewal......	5	1	

They believe the results of this independent check substantiates their idea that a reasonable level of field acquisition expense under the most common methods of operation in the United States would be in the range of 40 percent to 50 percent.

MR. C. F. B. RICHARDSON felt that the actuary advising the agency department must be completely independent of the agency department in order to maintain an unbiased viewpoint. He believed that the actuary should first reach an agreement with the agency department as to what is wrong with the financing plan in current use and the objectives to be reached by a new plan. The final plan usually represents a compromise which attains the main objectives, can be explained to the field, and can be administered at reasonable cost.

Mr. Richardson stated that most financing plans have too little incentive, and the relative degrees of emphasis on incentive and stability of income in the entire area of agency compensation should depend upon the job involved. For example, there should be more emphasis on stability of income in a manager's compensation formula than for a supervisor. In the case of the established agent, the entire compensation is of the incentive type. When a new agent is learning the job, he needs incentive in a high

degree, and those plans which involve a fixed salary or a fixed advance would be more expensive and less likely to develop the best men than plans involving a high degree of incentive.

On section B, Mr. Richardson said there are no standards now available for determining the limit of field expense other than those inherent in the New York law, and he felt there probably never will be such standards. The only data now available are contained in the annual studies of agency costs made by the Agency Management Association. Further long range research is now going on in the area of functional cost attributable to the agent, but this is a very difficult field, and it is likely to be a long time before any useful results are obtained.

He suggested the possibility of determining by fund techniques applied to a model office the maximum rate of field expense that can safely be incurred, pointing out that this is a function of the competitive position the company desires to maintain. The results would depend upon the level of premiums, dividends, cash values, surplus objectives, and the quality of the business obtained. He assumed that the question referred to regular operating field expenses rather than those arising from an expansion program which might be regarded as capital expense.

Concerning section C, Mr. Richardson felt that one-stop selling should diminish financing costs because of the higher frequency of sale per interview on casualty and property business. It would, however, create training problems if one agent sells all lines of insurance. He mentioned a recent study of the Agency Management Association which indicated that the public demand for one-stop selling is not as great as some people have suggested.