Marketing and Distribution: Compensation for Sellers and Distributors

By Nick Ortner and Brendan Costello

Building on our previous newsletter article ("Who Sells and Distributes"), we continue here in our attempt to define and clarify distribution terms that may be confusing or misunderstood. In this article, we focus on seller and distributor compensation, which includes payments to customer-facing sales experts for policies remaining inforce along with separate allowances for the entities supporting those experts. In this article, we use the term "agent" and intend its use to also capture "brokers" and "producers" in reference to customer-facing sales experts, while appreciating there may be subtle differences between them (see "Who Sells and Distributes" for more on this).

As we noted in our initial article, we view this series and emerging glossary as a work in progress and encourage feedback on items we may have omitted or defined incompletely.

SALES PATHS GUIDING COMPENSATION

One of the factors influencing compensation is the path by which sales develop. **Inbound sales** start when a potential customer contacts the insurance company or agent/sales organization with questions about a product (i.e., the inquiry is "inbound" to someone who can proceed with the sales process). **Outbound sales** are the result of outbound prospecting to customers regarding products offered by the organization and insurers the agent represents.

Both inbound and outbound sales can result in commission payments to the expert guiding and facilitating the sale. Commission payments for outbound sales are generally higher due to the additional costs associated with generating and developing leads.

AGENT COMMISSION COMPENSATION STRUCTURES

Insurers structure commission compensation to the agent in a variety of ways, summarized in Table 1 and detailed in the following paragraphs.

Table 1
Agent Commission Structures

Commission Description	First-Year Compensation	Renewal Year Compensation	Product Examples
Flat Fee	Flat dollar amount	Same dollar amount or zero	Annual open enrollment and/or guaranteed issue individual health
Heaped and Levelized	Stated percentage of premium. Higher than renewal years; first-year rates for heaped are higher than levelized	Lower than first-year; renewal rates for levelized are higher than heaped	Annuity; individual and worksite life; individual supplemental health
Level	Stated percentage of premium	Same percentage of first-year premium	Group life; group health; individual supplemental health

Unsurprisingly, agent commission rates tend to be higher for more complicated products or more complex sales, as well as lower premium products (e.g., dental or vision) to provide agents a sufficient incentive to market such products. Renewal compensation also tends to discontinue eventually on long duration contracts.

Flat fee compensation (one-time or annual dollar amount for a specified period) may be paid for products requiring reduced sales resources/effort (e.g., annual open enrollment and/or guaranteed issue individual health).

Heaped commissions are a structure where the commission scale is high in the first year and lower in subsequent years. Heaped commission schedules are intended to reward agents by providing a strong incentive to close new customers and recognizing that sales of more complicated products may demand more significant use of agent resources upfront. Like heaped commission sales, levelized commissions have commissions that are higher in the first year than in renewal years, while typically differing from heaped scales with lower first-year commissions and higher renewal year commissions.

Level commissions pay a level percentage of premium for a specified number of years, with those commissions typically paid as a percentage of the customer's first-year premium for all years (i.e., the agent is not paid for inflation on premiums, if applicable). Level (and levelized) structures provide agents an incentive to enroll clients for the long-term and provide high quality service to those clients because renewal commissions are not paid on lapsed policies.

Another common type of agent compensation is **service fees**, which are generally similar to renewal commissions and paid at a lower rate (perhaps 1 percent to 2 percent of premium) in later years as an incentive to sustain the occasional service needed on the policy and maintain the client relationship.

Target premiums are common in flexible premium universal life coverage, where a higher commission rate is paid on premiums up to an established target premium amount and a lower commission rate paid thereafter. Some products may have a **rolling target**, meaning that agents are paid first-year commissions on premium paid during the first two years of the policy, up to the target premium established at issue.

AGENT COMPENSATION ADJUSTMENTS

Agent compensation may also have additional complexity and adjustments. **Advancing of commissions** represent a financing arrangement akin to a loan from the insurer to the agent in anticipation of future commissions, typically paid back through future commissions earned. **Chargebacks** occur when the insurer takes back unearned compensation paid to agents for policies sold that subsequently lapse/cancel, often accomplished by reducing commission payments in the month following policy cancellation. **Vesting** represents agent ownership of commissions regardless of whether the salesperson still works for the insurer or sales organization, as a result of the account renewing with a carrier past the sales contract's initial policy term. Such commissions are payable to that agent (or her/his estate) even if that salesperson no longer sells business for the insurer.

SUPPORTING ORGANIZATION COMPENSATION

Supporting organizations higher in the typical distribution hierarchy (also known as "upline" entities) may also receive compensation. **Overrides/marketing overrides** are payments received by a sales manager and/or upline sales organization based on the sales made by those lower in the sales hierarchy ("downlines"). Overrides serve as compensation for the upline individual/entity for training and managing agents. Overrides are effectively "commissions paid to uplines based on downline sales."

Gross dealer concessions (GDC) represent revenue to brokerages when a commissioned securities and insurance salesperson sells an investment or insurance product and the agent receives a percentage of the GDC figure—for example:

- A mutual fund with a 5.5 percent sales charge is sold to someone investing $20,000, with the sales agent assumed to receive 30 percent of the GDC.
- $1,100 GDC (5.5 percent of $20,000) would be created by the sale, resulting in an initial account balance for the investor of $18,900 ($20,000 less $1,100).
- The sales agent receives $330 (30% of $1,100 GDC).

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In wrapping up this brief overview of compensation for sellers and distributors, we continue to seek feedback on these installments as we build an SOA Marketing and Distribution glossary that we hope helps simplify and clarify some of the terms and verbiage you may encounter. Over the next several newsletters, we anticipate adding further to the understanding of distribution with exploration of support for sellers and distributors and the pertinent regulatory elements and framework surrounding marketing, sales, and distribution.

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