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How to Reduce Agents' Commissions by 80% or More on Life Insurance from the Best Companies

by
David N. Barkhausen

First-year expenses, especially the payment of a standard first-year agent's commission, can detract significantly from the long-term performance of a permanent insurance product. Commissions have by far the largest impact on the short-term performance of an insurance policy, and, under most premium and commission structures, they result in almost no cash value accrual within a policy in the first year or two of a new policy.

The typical first-year agent's commission is largely responsible for this drag on product returns. Including portions of commissions paid to general agents and amounts paid as "expense allowances," commissions can often exceed 100% of the first-year premium. They typically range between 5% and 10% of the premium for the next 5 to 10 years.

At one time, inflexible premium structures on whole life insurance policies gave the consumer no choice. This is no longer the case. Today, the agent and policy applicant have considerable discretion in structuring a policy and premium so as to reduce the standard commission by 80% or more. This is done by designing a policy with a maximum amount of term insurance and a minimum amount of permanent insurance and then having most of the annual premium payments take the form of "additional premiums" or "dump-ins" on which the commission may run about 3 percent, or a mere 5 percent of the standard first-year agent's commission.

The difference between the full commission and the low-load commission falls straight to the bottom line, builds immediate cash value within the policy, and substantially enhances long-term returns from the policy.

The ability to achieve these savings and to increase policy values in the process is not limited to special products with very large premiums, such as private placement and offshore life insurance policies. Premiums can be structured to eliminate most of the commission for most any permanent insurance policy – whole life, universal life, or variable life – offered by the best companies. The process simply requires objective expertise and oversight of the agent or broker in applying for the policy to be sure that the premium is structured to minimize commissions.

Example of Commission Savings: Consider the example illustrated in the charts on the page attached to this article. It involves a $1 million permanent insurance policy for a 56-year-old male with an annual premium of $36, 685. With a low commission of only $3,950, the death benefit rate of return at age 85 is about 100 basis points, or almost 20% higher, than with a standard commission ($26,260) based on 55% of the first-year premium and an "expense allowance" of 30% of first-year commissions. The low commission is only 15% of the higher commission, a striking example of the ability to reduce commissions on today's flexible insurance policies to enhance long-term returns.

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The initial impact of this difference in commissions on policy performance is dramatic. It is revealed by the disparity in first-year cash values between the low commission and standard commission policies - $33,000 vs. $3,000. With the low commission approach, more than 90% of the first-year premium goes to work immediately within the policy to build long-term values. With the standard commission, almost all of the first-year premium is siphoned off to pay the agent's and other commissions (to the general agent, brokerage manager, etc.) and expenses.

The ultimate difference looks at least as startling in dollar terms as it does in percentage terms. With the low commission, the death benefit projected at age 85 increases from $3,626,000 to $4,351,000. For purchasers of larger policies, in particular, there is no reason to be throwing away this kind of money.

The Additional Advantage of Low Insurance Charges: If, on top of this differential from commission savings, one gains a further edge by obtaining the policy from a company with the best mortality results, rather than one with average mortality charges, that produces an additional rate of return advantage of almost 1 percent. Indeed, the combined benefit of a low commission and low mortality charges, as opposed to a standard commission structure and average mortality charges, increases the age 85 death benefit rate of return by almost 200 basis points – 8.29% vs. 6.34%. This difference translates into a death benefit from the low commission/low mortality policy that is 43% higher than that produced with the alternative - $4,351,000 vs. $3,041,000. The dramatic savings available from life insurance with low commissions and mortality costs are reflected in the charts on the following page.

In addition, a company with low operating expenses (other than for commissions and mortality charges) and top risk-adjusted investment results can offer further advantages. Considering these additional factors widens the rate of return gap between average companies and the best returns likely available from life insurance policies even further.

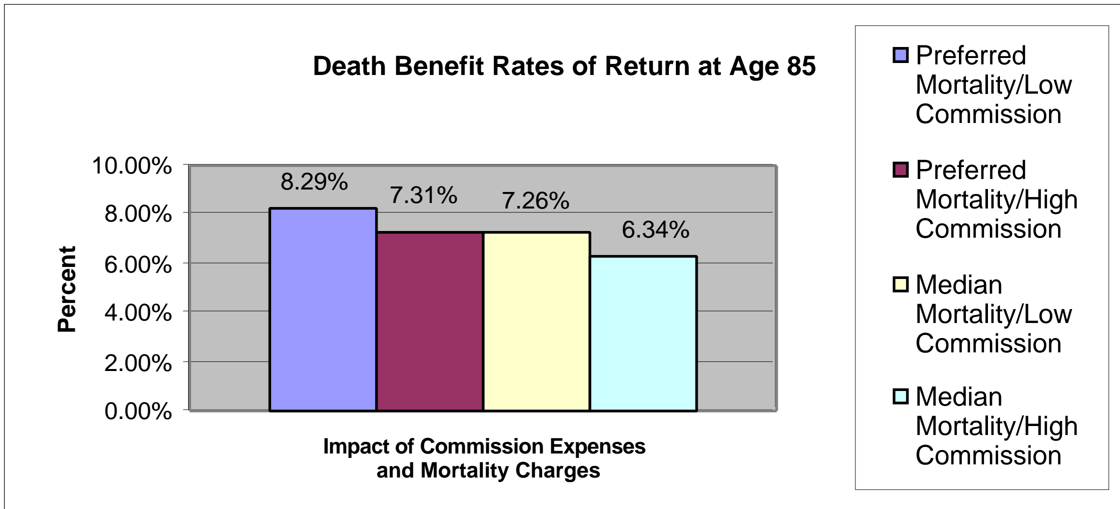
Life insurance consumers sometimes receive the advantage of low insurance charges if they happen to purchase a policy from the most competitive companies. However, the potential to obtain equally substantial savings from low-load commissions remains a carefully guarded secret of companies and agents. It is time to spread the word about this important opportunity. Let it be known that smart consumers, of the kind who have fueled the growth of the no-load mutual fund industry, can, with the benefit of objective advice, receive much greater value for the premiums they pay.

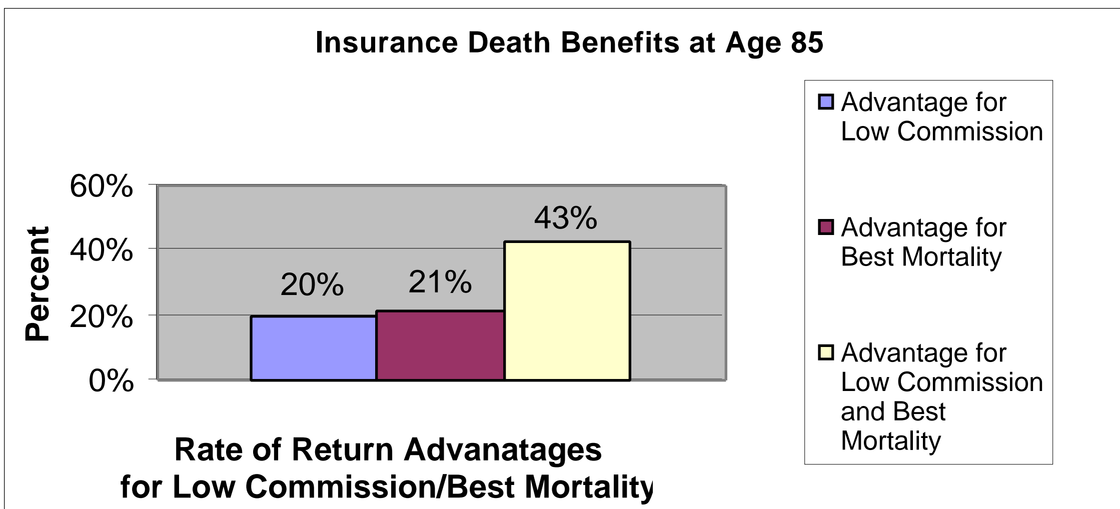
David N. Barkhausen is President of Life Insurance Advisors, Inc., a fee-only life insurance consulting firm. He was previously an agent with Northwestern Mutual Life from 1991-1998 and was the company's top first-year agent in 1991-92.

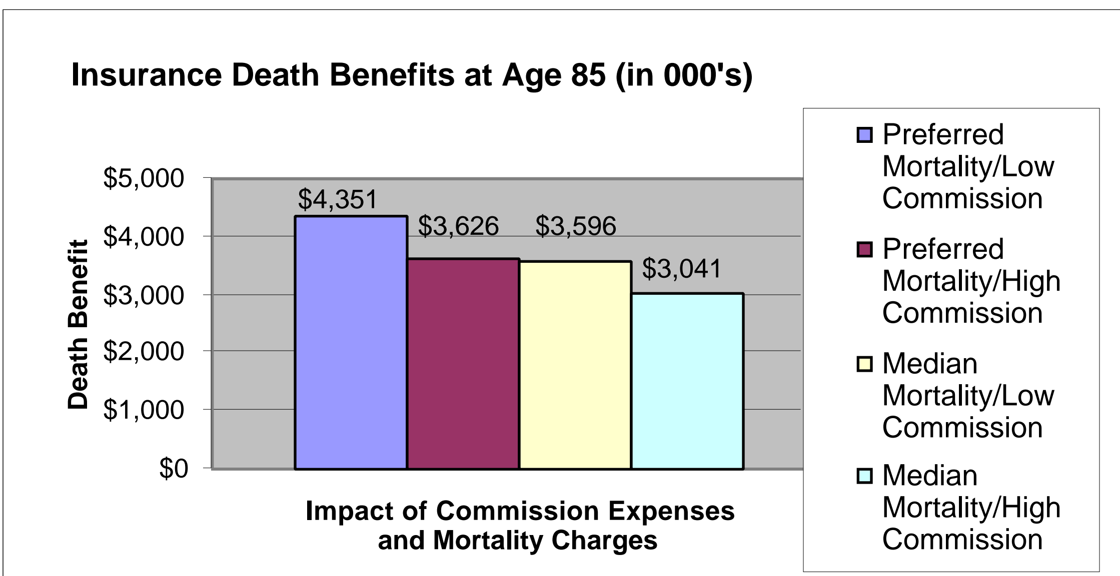
An estate planning lawyer prior to joining NML, Barkhausen is a member of the American, Illinois, and Chicago Bar Associations and the National Conference of Commissioners on Uniform State Laws. He has written for and spoken to these organizations on estate planning and life insurance topics, and he has also conducted Continuing Professional Education seminars for the Illinois CPA Society on the business and estate planning applications of life insurance.

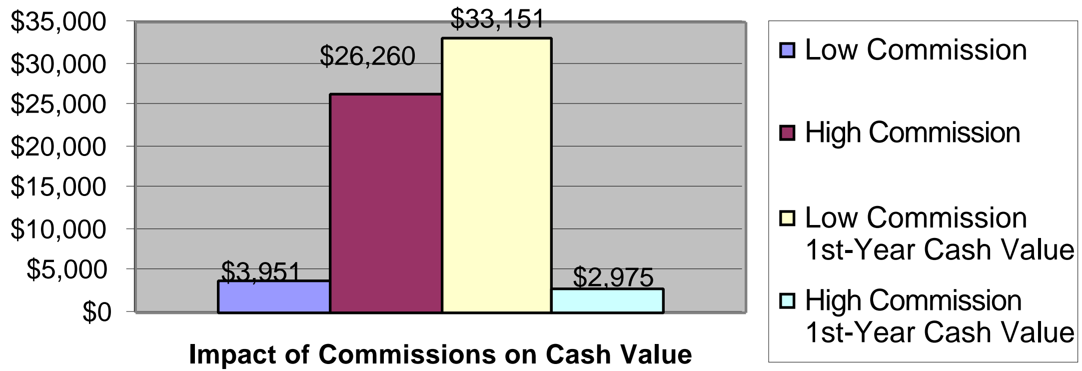
Barkhausen graduated with high honors from Princeton University in 1972 and in the first class of the Southern Illinois University School of Law in 1976. He and his wife, Sue, live with their sons, Wicks and Billy, in Lake Bluff, Illinois.

Impact of Commissions and Mortality Charges on Insurance Policy Rates of Return
$1 Million Policy for 56-Year-Old Male with $36,685 Annual Premium








Comparison of Commissions and Cash Values
for Low vs. High Commission Policies
$35,000
$30,000
$25,000
$20,000
$15,000
$10,000
$5,000
$0
$3,951
$26,260
$33,151
$2,975
Impact of Commissions on Cash Value
Low Commission
High Commission
Low Commission 1st-Year Cash Value
High Commission 1st-Year Cash Value