# Is No-Commission Life Insurance a Good Deal?

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For the fee-only advisor, commissions are poison. Fee-only advisors believe that commissions compromise anyone selling products that pay commissions. In many cases, this can be true. The belief is that commissions will add additional charges to a product and pay excessive compensation to the salesperson. But don't come to any conclusions just yet, or your clients may end up with the short end of the stick for the wrong reasons.

Let's take a closer look at how life insurance is priced. First, commissions are only a part of the first-year marketing costs. Some of those carrier expenses can reach 150% or more of the first-year premium. Even if an agent reduces his or her commissions, those up-front charges will be quite high. Why? Carriers pay agents, their sales organizations, outside marketing firms, and underwriting charges. Just the underwriting charges can run quite high, since a carrier must cover entire departments, the cost of exams, medical files, their own internal doctors who review the medical evidence, underwriters who assess the overall risks, and actuaries who structure pricing models. It is a common understanding that life insurance companies cannot make any profit until a policy is in force for 5-7 years. To say this a different way, the commission expense is not as much of a factor as one might think. However, we can't deny that a six-figure commission on a large policy is jaw dropping.

A good alternative to consider has been no-commission life insurance. With the departure of TIAA-CREF from the marketplace, let me list the carriers offering solidly better products: … (*do I hear crickets*?) …. That's right, there are none with anything especially competitive. One carrier, not a leader in the life insurance space, recently made an attempt to design a no commission product. We are aware of one other larger major carrier working on this right now, and we hope to give you the news when they complete their work. But until then, the elimination of commissions does less to help your client than you would expect, except make them think they have come out ahead. You can say that a particular mediocre product has no commissions, but it remains a mediocre product.

The next alternative is a "low load" product. Many products can be designed with term riders or other riders that result in lower commissions. Most of the corporately-owned life insurance products ("COLI") work this way. In exchange for a deferred or reduced commission, the product can be built with higher early cash values and reduced or eliminated surrender charges. There's a catch here. The fact is that the carrier is paying the agent over a longer period of time and amortizing the same up-front costs differently, but the agent is still getting paid. Often, what

looks like a better deal in the early years becomes a worse deal in the long term.

Let me give you a real-life example. We designed a policy for a public company several years ago with the purpose of creating a strong cash flow during the insured's retirement years. We used a non-COLI product. When their CFO looked at the first-year cash value, he demanded that we use a COLI product with an amortized schedule of policy charges. For him, the first-year surrender value was of primary importance (not the original objective we were addressing). When we built the COLI product with the same premiums as the non-COLI product, we were able to deliver a much higher first year cash value. That made the CFO happy. But when the illustration projected the cash flow to be delivered during retirement, it was less! That appears to be the case with the most recent no commission product as well, the one mentioned earlier in this article.

There's a lesson here. The client's objectives should drive what they buy. If cash value in year one must be the highest possible without regard to future performance, one design might win. However, if future cash flow and ultimate growth of the cash value is the objective, then another product should be used. Oh, wait. What about commissions? They become irrelevant, once you are comparing what fits the client's needs in the best possible way.

Sure, commissions can be a factor, but once you are delivering a client the best deal **for them**, the commission should not be a game-changer. Would you want a client to buy a lesser-value policy just because it had a lower commission? That's the point here. Advisors can be blinded by their aversion to commissions. Don't be "that guy".

## ***The determining factor remains: what product addresses your client's objectives in the best possible way?***

So, let's assume you have gotten over the fact that someone could possibly be paid more than you think is fair. The place where you can have a very positive influence is in how you direct the agent to design the policy. Whenever the agent can improve performance by reducing compensation in a meaningful way, they should be doing this. We do this at AdvisorServe. Many of the policies we design begin with a 50% reduction in the commissions in the first pricing estimate. We then look at other arrangements, but there is also a point where commission reductions have a diminishing impact on the policy performance. For the fee-only advisor, whenever you are asked to review an insurance proposal, make sure you ask the agent if the commission aspect has been "optimized" to that point where the trade-off is fair. In effect, you will have built a low load product.

Of course, term insurance is a different animal, and we know of no term policies that have any wiggle room when it comes to commissions. After all, commissions are already so low that agents have difficulty making a living when they sell only term insurance. There are some term policies on the books of the life insurance companies with no commissions, but they are not really sold. They are used by the carriers to establish term rates for the inner mechanics of split dollar coverage. No one would really buy these products, since they can be non-convertible and non-renewable!

Let me offer one more example of the illusion of no-commission insurance. There is a no-commission disability policy available today offered by a major carrier. First, there are clear indicators that the carrier is paying the distributor a fee for the sale of their products,

even if the fee-only advisors are not getting paid. More importantly, what is the client receiving? The same product they could have received from an agent selling that carrier's disability coverage with a commission! In our view, this is just pandering to advisors who hate commissions. It is doing nothing to help their clients by delivering any more value than what can already be delivered through common arrangements. One also has to ask, are the marketers of this "no commission" disability even showing other fully-commissionable products that might be less expensive? The same carrier doesn't win every comparison.

While current life insurance products have failed to deliver significant improvements in the no-commission space, the concept is still of interest to the carriers. Their challenge will be to figure out how to offer products that don't undercut their sales force. Several years ago, I was in a meeting at a major carrier where they rolled out their no commission life insurance product. At the end of the presentation, one of the agents asked a simple question: "So if I sell a client a commissionable product, and his accountant reviews my work and tells the client he can obtain the same product for less on a no commission basis, where does that leave me?" Within hours, the project got pulled. The carrier wasn't ready to throw its regular distribution system under the bus.

We believe the solution for the life carriers may be in the replacement of up-front commissions with compensation spread over the life of the contract in an attractive way. Carriers will need to do a better job of building policies that can re-design compensation without disadvantaging the buyer with lower long-term results. That would serve everyone well. Of course, in the end, the agents selling the coverage would still be paid, but their compensation would line up much more closely with the compensation paid to the fee-only advisor who is paid a management fee on assets.

We believe there are changes occurring in the marketplace that will bring better value to your clients. There may be real differences in life insurance products offered by insurance companies in the future, but currently the situation is much like what was happening a decade ago with electric cars. We were not there yet. It would seem that carriers will come up with better values for your clients in the future, and some of the changes may impact agent compensation.

***For now, anyone telling you that they are unique because they offer no-load life products or low-load life products has nothing more to sell than what most other firms can deliver***.

We also suspect that this identification with no load and low load is purely a marketing ploy. What is actually sold by those firms is most often identical to what is sold by any other firm trying to be competitive.

AdvisorServe is here to help good advisors become better advisors. We want to help you bring the best values to your clients, and let the compensation take care of itself. The fact remains that when subjected to good comparisons and due diligence, products designed with excessive compensation can't win. The products that are carefully designed and optimized are the ones that will win. If you fully address client objectives and deliver a well-designed and competitively priced product, you have served your client well. How someone is paid by the carrier will be of little consequence to your client.

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