

December 2, 2004

Hon. Alexander Grannis, Chair
Assembly Insurance Committee
Room 712 – LOB
Albany, NY 12248

Dear Pete:

As you know the New York Insurance Association, Inc. (NYIA) is the statewide trade association of property/casualty insurers. NYIA is comprised of approximately 75 member insurers collectively writing more than \$7 billion in premium on New York risks. Our membership roster consists of stock and mutual companies, both large and small. It includes the largest personal lines writer and the largest commercial lines writer in the United States as well as small cooperative insurers writing in only a few counties in the state.

Although I am unable to attend the public hearing on Monday, December 6th, I wanted to take this opportunity to submit our comments regarding the role of brokers, insurers, regulators and risk managers in the ongoing broker compensation controversy.

In the hearing notice you state that the purpose of the public hearing is to “investigate the oversight of insurance licensees and determine the need for enforcement and legislative remedies in order to restore integrity to insurance markets that have been shaken to their core by the widespread fraud and corrupt practices revealed in ongoing investigations by NYS Attorney General Eliot Spitzer.” At the outset, let me state that there is little evidence to support the contention that insurance markets have been shaken to their core. Quite the contrary. While the industry itself undertakes a rigorous self-examination, the markets continue to function in an orderly fashion. Secondly, the use of the terms “...widespread fraud and corrupt practices....” is hyperbole. The assertions are simply not supported by the facts uncovered to date.

The vast majority of P&C insurers operate with great integrity. This industry has had a longstanding reputation of providing assistance and relief to millions of policyholders following a loss or catastrophe, sometimes during their most desperate time of need. Insurers have repeatedly demonstrated exemplary business practices. These facts are supported by the Insurance Department’s Consumer Services Bureau reports, complaints and statistics. This industry is one of the most highly-regulated to further ensure an honest and trustworthy system. On the issue of the most serious of the Attorney General’s charges let me make it perfectly clear that NYIA espouses the working of a free competitive market. Rigging bids and price collusion

are illegal. Those engaging in that activity should be prosecuted because they have violated a fundamental principle of free markets and in so doing have impugned the integrity and reputation of the vast majority of insurance industry competitors who operate within the law and in an ethical manner.

On the issue of contingent commissions, the matter that was the subject of Mr. Spitzer's original inquiry, I think it important for this committee to distinguish between a variety of contingent commission arrangements. Allow me to explain.

1. A very common form of contingent commission is that paid by an insurance company to its agents based upon certain criteria. These almost always weigh most heavily a factor for the profitability of the insurance agency book of business versus the profitability of the insurer. The reason is fairly obvious. Insurers want to encourage the Agency force to place good business with the company. When placing the business, the agent does not know if a contingent commission might be payable because they are paid at the end of a calendar year after the company has applied its contingent commission formula to its overall operating results. Companies have told me that all contingent commission payments to all agents in the aggregate rarely exceed one percent of premium and are commonly below the figure!

In all of these situations, the contingent commission is paid by the insurance company under a contractual arrangement it has with its agents. It is important to note that the legal contract and compensation arrangement are between insurance company and insurance agency. The customer is not part of that arrangement. On the other hand, the customer has a wide array of agents to select from and is free to do business with any agent captive or independent. They can also buy insurance over the phone, by mail or online. The customer does not pay a fee directly to the agent under a contractual arrangement. Therefore the issue of "how much" the agent is being paid by the insurer is of no concern to the customer. If the agent's price and service is not satisfactory to the customer, the customer will take the business elsewhere. There are plenty of agents to choose from. Incidentally, virtually all personal lines Property & Casualty transactions and the vast majority of small and medium sized commercial insurance transactions are conducted under the generic system I just described. To put it another way, the vast majority of Property Casualty insurance transactions, both personal and commercial line, that are subject to the payment of contingent commission in New York are effected under a system in which the insured pays a premium for insurance and nothing else. Under that system, the payment of contingent commissions is a sound business practice, perfectly ethical and perfectly legal. I urge you to not tinker with that system. It isn't broken.

2. The much smaller piece of the Property and Casualty insurance market, the segment where the Attorney General first questioned the payment of contingent commissions was in the area of large commercial risks. That market operates quite differently from the market I described above. In that market risks, coverages, exclusion, retentions, policy limits etc. are often customized to serve the needs of the insured. These insurances often have a risk manager involved and there is a good deal of work done before the risk can even be "shopped" for placement. In many of these cases a broker contracts with the insured to represent the insured's interest in the formulation of contract terms and premiums. There are two additional factors that

distinguish the large risk commercial market from the personal lines and small risk commercial market. Because of the large size of the risks involved, only larger, well-capitalized insurers are able to compete for the risks. Secondly, because of the specialization involved in tailoring coverages, only a relatively few brokerages are able to represent insureds. For example it has been reported that Marsh & McLennan alone had thirty-five percent of the broker market. That concentration of a market among a comparatively few competitors is another significant difference between the two markets. Most insurers have now eliminated contingent broker fees, insurers and producers are now re-examining their business practices, and as I noted before the markets from an insured's perspective have not been affected..

In closing I would urge you and your colleagues to move forward judiciously. Keep in mind the difference between broker markets and agent markets, the latter constituting the vast majority of all insurance transactions in New York. We await the results of the Attorney General's full investigation and recommend no legislative action until it is complete. My major concern is that a knee-jerk public policy reaction to these allegations could actually cause a major market disruption affecting insureds; a disruption that has not occurred to date. The Property Casualty industry is currently taking care of the problem itself by eliminating contingent commission contracts for brokers and in some cases returning commission payments. If after all the facts are in, you determine that legislative action is necessary, NYIA will be happy to work with you in drafting statutory changes.

Thank you for the opportunity to comment on these issues. If you have any questions, please feel free to contact me.

Sincerely,

Bernard N. Bourdeau, CAE
President