LEGISLATIVE POSITION

Professional Insurance Agents of New York State Inc.

25 Chamberlain St.
P.O. Box 997
Glenmont, NY
12077-0997
(518) 434-3111

LEGISLATIVE REPRESENTATIVES
Patricia Lynch
Allison Lee

ASSISTANT EXECUTIVE DIRECTOR *for Government/Industry Affairs*
Ellen D. Kiehl, Ph.D.

GOVERNMENT AFFAIRS COUNSEL
Matthew F. Guilbault, Esq.

EXECUTIVE DIRECTOR
Diane Fowler, CAE

STATEMENT RE: Broker Compensation Hearings

TO: New York State Insurance Department

BY: Professional Insurance Agents of New York State Inc.
John W. Bailey, CIC
Past President

ON: July 23, 2008
Chancellor's Hall, State Education Building
89 Washington Ave.
Albany, NY 12234

We are pleased to have the opportunity to offer our testimony to the Department and Attorney General as you explore how best to ensure the marketplace is competitive, transparent and fair to all.

From the outset, let me be perfectly clear. We wholeheartedly agree not only that those who sell insurance deserve to be fairly compensated but that those who buy insurance deserve to be treated fairly. In fact, this statement represents the successful business model of our PIANY members. Moreover, we believe that the existing producer compensation system accomplishes both of these goals. At the conclusion of these hearings we believe you will find no substantiation of widespread abuse of the public interest that would compel the imposition of additional regulations relating to producer compensation and disclosure. Finally, we believe that the Department's goal of fostering the growth of the insurance industry in the State of New York would evoke an approach to rulemaking that remains proportionate to the actual facts of the marketplace.

The New York insurance marketplace remains a highly regulated, yet very competitive market system. The thousands of “Main Street” brokers and agents in every neighborhood throughout the state touch the lives of millions of New York consumers. Moreover, the structure of the insurance distribution system and the sheer number of choices available to the consumer through independent agents, captive agents and direct writers ensure a market that is competitive and fair to all New Yorkers.

- continued -

Within this marketplace, contingent and supplemental commission arrangements represent a legal and time-tested method of compensating producers for the work they do. This has been verified by legal opinions in court after court. We cannot stress strongly enough that these agreements should not be confused with, and are not the same as "placement service agreements," which were negotiated by certain mega-brokers as part of systematic schemes to illegally manipulate the insurance market to the detriment of consumers.

PIANY and its members have, from the outset, condemned the illegal actions of those mega-insurance brokers. It is important to remember that these actions were already illegal and, therefore, the enactment of additional laws or regulations is not necessary. Moreover, additional laws or regulations could not be expected to prevent unlawful actions by those intent on manipulating a market segment and frustrating market competition. As we have said from the start, the deliberate and systematic anti-competitive behaviors of those few brokers represent isolated and unusual cases, perpetrated by mega-brokers who are not representative of the local independent insurance professionals serving the majority of New Yorkers.

In contrast, the public has been and continues to be treated honestly and fairly by Main Street independent agents (and brokers). PIANY members operate in an extremely competitive environment in which customers are well aware of the many alternative sources of coverage available. Competitive forces ensure that clients consistently benefit from their agent's or broker's ongoing efforts to retain their business. Just last week, a new industry study revealed that buyers who purchase their auto insurance policies through local agents give significantly higher average satisfaction scores compared with those who purchase policies from call center representatives or via Internet channels.[1]

This comes as no surprise to PIANY members. Four years after the widely-publicized charges against the mega-brokers began, there remains a lack of public outcry alleging deception or anti-competitive practices against the independent agent. We suggest that the evident lack of customer complaints should be clear enough indication that independent insurance agents are acting honestly and in the best interests of our clients.

Moreover, we strongly believe that existing regulatory oversight and guidance (including Circular Letter 22, governing disclosure of additional compensation) are sufficient and, therefore, no new regulation is necessary.

Competition protects consumers

Insurers operate in a complex market in which many firms compete for business. The various types of producers; distribution systems and compensation structures, including contingent commission compensation, are a natural development of the competitive insurance marketplace that helps to make insurance available and affordable to millions of insurance consumers.[2]

---

[1] J.D. Power and Associates *2008 Insurance New Buyer Study*

[2] In fact, a 2006 study by Cummins and Doherty offers empirical evidence on how contingent commissions can serve to benefit the insurance buyer through improved services and increased competition. Cummins, J. David and Neil A. Doherty, 2006. *The Economics of Insurance Intermediaries, Journal of Risk and Insurance,* 73: 359-396.

The idea that an insurance agent or broker would seek to increase the cost of their customers' insurance is a formula for business failure. The high level of competition inherent in the insurance marketplace provides a reliable "check" against any incentive for producers to act in anything other than the best interests of the consumer. The insurance industry is an intensely competitive business, and this level of competition effectively safeguards consumers.

Moreover, in the current market few, if any, risks exist without competition. As long as an insurance agency has to compete for business, there is no perceived or actual conflict created by having performance-based compensation arrangements. Because of widespread competition and the number of choices available to the consumer, there is no inherent advantage in trying to place business in anything but the most appropriate and competitive market. This results in lower premiums and better coverage for the consumer.

Contingent commission agreements encourage professionalism

Evidence suggests that contingent commission agreements encourage and perpetuate professionalism. They recognize and reward careful underwriting and consistent daily service that supports business retention, industry reputation and, therefore, growth. Moreover, these legal and effective compensation systems are not unusual or even exclusive to the insurance industry. Performance-based compensation arrangements have a long history throughout the free market system. From office supplies to industrial hardware, from home sales to automobiles, sales operations are compensated based on performance. But unlike traditional retail contingent arrangements, insurance industry performance is measured not only by policy count and premium dollars but also by the underwriting success of the accounts written. Because an insurance contract represents a promise of future payment, it is important to incentivize sound underwriting, the key to insurers' financial stability, and ultimately a strong, open and competitive market for consumers.

Companies reward agencies for producing good profitable business because they believe the producers are positioned to have superior knowledge of the risk. We have recently seen, in the mortgage industry, the downside of a compensation system that rewards intermediaries strictly for the consummation of a financial transaction, without regard to the suitability of the contract and the long-term welfare of the parties involved. If a company were to lump all its compensation into the up-front sales commission, it risks failing to provide sufficient disincentives against adverse selection and incomplete underwriting.

Contingent commissions help customers manage risks

Contingent commission structures provide incentives for the producer to assist the consumer in "improving" risk. That is, the producer is encouraged, through these compensation arrangements, to assist the consumer in taking proper loss control steps to mitigate the risk that the consumer faces. Most insurance buyers do not have full-time risk managers. As a result, their agent or broker often is the most likely insurance professional to assist the insurance buyer in taking steps to mitigate the risk.

Contingent compensation arrangements help agencies remain competitive

Contingent compensation agreements have been a feature of independent insurance professionals' business plans for decades. They provide crucial support for our members' ongoing operations. Over the past 20

years or so, insurers have systematically shifted many functions and their attendant costs from their own operations to those of their contracted agents. At this same time, traditional commission levels have decreased. To cite just one important result of this process, local, independent professionals need to maintain the latest computer hardware, software and online connectivity in order to provide essential services to both their clients and their insurers. Contingent commission arrangements represent one way in which insurance companies are able to compensate producers for this extra work. Contingent commissions allow our members to make ongoing investments in their business infrastructure, and to continue to serve their customers effectively as consumer expectations and company technology requirements evolve.

Contingent compensation is legal

Recently decided and filed cases support the legality of contingent commissions. These cases directly support the conclusion that, absent a horizontal conspiracy to restrain trade, contingent commission agreements are lawful and do not violate the antitrust laws.[3]

Disclosure

There is no uncertainty with the insurance-buying public that insurance agents and brokers earn a commission on the sale of insurance. One need look no further than the constant television, print and radio advertisements of direct-market carriers to affirm this statement. The claims that in 15 minutes, consumers could save 15 percent by "cutting out the middle man" make it plainly obvious that independent producers are compensated for their services from the carriers.

Moreover, the voluntary choice of consumers to choose the services of an independent agent over a direct writer is evidence of the fact that they believe the services our members provide are worth any additional cost (although it is not necessarily true that direct sellers, with their high marketing costs, are invariably less expensive). A J.D. Power and Associates *2008 Insurance New Buyer Study* revealed that insurers (and agents) who disappoint buyers during the shopping and sales process run the risk of losing sales from potential new customers and of losing renewals from existing customers.

---

[3] One need only look to the number of recent cases that have consistently held that contingent commission agreements, in the absence of a horizontal conspiracy to restrain competition, are legal and do not violate antitrust laws:

- People of the State of N.Y. v Liberty Mutual Insurance, No. 401726/2006 (N.Y. Sup. Ct. filed July 31, 2006)—since no special relationship was alleged, claims of common-law fraud, including a breach of fiduciary duty to disclose, as well as unjust enrichment based on defendants' use of contingent commissions or such nondisclosure, must fail.
- Hersch v DeWitt Stern Group, Inc., 43 AD3d 644, 645 [2007]—"Contingent commission agreements between brokers and insurers are not illegal, and, in the absence of a special relationship between the parties, defendant[s] had no duty to disclose the existence of the contingent commission agreement."
- Murphy v Kuhn, 90 NY2d 266, 270 [1997]—absent a special relationship, an insurance agent or broker owes no common-law duty to its customer other than to obtain the policy requested within a reasonable period of time, or to inform the customer that it could not do so.
- In re Insurance Brokerage Antitrust Litigation, Civ. Nos. 04-5184, 05-1079 (D. N.J., Aug. 31, 2007),—undisclosed broker and insurer contingent commission agreements are legal as long as the brokers and/or insurers do not conspire with each other to use contingent commissions, or any other business transaction, in a manner, such as bid rigging, to restrict competition.

Moreover, issued NYS Insurance Department Office of General Counsel Opinions comport with this legal principle and address issues where disclosure is clearly warranted:

- Circular Letter 22, Aug. 25, 1998—insurance brokers should disclose all arrangements involving additional compensation (i.e., any compensation to be received in addition to commissions).
- Disclosure of Broker Commission, Aug. 30, 2005, —"neither the Insurance Law nor the regulations promulgated thereunder require an insurance broker to disclose to its clients the commission it earns on the policies it places."

For these reasons, we believe that additional disclosure requirements are unnecessary. More importantly, however, we believe that additional disclosure could be confusing to consumers and if applied only to independent agents would be inherently unfair and discriminatory. To the benefit of the insurance-buying public, we have a market that features multiple channels of distribution. (The cost to the insurer of acquiring business, in some models, involves face-to-face sales, while other models entail high costs of advertising and direct mail.) The creation of regulation that would require only independent agents to disclose our compensation could create a false impression that insurance purchased through this channel involves costs for which there are no comparable costs for other channels.

Moreover, properly structured contingent commissions are not linked to specific policies. Normally, an independent agent (or broker) does not know if any contingent compensation will be paid, or the amount of that payment, until the underwriting year is closed and the profitability of a particular book of business can be evaluated. Qualifications for such payments generally are based upon an entire book of business, so it is impossible to determine precisely the portion of a contingent commission attributable to a particular client or risk.[4]

Agents do disclose

Responding to issues raised by the Attorney General's original complaint, PIANY prepared a Q&A information piece for our members' business customers. It included the question, "*How can insurance buyers find out what insurers are paying their agents or brokers?"* The answer: *"Ask your agent or broker*. It's that simple. Reputable insurance agents and brokers have nothing to hide. Moreover, they want their clients to be well informed about normal practices involving compensation to professional agents and brokers."

Mandatory disclosure applied only to independent agents would be inherently unfair and discriminatory

If, however, a disclosure model is under consideration that would be limited to producer compensation (as opposed to an alternative suggestion communicated by PIANY to Superintendent Dinallo in a July 16, 2008 letter[5]), we would recommend that all agents and brokers be included. The exclusion of all "captive" or "exclusive" agents from disclosure would risk misleading the consumer in several ways.

The truth is that, in many cases, such agents' contracts do not in fact prevent their offering access to a variety of insurance products. For years, these agents have maintained widely known (but not always publicly acknowledged) brokerage arrangements with their friendly local independent agents to accommodate risks that do not fit the mode or appetite of their primary carriers. More recent examples include arrangements that Allstate made for its captive agents, to provide a market for homeowners policies. Moreover, some captive property-casualty agents may also be licensed as brokers; and of course

---

[4] Insurance Information Institute, 2004. *Background on Insurance Intermediaries,* (III: New York, N.Y.), November 2004.

[5] PIANY letter to Superintendent Dinallo, dated July 16, 2008, wherein PIANY suggested an alternative model expecting licensees to disclose not only certain comparable costs that exist across various distribution channels, but also the type of access that can be provided by the particular access point that the consumer is dealing with.

they also can access the state's residual markets. Even on the "life side," many life insurance agents now avail themselves of the more recently created "life broker" license so they can provide a wider variety of markets.

In short, we believe that if you proceed on the assumption of finding a totally exclusive placement model outside of the true direct-to-consumer carriers, you will not easily find a "bright line" that separates our members' business model from those of most so-called captive or exclusive agents.

Finally, these points aside, we believe that requiring disclosure only by independents will convey that some special sanctions, perhaps hinting at a need for extra consumer vigilance, apply to certain agents and brokers, but not others. For these reasons, the effect of confining any proposed requirement only to independent agents would arguably be to place them at a significant competitive disadvantage.

Disclosure may hint at rebating possibilities

Also, putting forth a figure that represents producer compensation exposes the producer to the expectation that this figure is negotiable. However, currently, neither the producer nor the client may engage in any conversation about the possibility of rebating. So, confining disclosure to one type of producer and exempting others would introduce a potential source of friction, and exposure to impermissible conversations, between customers and their insurance producers which would be absent for the "exclusive agent."

Conclusion: consumers need practical, easy to understand information

We believe incentive-based compensation benefits insurers and their customers by rewarding responsible market behavior. However, contingent commissions are calculated some period after business is placed and loss experience is observed. This makes prospective specific-dollar disclosure impossible. Moreover, the argument for commission disclosure does not take into account premium changes that occur during the policy period due to endorsements and audits.

All of this has the potential to create uncertainty to the consumer about the real cost of insurance. Moreover, inundating the consumer with speculative and confusing information has the very real possibility of distracting them from the aspects of the policy that should form the basis of their decision.

Finally, from a practical perspective, we must constantly remind ourselves that four years ago it wasn't the contingent income that was the problem, it was the illegal bid rigging. From the viewpoint of law-abiding agents and brokers, just because some brokers were caught being greedy does not mean that "us law-abiding professionals" should pay the penalty.

To them, it's as if a doctor, who got caught devising an elaborate scheme to cheat Medicare, then called for a level playing field by saying no doctor should receive Medicare payments.

7/08