**Statement of**

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**Past Chairman, The Council of Insurance Agents + Brokers**

Chairman Fitzgerald, Ranking Member Akaka and members of the Subcommittee, I'm Skip Counselman. I'm President and CEO of Riggs, Counselman, Michaels and Downes in Baltimore, MD, Maryland's largest independent insurance agency and brokerage. I'm also past Chairman of The Council of Insurance Agents & Brokers ("The Council"). Thank you for giving me the opportunity to testify before the Subcommittee today.

The Council represents the nation's largest, most productive and most profitable commercial property and casualty insurance agencies and brokerage firms. Council members specialize in a wide range of insurance products and risk management services for business, industry, government and the public. Operating both nationally and internationally, Council members conduct business in more than 3,000 locations, employ more than 120,000 people, and annually place more than 80 percent of all U.S. commercial insurance products and services protecting business, industry, government and the public at-large, and they administer billions of dollars in employee benefits. Since 1913, The Council has worked in the best interests of its members, securing innovative solutions and creating new market opportunities at home and abroad.

Riggs, Counselman, Michaels and Downes (RCM&D) is the largest independent agency/brokerage firm in Maryland, with more than 250 employees. We are headquartered in Baltimore, with offices in Washington and Richmond. Based on information reported by Business Insurance in its annual survey of firms, RCM&D is the 75th largest insurance/risk management agency in the United States. Our clients range from large, multi-state employers in the Fortune 1000, to large and small hospitals, to mid-size and small businesses and individuals. We provide risk management, including risk control and claim management programs, commercial and personal insurance, self-

insurance and employee benefit programs. We represent most of the largest and best known insurers operating in the United States and many that are based overseas. We have been in business since 1885 and continue to be privately owned by individuals active in the operation of the business. Through our involvement in organizations such as Assurex Global and the Worldwide Brokerage Network, we service clients domestically and around the globe.

## Introduction

Insurance brokerage is a highly competitive business that is built on and relies on trust – trust between broker and client; trust between broker and carrier; and ultimately – through those two relationships – trust between carrier and client. The ultimate trust between carrier and client is essential because the insurance business is one of promises, including the promise of the client to detail the nature and extent of its risk exposures and the promise of the carrier to cover those exposures in case of trouble, accident or tragedy.

At the outset, I must make clear that, like you, we are deeply troubled by the serious charges of bid rigging and fraud brought by New York Attorney General Eliot Spitzer. Such activity is not only wrong but illegal, and it has no place in an industry that is based on trust. No one is more concerned about this activity than our brokerage community as we pride ourselves on earning the trust of our customers everyday. We intend to keep it. If these allegations are true, the wrongdoers should be prosecuted to the fullest extent of the law. These individuals have not only severely damaged their own brokerage firm, but they also have cast an undeserved pall over an entire industry, besmirched the reputations of honest brokers throughout the country and undermined the trust on which our industry is built.

While isolated bad actors created a corrupt scheme to limit real choices for some customers, the role of contingent commissions in this evil equation has been irresponsibly hyped and misrepresented. Contingent commission payments were not central to the alleged fraud, despite the connections that some have claimed. Contingent commissions are legal and proper methods of compensation that have been used throughout the

industry for decades. Although they are not a significant source of income in most firms, they are, nonetheless, well understood and widely accepted by the sophisticated commercial marketplace. It is the lack of effective disclosure in some cases, combined with the intent to defraud (in isolated cases), that is at issue here, not a systematic industry-wide failure to disclose fees or a failure of the entire business model, as some have suggested.

Even so, we realize that there is increased concern and confusion in the marketplace, and we support clear disclosure of this income. A basic tenet of any competitive marketplace is access to good information to enable informed decision-making; transparency therefore enables better decision-making. We also believe that any conflict or appearance of conflict is avoided if there is transparency in the compensation arrangements which enables each client to decide what is in its own best interests. The Council has had a toughly worded policy in place since October 1998 recommending precisely such disclosure.

To the extent that you are seeking guidance on potential public policy responses, we offer some observations. First, it is most important that the solution to these isolated examples of fraud and this chance to improve disclosure be developed in the legislative and regulatory cycle, not the news cycle. Contrary to recent news stories, isolated examples of abuse should not be equated with an industry-wide system of "secret payoffs and conflicts of interest." While such baseless and over-heated charges create good headlines and produce new class actions for trial lawyers, they do not represent grounds for a stampede to judgment on a wrong-headed solution that will cost more to consumers than it saves. Solutions should be based on facts and deliberation, not headlines and court settlements.

Second, we do not believe that the fraud Attorney General Spitzer uncovered resulted from a failure of the state-based insurance regulatory system. The toughest of regulations or laws will not stop an individual intent on malfeasance. There have always been bad actors in all industries – not just insurance – and there always will be. That

said, we also believe that regulatory reform is essential for the industry's long-term viability because of the inherent inefficiency and confusion stemming from the vast array of overlapping and sometimes conflicting regulatory requirements imposed from state to state.

In recent years, there has been a focus on the potential creation of an optional federal charter for insurance companies. The Council has been a strong advocate of such legislation for a number of years, but realistically, we understand that it could take several years for optional federal charter legislation to be enacted. It is a major undertaking with a great number of issues to be resolved. Political reality dictates that it will not be an easy process, nor will it be quick.

Between now and then, however, insurance regulation is in desperate need of reform. In order to better serve our policyholders and clients, we need practical solutions to real marketplace problems. To that end, The Council has been an early and ardent supporter of the proposed "State Modernization and Regulatory Transparency Act" (the "SMART Act") discussion draft that Congressmen Mike Oxley (R-OH), the chair of the House Financial Services Committee, and Richard Baker (R-LA), the chair of that panel's Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, have been working toward for the last two years. The SMART Act is intended to help create a more uniform and harmonious insurance regulatory system. It includes specific provisions that would require the states to develop and implement a uniform consumer disclosure regime that would include transparency of contingent commission arrangements. I have attached for the record a copy of testimony I presented on behalf of the Council to the Senate Banking Committee at a hearing in September on insurance regulatory reform.

The balance of my testimony today will focus on the role of the insurance broker, the manner in which the broker is compensated for fulfilling that role, and the benefits of contingency arrangements to carriers, to producers and, most importantly, to clients.

### 1. The Role of the Broker

The importance of insurance in American life and its value to the American economy is unquestioned and has been recognized since the earliest days of our nation. The Supreme Court, for example, has, on several occasions, recognized the central role of insurance to the well-being of individuals and industry alike. "Perhaps no modern commercial enterprise directly affects so many persons in all walks of life as does the insurance business. Insurance touches the home, the family, and the occupation or the business of almost every person in the United States."[1] Indeed, insurance "is practically a necessity to business activity and enterprise."[2] But insurance also serves a broad public interest far beyond its role in business affairs and its protection of a large part of the country's wealth. It is the essential means by which the "disaster to an individual is shared by many, the disaster to a community shared by other communities; great catastrophes are thereby lessened, and, it may be, repaired."[3]

Within this great enterprise, a broker has two primary responsibilities – to help sophisticated commercial clients minimize and manage their risk and to help such clients design, find and implement comprehensive insurance programs that meet their needs and adequately insure the remaining exposures. The risk management part of the process is essential both to limit the potential risk exposure of the client and to contain the client's cost of insuring its outstanding exposures. The insurance component may encompass, for example, assisting the client with the negotiation of traditional insurance contracts with state licensed carriers; accessing alternative insurance markets to insure more specialized risks; identifying specialized insurance programs or risk pools in which the client can participate; and/or assisting the client with the development of a self-insurance program through the use of one or more self-insurance tools.

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[1] *United States v. South-Eastern Underwriters Ass'n*, 322 U.S. 533, 540 (1944).

[2] *German Alliance Ins. Co. v. Lewis*, 233 U.S. 389, 415 (1914).

[3] *Id.* at 413.

As a technical matter, almost all Council members will sometimes act as an "agent" and at other times act as a "broker" when assisting a commercial client with insuring its risk exposures through an insurance contract with a traditional carrier. As a practical matter, however, regardless of the legal role in which they are acting, the manner in which they approach all such placements for their commercial clients is as an intermediary – working on behalf of their clients to facilitate the consummation of insurance contracts with carriers that have the ability and the capacity to properly insure their risks.

To achieve that end, the agent or broker – or "producer" as both agents and brokers now are jointly defined under the licensure laws of almost every state – cannot simply do an internet search of all of the available off-the-shelf insurance policies and their costs because commercial insurance products are not commodities. They are customized risk-transfer tools, the price and terms of which almost always must be negotiated on a case-by-case basis. Commercial clients rely on their insurance producer to fully understand and appreciate their insurance coverage needs and to work with the carriers that the producer believes are best situated to address those needs.

To give you one example of this, one of my firm's specialized areas of expertise is in the health care sector. A typical hospital requires 142 separate layers of coverage to fully insure its risk exposures. We usually must work with a number of carriers to assemble a complete coverage package for these clients. Some of our other clients may present a more homogenous range of risk exposures, but their risk level may be too high for any one company to bear all of the exposure for any one type of risk. For the World Trade Center, for example, a number of carriers collectively participated in insuring the building, and all of those carriers ultimately contributed to the millions of dollars in payments necessitated by the terrorist attacks of September 11, 2001.

The key questions are – how do we identify the best carrier(s) for any given client? and how do we obtain the "best value" for our client from that carrier or those carriers? Over the course of the last several weeks, some have suggested that the

broker's job is to canvass every available product from each and every carrier to identify the "best" carrier for that particular client and to then zealously represent the client in an adversarial negotiation process against that carrier. The claim is that only through this adversarial process will the client receive the broadest coverage at the cheapest possible price from the "best" carrier.

In the real world, however, it is neither practical nor desirable to evaluate each and every carrier for each and every client. There are literally thousands of insurance carriers, from large national carriers that offer a broad range of insurance coverages to small regional carriers that may specialize in a single product line. At one level, all these carriers offer the same promise – to compensate the insured for a loss. But to make that promise meaningful, the carrier must have the ability to properly understand and evaluate the risk presented and – this is critical – the capacity and financial solvency required to pay any claims that may result from that risk, as well as a reputation that suggests a willingness to make good on that promise.

It is not as if you can simply scan a list of product offerings to determine which carrier offers the most tailored product at the best price. For most clients, coverage terms must be solicited from and negotiated with the carriers on a case-by-case basis, and that simply cannot be done with every carrier in the marketplace that has the capacity to insure a given exposure. And clients do not expect that. They instead expect – indeed demand – that their broker have expertise with the risk profile presented by their business and the savvy to go to the right place for the right coverage for that risk profile. Clients rely on their brokers to know a universe of carriers that are well-situated to address their needs and to negotiate with a handful of those companies to obtain the best overall insurance value for them. As is true in so many facets of life, the best broker for a given client often is the broker that knows that client – or that type of client – best.

The best way for a producer to evaluate a carrier's ability to insure a risk and its capacity to pay claims is by working with that carrier over time. Conversely, a carrier will be in a much better position to understand and evaluate the risk presented if it

understands and trusts the producer presenting the risk to be insured. Quality of business is important to all insurers for a number of reasons including profitability, regulatory compliance, and, indeed, their financial survival. Insurance companies need to make sure the risks they cover are insurable – and spread these risks appropriately – so they are not susceptible to catastrophic losses. As one of the principle insurance distribution channels, brokers help carriers spread the risks in their portfolios according to industry, geography, volume, line of insurance and other factors, and help minimize risks through risk management. As noted previously, brokers provide risk management services to help their clients improve their risk profiles and reduce the likelihood that an insurance event will occur. Brokers also provide claims management, advising policyholders as to how, when and where to file claims. Risk management helps reduce the probability that a policyholder will file an avoidable claim, and claims management helps to ensure that policyholders receive the appropriate payments for any losses that result in a claim.

Thus, the development of a relationship between broker and carrier is essential to enable brokers to provide the best possible products and services to their clients. A strong relationship with the carrier gives the broker clout that can be to the customer's benefit for lower premiums, better coverages, specialized coverages and quicker service and claims payment. This is why the characterization of the client-carrier relationship as adversarial is misguided; at the end of the day, the carrier partners with the client – through the broker-intermediary – not as opponents but in a cooperative way to insure the risks that client presents.

### 2. Compensation Arrangements and Their Benefits

There are three primary compensation mechanisms to compensate all producers for their services: a fee basis, under which the client directly pays for the services provided; a commission basis, under which the producer is paid a percentage of the premium for the placement services that have been provided based upon the producer's agreement with the carrier; and a contingency basis, under which the carrier provides compensation to the producer, generally at the end of the fiscal year, based on various

compensation formulas that look to the aggregate book of business the broker has placed with that carrier, **not** on any specific transaction or client.

At one level, all of the compensation paid to a broker is funded by the client either through direct payments or through the client's premium payments. The only type of broker compensation paid by the client directly, however, is fees. But the vast majority of clients do not pay fees, and the vast majority of broker compensation – in excess of 90 to 95 percent for most agencies/brokerage firms – is paid by the carriers under agreements between the carriers and the brokers. Forty states require a broker to make an affirmative disclosure to a client if the client is paying the producer a fee and that producer also is receiving compensation from a carrier. The majority of those states require that disclosure to be in writing and agreed to by the client.

Contingency arrangements have been a feature of the compensation landscape for decades, and they generally have been well understood and accepted by the sophisticated commercial client base. They replace a portion of the up-front commissions previously paid to producers, and, on average, contribute approximately 4-5 percent of a brokerage firm's revenue. In my firm, this represents less than one percent of premium volume, which approximates the norm across the industry.

Payments to producers under most contingency compensation arrangements are dependent upon a variety of factors that generally cannot be evaluated at the time any one piece of business is placed, such as overall volume of business with the carrier and the profitability of the business placed with the carrier. These arrangements are based on the overall relationship between a broker and a carrier and on specific services the broker provides to the carrier. Those services include efforts to provide detailed information to assist in underwriting and smooth submissions; work to help research and develop new insurance and risk management products; collection of risk-specific or general information for the insurer to assist in marketplace competitiveness; feedback on quality, service and cooperation in the underwriting and client-service processes; technical services related to claims, risk control, engineering and actuarial skills; assistance in

policy documentation; and analysis of the business submitted to the insurer for underwriting consideration.

Contingency arrangements became controversial in the late 1990s when a new type of compensation arrangement, called a "Placement Service Agreement" ("PSA") (later renamed "Market Service Agreements"), emerged that was not well understood by commercial insureds. Indeed, those commercial clients responded through their trade association – the Risk and Insurance Management Society ("RIMS") – by petitioning the New York Superintendent of Insurance to review the use of such arrangements. That review resulted in the issuance of New York Insurance Department Circular Letter Number 22 in August of 1998. In that letter, the New York Superintendent found nothing illegal or impermissible about contingency compensation agreements but found that the use of PSAs and other contingency arrangements should be disclosed.

At the same time, The Council also undertook its own review. In October 1998, The Council's Board of Directors issued a policy position recommending that all intermediaries provide their clients with notice of the types of compensation arrangements they have in place to give the clients the opportunity to fully evaluate those arrangements and how they affect their interests. This policy position was predicated in part on the recognition that contingency arrangements were put into place for specific purposes. They are to hold a producer accountable to some extent for representations of the risks they place with a carrier (the "preunderwriting" service); for the brokers' success in assisting with the risk management efforts of such clients; and to compensate the producer for the costs they bear in the placement process and the cost-savings they generate for the carrier when the producer and carrier have a more extensive relationship. In other words, contingency arrangements can play a valuable role in helping to facilitate a cooperative risk management/insurance environment from which all participants – client, carrier, producer – benefit.

**Conclusion**

In conclusion, let me repeat this in the strongest possible terms. The Council and its members are deeply troubled by the evidence of egregious conduct uncovered by Attorney General Spitzer. We embrace this process of review and pledge to do everything in our power to make sure that these bad actors are prosecuted to the fullest extent of the law and that this pattern of behavior is never repeated.

In addition, we sincerely believe that contingent commission arrangements – when properly constructed, disclosed and utilized – fulfill a need in the industry and help foster a cooperative insurance environment that works to the benefit of all participants – the commercial client, the carriers and the producers. Having said that, we appreciate the increased level of concern in the marketplace and, as our 1998 policy statement indicates, we strongly support improved disclosure and heightened transparency in these arrangements in order to remove any potential specter of conflict.

As I said at the outset, this industry is based on, and committed to, trust – trust between broker and client; broker and carrier; and, ultimately, carrier and client. We stand ready to work with the appropriate committees of jurisdiction in the Congress and the states to find solutions to the issues raised at this hearing to ensure that this trust is maintained and that the important work of the insurance industry – protecting people and the economy – continues.

Thank you.

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