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N.Y. Attorney General Spitzer Targets Insurance Broker Compensation Agreements

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Marsh & McLennan, Willis Group and Aon Corporation have confirmed that they have received subpoenas from New York Attorney General Eliot Spitzer. The subpoenas are seeking information as part of a preliminary inquiry into compensation agreements between insurance brokers and insurance companies.

In February, the national, non-profit public policy group, Washington Legal Foundation (WLF), wrote the New York and California attorneys general and insurance departments asking them to probe "two potentially damaging practices engaged in by some in the insurance brokerage industry."

The two practices WLF wants targeted are placement service agreements (PSAs) and "leveraging" in the insurance brokerage industry. WLF alleges that these practices present conflicts of interest. The group maintains that PSAs encourage brokers to steer customers to insurers that will profit the broker in contingency fees, but not necessarily benefit the customer.

"This is a troubling trend in the insurance brokerage industry," said WLF Chairman and General Counsel Daniel J. Popeo. "Insurance brokers are paid to advocate for their customers, not themselves."

WLF likened these agreements to abuses recently uncovered in the mutual fund industry by the Securities and Exchange Commission.

The practice of "leveraging" or "tying" refers to brokers coercing insurance companies into using their services to purchase their reinsurance in exchange for future referrals for their primary insurance business.

"These types of leveraging or 'tying' arrangements retard competition and distort the marketplace," Popeo wrote to state officials in February. "Over the past few years, the public has witnessed how selected instances of conflicts of interest have damaged the investment banking, public accounting and mutual funds industries and their customers. WLF is concerned that this leveraging practice, especially when viewed in combination with PSAs, could potentially have the same effect on the insurance industry as well."

The National Consumers League had called for a probe into "leveraging" last summer.

A J.P. Morgan report in January warned that PSAs "can create the appearance of factors other than the best interests of the insured being contemplated." It also said these agreements are likely to be scrutinized in 2004.

Aon noted that such compensation agreements between insurance companies and brokers are a longstanding and common practice within the insurance industry. Aon discloses such arrangements in fee agreements with clients, invoices to clients, and its web site.

Aon said it would fully cooperate with the inquiry.

Popeo said that often clients have not been appropriately informed of PSAs and maintained that even with open disclosure there might still be a conflict of interest.

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