

Advocates for Marketplace Options on Mainstreet (“AMOM”) Policy Statement on Insurance Commission Transparency

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Executive Summary

When purchasing health insurance, many employers and consumers use independent insurance agents, consultants or brokers (“producers”) to assist in soliciting insurance quotes and evaluating policies. Payments to producers from insurers are often hidden from the customer. These payments may materially impact the information and advice given by producers to their consumers. The influence of these payments may cause insurance premiums to be higher and competition between insurers to be lower.

Advocates for Marketplace Options on Mainstreet (“AMOM”) has long been an advocate for transparency in health care costs. AMOM believes that State of Minnesota should take action requiring transparency and disclosure of all payments that producers receive from insurers.¹

About “Producers”

A variety of professionals provide advice to employers and individual consumers on the purchase of health insurance:

- *Benefits consultants and brokers* usually specialize in serving more sophisticated commercial enterprises. Consultants and brokers are usually paid by their client to solicit proposals from insurance companies, but, in some cases, these consultants and brokers may also receive payments from insurance companies which may or may not be disclosed to their client.
- *Captive insurance agents* work for one insurance company, clients understand that they work for that insurance company, and these professionals are usually paid through salary, commissions and/or bonuses.
- Most employers and individuals purchase health insurance by using *independent insurance agents*. Independent insurance agents are different than captive agents in that they do not necessarily have an exclusive relationship with one insurer.

¹ 1/10/06: “Options for Health Care Providers and Employers: A Report Card After 10 Years of Efforts, Advocates for Marketplace Options on Mainstreet.” On page 3 of the Assessment, AMOM recommends the following: *The Legislature should direct the Department of Commerce to require complete transparency to the purchaser (employer and/or consumer) of all broker compensation and incentive arrangements.* Available at www.AMOM.org.

Most businesses and many individual customers use independent agents to purchase health insurance. There are nearly 40,000 independent insurance agencies in the United States and approximately 3.5 million licensed agents and brokers. Clients usually understand that independent agents are compensated by the insurance companies, but specific information about how this compensation is structured – and how it might influence the information and advice they are given – may not be disclosed. Independent agents also usually do not disclose from which insurers they have “appointments”; the client may believe the independent agent will shop for policies from many insurers when, in fact, the independent agent may solicit a proposal from only one insurer.

These various professions are known collectively as “producers”.

Producers serve an important function. Specializing in the insurance business, they can be an expert resource for businesses and individuals needing coverage, while also helping customers navigate the often complex rules and paperwork associated with insurance. Producers also promote competition; because many insurance companies don’t have the volume to employ their own captive agents, independent brokers and agents give them an opportunity to reach potential customers.

Producers Compensation

Consultants and Brokers negotiate direct payment from the client, and may also receive compensation from the insurance company. Independent agents usually receive compensation only from the insurance company. Insurance company payments to producers fall into three categories:

- **Commissions.** A percentage of the insurance premium which is paid by the insurer to the consultant, broker or agent. This is traditional way that insurers pay those who sell their products.
- **Contingent Commissions.** After the policy has been in force, typically for a year, the insurance company makes a calculation of the profitability, loss experience, or other factors. The better this experience is, the more the contingent commission may be. While this type of commission is believed to be relatively uncommon for Minnesota independent agents, contingent commissions have been around for several decades. In a January 2004 report, J.P. Morgan estimated that contingent commissions accounted for more than 5 percent of brokerage revenues and nearly 20 percent of earnings year-to-date for the publicly traded U.S. brokers.
- **Placement Service Agreements (PSAs) or Marketing Service Agreements (MSAs).** These are a relatively new type of compensation that were introduced for the first time in the 1990’s. These payments are typically used to reward independent agents for placing or renewing a volume of business with a particular insurer. These payments are not contingent on policy experience, rather they are

simply additional rewards given to the agent for bringing a volume of business to that insurer.

The Need for Transparency

“Transparency” means that producers disclose to their customers all sources of compensation, direct and indirect. While some progress has been made in recent years towards greater commission transparency, much more progress is needed.

In October 2004, the New York Attorney General filed a civil suit alleging that brokers were illegally steering clients to insurers that paid the highest commissions. Subsequently, certain other state’s Attorney Generals and insurance regulators initiated similar actions. As a result, several of the nation’s largest insurance brokers reached settlement agreements with state officials, including the Marsh brokerage firm with New York, the Aon brokerage firm with New York, Connecticut and Illinois, and the Willis brokerage firm with New York and Minnesota. While these settlements did not admit wrongdoing and no criminal charges were filed, these brokers agreed to restitution to clients and, going forward, transparency of insurer compensation.

While reform has transpired and transparency may now exist at several of the largest brokerage firms, **it does not exist with the independent agents that are most commonly used by smaller businesses and individuals. This lack of transparency may be suppressing health plan competition in Minnesota as well as influencing the advice these producers give to their customers. Also, some “independent” Minnesota agents may actually place virtually all of their business with only one insurance company.**

The damage caused by undisclosed payments to producers could be substantial and falls into three categories. First, there is the damage done to individual employers or consumers. When there is no transparency, employers and consumers have no way to know to what extent the agent they select is independent and neutral, and no way to evaluate whether the advice the agent gives them is in their best interests or the agent’s best interests. Second, the entire market for insurance products may be less competitive as a result of these practices; for example, insurers with substantial existing market share may have the leverage with brokers and agents to effectively keep competitors from entering the market. Finally, there is no potential for competition amongst independent insurance agents based on price; commissions represent a significant percentage of insurance costs, yet consumers have no opportunity to shop based on differences in these costs.

Legal Requirements for Transparency

With the exception of the Willis brokerage firm’s settlement agreement, there are no legal requirements for Minnesota consultants, brokers or agents to disclose to clients or the public any information about their financial arrangements with insurers. According to staff at the Minnesota Department of Commerce, while there is no legal requirement for

transparency, the department employs investigatory staff who could potentially look into allegations that producers were steering business to certain insurance companies.

In fact, most states do not currently require transparency. The only transparency rule that AMOM has identified which applies generally to independent agencies was issued by the New York Department of Insurance in 1998 as Circular Letter No. 22; this rule requires the disclosure in New York of any commission income that is received specific to a client's account.

In late 2004, the National Association of Insurance Commissioners (NAIC) created a Brokers Activities Task Force to focus on issues related to compensation disclosure. Since its establishment, this task force has created a three-prong effort to address issues "...relating to producer compensation disclosure and state inquiries into potential fraud, conflicts of interest and inappropriate activity between insurance producers and insurance companies". The three prongs are as follows:

1. A Compensation Disclosure Amendment to the NAIC's Producer Licensing Model Act.
2. Development of templates for querying insurers and agents about anti-competitive practices, as well as creation of model settlement agreements for correcting such practices and reimbursing policyholders for inflated premiums.
3. Creation of an online fraud reporting system.

Support for Transparency

Transparency is supported by the professions largest and best recognized associations, such as the Council of Insurance Agents & Brokers (CIAB), as well as the Independent Insurance Agents & Brokers of America (IIABA).

Organizations that have considered the ethics of commission disclosure have determined that transparency should be the professional standard. In August 2004, the Risk and Insurance Management Society (RIMS) said brokers and agents should disclose the details of all compensation payments they receive from insurers, even if clients do not request the information. A statement said: "RIMS strongly supports the position that broker compensation and placement agreements should be transparent, with all sources of compensation, direct and indirect, disclosed without client request. This disclosure will ensure that the risk manager understands not only the cost of coverage, but any arrangements with specific insurance companies, or any fees obtained by the broker from markets approached on behalf of the insured." RIMS also stated that brokers are obligated to obtain the best coverage at the best price for clients and disclosure of agreements and relationships with insurers is an important part of the integrity of this relationship.

Conclusions

1. Among the independent agents who generally serve small and medium-sized businesses, current producer practices do not provide customers any information to determine how much of their health care costs are attributable to brokerage services.
2. Current producer practices may increase the costs of health and other types of insurance and may diminish the competitiveness of insurance markets.

Recommendations

1. Require prospective, line item disclosure by all producers to clients of all relevant compensation arrangements with insurers, including disclosing the names of the insurers with which the producer has compensation arrangements.
2. Request information from all insurance companies and licensed producers, using the NAIC templates, to determine the extent of anti-competitive practices now existing.
3. Participate in the NAIC Online Fraud System and publicize its existence to the public and commercial enterprises.

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