

SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
SUBCOMMITTEE ON FINANCIAL MANAGEMENT, THE BUDGET AND
INTERNATIONAL SECURITY

OVERSIGHT HEARING ON INSURANCE BROKERAGE PRACTICES INCLUDING
POTENTIAL CONFLICTS OF INTEREST AND ADEQUACY OF
REGULATORY FRAMEWORK

Good morning, Mr. Chairman and members of the subcommittee. My name is Janice Ochenkowski. I am the Vice-President of External Affairs for the Risk and Insurance Management Society (RIMS), the largest professional organization for the risk management community. I am also the Senior Vice-President, Risk Management, for Jones Lang LaSalle, a multi-national real estate company based in Chicago. I appreciate the opportunity to appear before you today on behalf of RIMS on the issue of broker compensation and placement practices.

RIMS' member companies, which number over 4,000, are commercial insurance consumers and are directly affected by the issue of broker compensation and placement practices. RIMS' membership spans the country and consists of entities of all different industries and sizes, including 84 percent of the Fortune 500 companies, as well as approximately 950 "small businesses," those companies with less than 500 employees. Many member companies have full-time risk management departments to identify and manage risks, including purchasing insurance, while some rely solely upon their insurance brokers for these services.

RIMS has always believed that the relationship between brokers and insurance consumers should be governed by the principle of complete transparency. RIMS emphasized this position initially in 1999 and again in a statement issued in August of this year. In both instances, RIMS has advocated for an open and honest dialogue among all parties in an insurance transaction.

RIMS' August 2004 policy statement on industry compensation and placement practices states the following:

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. Disclosure should include compensation or fees related to the broker's overall book of business, as well as those fees related to specific offices, to individual primary and excess coverage, and to reinsurance placements. Existence of compensation arrangements should be disclosed prior to placement of business and annually by line of coverage. Failure to disclose such arrangements runs counter to the spirit of partnership that risk managers seek to achieve with their brokers, vendors, and insurers.

A copy of the statement is attached as Exhibit A.

RIMS is shocked by recent allegations of illegal activities by certain brokers and insurance companies in the placement of insurance contracts. We have been particularly distressed by the findings and allegations by New York Attorney General Spitzer that insurance brokers have violated their position as a trusted advisor to their clients by steering clients to favored insurance companies and engaging in bid-rigging schemes. Such activities undermine the trust and confidence that are at the heart of the customer/broker relationship. RIMS' President, Nancy Chambers, issued a statement addressing this issue on October 22, 2004, a copy of which is attached as Exhibit B.

Insurance brokers are an integral part of the insurance placement system. Brokers serve as intermediaries between commercial consumers and insurers. Traditionally, insurance brokers represent their customers, while insurance agents represent the insurance companies. Commercial insurance transactions often are very complex, and brokers are essential to finding available insurance coverage to meet their customers' needs. Brokers are also responsible for negotiating premiums and policy coverage terms and conditions on behalf of their customers.

RIMS is not a standard-setting body for the insurance industry. RIMS does, however, place great emphasis on educating its members about current issues and advising members on those issues and providing them with useful tools to use to deal with a particular issue. This is the approach taken by RIMS with respect to contingent fees. Members were provided information that some brokers and insurance companies had entered into contingency fee arrangements, and members were given educational tools to assess their impact on their broker relationships.

As the use of placement service agreements and contingent fee arrangements (hereinafter referred to as placement service agreements) became popular with some brokers and insurance companies in the 1990s, RIMS advised its members of such practices. In 1999, RIMS issued a disclosure statement whereby brokers would disclose insurers with which they had contingency fee agreements upon the client's request. Brokers and insurance companies declared at that time that contingent fees represented only a small part of total fees and, as such, this approach seemed appropriate. RIMS followed up on the 1999 statement through its Quality Improvement Process in 2000. RIMS' Quality Improvement Process (QIP) is a comprehensive program designed to guide and facilitate quality improvement for risk managers. Risk managers use these guidelines to improve communications, develop performance expectation agreements, and evaluate the performance under those agreements. Specifically, the QIP states that the broker should work in conjunction with its client to determine coverage needs, and to negotiate with the market to obtain the best terms and conditions at the most favorable pricing level for the client, regardless of any other compensation. Furthermore, it states that all remuneration for services should be supported and disclosed to the client while complying with local insurance laws. In representing the interests of risk managers, RIMS provides workshops, discussion groups, and other educational programs that

address the most pressing issues of the day. In fact, for the past three years, RIMS has offered sessions at its annual conference that explored the many facets of the client/broker relationship. We believe that by educating our members, they will be fully equipped to make the best decisions when they purchase insurance for the companies they represent.

RIMS believes that all compensation arrangements should be disclosed in writing. As I have said, the relationship between the broker and the commercial consumer must be based on a foundation of trust, truth, and honesty. Complete disclosure of all compensation arrangements will go a long way to promoting transparency, reestablishing the trust between the broker and the customer, and providing customers with sufficient information to evaluate any potential conflicts of interest in the placement of insurance policies.

As the facts are becoming known and the investigation into placement service agreements continues, in an effort to address the potential conflict-of-interest issue, RIMS would support a prohibition on the use of placement service agreements by insurers and brokers. Three of the largest brokers have publicly stated that they will no longer enter into placement service agreements or accept contingent fees. Such action, coupled with compensation disclosure, should bring greater transparency to the broker/client relationship and help to restore trust and confidence in the relationship.

Whatever actions legislators and regulators decide are appropriate to address the issues of placement service agreements and contingency compensation, the interests of insurance consumers must be considered. Consumers should not have to pay higher costs for insurance because of abusive actions that may have been taken by some brokers and some insurers. Hopefully, any remedial action will result in lower costs for insurance for consumers by eliminating improper actions that may have increased costs of insurance.

The recent allegations against several insurance brokers in New York have been very troubling. The notion that brokers deliberately acted unlawfully to gain additional profit at the expense of the insurance consumer is simply unacceptable. These allegations have not only undermined the broker/client relationship, but they also have wider implications for the industry as a whole. Any penalties that may ultimately be levied against the companies involved should be used to offset consumer losses that have resulted from these deceptive practices.

I understand that the National Association of Insurance Commissioners (NAIC) is preparing to address the broker compensation issue. One approach that I understand is on their agenda is adoption of a model law on disclosure of broker compensation arrangements. RIMS believes that a national, uniform approach should be taken to address this issue. Regulatory clarity and uniformity are needed, not 51 different approaches.

Thank you for this opportunity to testify on this important issue. RIMS looks forward to working with your Committee and the Congress to address the issue of insurance broker compensation and placement services. I appreciate your time, interest, and leadership, and I welcome any questions by the Subcommittee.

Exhibits (2)

Exhibit A

Policy Statement on Industry Compensation and Placement Practices

August 24, 2004

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. Disclosure should include compensation or fees related to the broker's overall book of business, as well as those fees related to specific offices, to individual primary and excess coverage, and to reinsurance placements. Existence of compensation arrangements should be disclosed prior to placement of business and annually by line of coverage. Failure to disclose such arrangements runs counter to the spirit of partnership that risk managers seek to achieve with their brokers, vendors, and insurers.

Because of the complex nature of insurance transactions, a special trust relationship built on a foundation of truth and honesty must exist between broker and client. Brokers are obligated to obtain the best coverage at the best price for clients. Disclosure of agreements and relationships with insurers is an important part of the integrity of this relationship. Risk managers should evaluate the impact of contingency fees on their program or marketing process based on that disclosure.

The Society has developed the Quality Improvement Process (QIP) for risk managers, including Guidelines for Performance Expectations, the Broker and Risk Manager Partnership Tool and the Underwriter and Risk Manager Partnership Tool. These tools are available to assist risk managers in working with brokers and other insurance industry providers in a professional manner. RIMS advocates for an open dialogue among all parties on all issues of compensation, as well as all other aspects of the insurance transaction. RIMS believes that broker compensation and insurer selection should be governed by the principles of complete transparency and full disclosure without client request.

Exhibit B

Message from the RIMS President
Industry Compensation and Placement Practices
October 22, 2004

RIMS is shocked by the allegations of illegal activities and their effects on our members. We are distressed by the allegations appearing daily and are disappointed in the individuals who have plead guilty to wrongdoings.

As stated in 1999 and again in our August 2004 statement, RIMS has always advocated for an open and honest dialogue among all parties in an insurance transaction. We support cleanup of any wrongdoing in the industry and hope that these are isolated incidents.

We are carefully watching as this situation unfolds and will keep you, our members, informed via RIMS Alert and other communiqués. We will shortly designate an area on the RIMS Web site for news and information regarding contingency fee issues. Visit www.rims.org to keep informed on this important issue.

A special trust relationship built on a foundation of truth and honesty must exist between broker and client. We look forward to the resolution of these issues and a positive outcome for the industry.



Nancy L. Chambers
RIMS President