IN THE UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

IN RE: INSURANCE BROKERAGE ANTITRUST LITIGATION	)	MDL No. 1663
	)	Civil No. 04-5184 (FSH)
APPLIES TO ALL ACTIONS	)	Hon. Faith S. Hochberg

BRIEF OF *AMICUS CURIAE* INDEPENDENT INSURANCE AGENTS AND BROKERS OF AMERICA, INC. IN PARTIAL OPPOSITION TOTHE PROPOSED CLASS SETTLEMENT WITH ZURICH INSURERS

Motion Date: October 23, 2006

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BRIEF OF *AMICUS CURIAE* INDEPENDENT INSURANCE AGENTS & BROKERS OF AMERICA, INC. IN PARTIAL OPPOSITION TO THE PROPOSED CLASS SETTLEMENT WITH ZURICH INSURERS

The Independent Insurance Agents & Brokers of America, Inc. ("IIABA"), as *amicus curiae,* respectfully submit this brief in opposition to that portion of the proposed class settlement between class plaintiffs and the Zurich Insurers which purports to require independent insurance brokers and agents to deliver to the Zurich Insurers' own insureds a form disclosure describing the Zurich Insurers' practices and policies in compensating their brokers and agents (the "Mandatory

Disclosure Form").[1] This provision is contained in Paragraph 18 of a proposed Order and Stipulated Injunction between the Zurich Insurers and several state Attorneys General. These Attorneys General have moved for this Court to enter the proposed Order and Stipulated Injunction in connection with the Zurich Settlement.

Pursuant to Rule 23(e)(1) of the Federal Rules of Civil Procedure, the Court should strike Paragraph 18 from the proposed Order and Stipulated Injunction, or modify that paragraph to make the Zurich Insurers directly and solely responsible for delivering their Mandatory Disclosure Form to their insureds. The requirement that independent insurance brokers and agents distribute the Zurich Insurers' Mandatory Disclosure Form inhibits the brokers' and agents' ability to communicate with their customers about compensation, thereby decreasing the likelihood that Zurich Insurers' insureds will fully understand the compensation disclosure in the context of the overall cost and coverage of the insurance choices being considered by the customer. Furthermore, it would be more efficient for the Zurich Insurers to comply with their own voluntary disclosure obligation, as they have already agreed to send information regarding their compensation policies and practices directly to their insureds. Regulators and the Court can monitor

[1] For the Court's convenience, this brief employs the same defined terms that appear in Section I of the Stipulation of Settlement filed July 31, 2006 (Docket No. 648-1).

compliance with the written disclosure requirement and punish noncompliance more effectively and efficiently if the Zurich Insurers are the sole parties required to make these disclosures, since the brokers and agents who sell the Zurich Insurers' products around the country are not necessarily subject to this Court's jurisdiction.

I. IIABA Qualifies as *Amicus Curiae* on Issues Concerning Insurance Brokers' and Agents' Disclosures Regarding Compensation

IIABA is the nation's largest and oldest trade association of independent insurance brokers and agents, representing more than 300,000 brokers, agents and their employees. Founded in 1896, its members are businesses that offer consumers all lines of insurance—property, casualty, life and health, employee benefit plans and retirement products in every state and the District of Columbia. IIABA's members range from large to medium-sized brokerage and agency firms, to the many small "Main Street" agencies that may have no more than one or two employees.

IIABA has publicly condemned bid-rigging, market manipulation and other anti-competitive conduct affecting insurance customers, including the alleged conduct underlying the claims against the Zurich Insurers in this action. See, e.g., Ex. 1 hereto (Statement of Alex Soto on Behalf of IIABA, Delivered at a Hearing of the Subcommittee on Financial Management, the Budget, and National Security,

of the Committee of Governmental Affairs, of the United States Senate, November 16, 2004). IIABA has also advocated for transparency to customers regarding insurance company compensation practices. See, e.g., id.

IIABA seeks to assist the Court with respect to a provision contained in a proposed Order and Stipulated Injunction between the Zurich Insurers and several states' Attorneys General, which is being submitted for entry by the Court in connection with the Zurich Settlement. This provision would require independent insurance brokers and agents to provide a written Mandatory Disclosure Form to consumers in connection with offering the Zurich Insurers' products. If this provision is included in the Court's order, it would have a wide-ranging and negative effect upon insurance consumers who are not parties to this Multi-District Litigation, as well as upon independent insurance agents and brokers. This provision threatens to inhibit independent insurance brokers' and agents' ability to comprehensively explain compensation issues to customers seeking to purchase insurance, and would lead to greater confusion among consumers of insurance products.

Given its expertise in issues involving insurance transactions and independent brokers and agents, IIABA is in the best position to present the Court with the reasons to strike or modify the provision in the proposed Order and

Stipulated Injunction requiring brokers and agents to provide each Zurich insured with the Mandatory Disclosure Form.

II. The Need for Transparency and Flexibility in Brokers' and Agents' Communications with Customers

As independent insurance brokers and agents, IIABA's members must invest substantial time identifying consumers' wants and needs, understanding the complex terms of policies available, and assessing the products to offer. Independent brokers and agents provide consumers with choices about the price, service, type and breadth of insurance coverage, as well as information about claims service and the financial strength of carriers whose policies are being considered for purchase. They also must remain available to assist insureds with questions and policy changes as needed. Independent brokers and agents are not beholden to any single insurance carrier, giving them the flexibility to offer insurance products from multiple insurance companies in order to seek coverage that is tailored to each customer's needs or desires from carriers with which the customer is comfortable doing business. Independent agents and brokers also tailor their interactions to the specific needs and requests of their customers in order to deliver complex insurance information comprehensively, in a way that will be meaningful to the consumer. Agents' and brokers' freedom to tailor their communications to the customers' individual circumstances is critical to the

success of the independent agency and brokerage system, and thus to the health of a competitive insurance marketplace that serves the public well.

In the most basic terms, the main difference between independent agents and brokers is that brokers represent the customer and are typically paid a fee by the customer. Agents, in contrast, work under contracts with insurance companies, which compensate agents for the policies they place with the company, usually in the form of a base commission. In addition to this base compensation, some agents may qualify for incentive compensation (also called "contingent compensation") from insurance carriers, if certain sales objectives are met at the conclusion of a fixed period. Such incentive compensation is based upon aggregate sales and the profitability of the insurance business placed by the agent with the insurance company, and is not based upon sales to any one customer.

Incentive compensation is entirely legal in all 50 states and in the District of Columbia. None of the pending investigations into alleged anti-competitive conduct in the insurance industry has suggested that the payment of incentive compensation to agents and brokers is illegal. The Multi-State Agreement does not bar the Zurich Insurers from choosing to continue to make incentive compensation payments to brokers and agents. See Stipulation of Settlement Ex. A (Multi-State Agreement) (Docket No. 648-1). The Three-State Agreement does not impose an immediate bar on such payments either (except in connection with excess casualty

insurance lines from 2006-2008), although it does provide that the Attorneys General of New York, Connecticut and Illinois can seek to bar the Zurich Insurers from making such payments in the future if 65% of the insurance companies in the marketplace (including insurers employing direct or only captive agents) do not pay incentive compensation for a specific line, product or segment of business (including excess casualty lines from 2009 forward). See Stipulation of Settlement, Ex. H (Three-State Agreement) (Docket No. 648-8) ¶ 24.[2]

IIABA supports transparency in insurance transactions. IIABA recognizes that, to achieve transparency, the individual needs of each customer may be most effectively met through customized communications from the agent or broker. Thus, IIABA recommends that its members determine for each customer how best to address information and questions about insurance transactions, including the agent's or broker's compensation. For example, in some circumstances, and with some customers, the agent may choose to explain compensation arrangements by means of a form that the agent creates, which addresses the variety of

[2] IIABA opposes the Three-State Agreement's potential limitations on incentive compensation. If these limitations are put in place, it will harm consumers because it will make it more difficult for smaller-sized agents to remain in business, which will in turn decrease competition and lead to higher prices. This impact would be particularly severe in rural and underserved markets, where these insurance agencies are a primary channel for distribution of insurance to consumers. Ultimately, it is not for Attorneys General to determine whether carriers should be permitted to offer incentive compensation or how it should be disclosed to consumers.

compensation arrangements the agent may have with different carriers. Or, the agent may choose to communicate this information to the customer verbally. The agent may also post information on its website, include it in other materials given to customers describing the services offered, or present it in another way to customers. This flexibility allows agents and brokers to account for the compensation policies of all carriers whose products are being offered, and for the customers' own interests and levels of sophistication. Because customers' interests and concerns differ, a company's canned disclosure form with boilerplate language regarding compensation should not be imposed on agents and brokers. Nor should an agent be required by a company to make these disclosures in writing where the laws of the jurisdiction in which the agent is licensed do not impose such requirements. Agents and brokers should continue to have the latitude to determine the best way to communicate complex information regarding insurance transactions to their customers – including information about compensation arrangements.

III. The Proposed Mandatory Disclosure Form Does Not Promote Transparency, and Threatens to Interfere with the Relationship Between Brokers and Agents and Their Customers

The proposed Zurich Settlement threatens to interfere with brokers' and agents' abilities to determine how best to communicate with their customers. The Zurich Insurers have entered into a proposed Order and Stipulated Injunction with

Attorneys General from a number of states, as part of the Multi-State Agreement. See Stipulation of Settlement Ex. A (Multi-State Agreement) (Docket No. 648-1), at 4. These state Attorneys General have filed a motion to intervene in this proceeding for the purpose of asking the Court to enter the Order and Stipulated Injunction. See Motion to Intervene, filed August 25, 2006 (Docket No. 672). The proposed Order and Stipulated Injunction provides, among other things, that "each of the Zurich Insurers shall require, in connection with the placement or renewal of a Commercial Insurance Policy issued by a Zurich Insurer, that each Broker or Agent has undertaken to provide each Insured with [the Mandatory Disclosure Form]." See Proposed Order and Stipulated Injunction ¶ 18 (attached to the Motion to Intervene) (See Docket No. 672-3 ("Exhibit B")). A true and accurate copy of the Mandatory Disclosure Form is attached as Exhibit 2 hereto.

IIABA respectfully submits that the Court should strike Paragraph 18 of the proposed Order and Stipulated Injunction because of the damaging effect it would have upon the relationships between independent insurance agents and brokers – IIABA members – and their customers. Consumers of insurance products are best served when agents and brokers have flexibility to choose how to disclose information regarding their compensation as well as other aspects of the insurance transaction.

Paragraph 18 of the Order and Stipulated Injunction proposes to regulate and inhibit communication between independent insurance agents and brokers and their customers, none of whom are parties to said stipulation. The effect of Paragraph 18 would be to delegate to insurance agents and brokers the obligation to provide the Zurich Insurers' insureds with the Mandatory Disclosure Form, which describes the Zurich Insurers' own compensation policies. In so doing, the proposed Order and Stipulated Injunction would eliminate entirely the ability that brokers and agents have to customize the manner in which they inform customers about the compensation that they may receive from carriers, including the alternative of providing one disclosure that takes into account the compensation policies of all insurers whose products are being offered.

The requirement that brokers and agents use the Mandatory Disclosure Form can reduce the comprehensiveness with which compensation disclosures are made, and hence reduce transparency. Even though the Mandatory Disclosure Form describes the Zurich Insurers' compensation practices, and uses the Zurich Insurers' language, the proposed Order and Stipulated Injunction makes the brokers and agents responsible for delivering the Mandatory Disclosure Form to customers on the Zurich Insurers' behalf. The Mandatory Disclosure Form effectively precludes the brokers and agents from explaining their potential compensation from the Zurich Insurers in a manner that differs at all from what is

set forth in the form, about which the brokers and agents had no input. If the agent attempts to describe comprehensively the compensation practices of several carriers whose policies are being offered to the customer, the Mandatory Disclosure Form also may create confusion in the event the agent uses different terminology or a different framework than that set forth in the form. If other carriers follow the Zurich Insurers' lead, and also require agents and brokers to deliver to insureds written disclosures about their compensation practices, the multitude of forms will significantly exacerbate consumer confusion. The same problem would arise for consumers purchasing levels of coverage on the same risk from different carriers employing different disclosure forms.[3]

A requirement that brokers and agents provide customers with compensation disclosure forms for companies would reduce, rather than increase, the likelihood of customer comprehension. Customers receiving quotes on insurance products offered by different carriers would become inundated with varying written disclosures, which would be overwhelming and impossible to compare and understand in the context of complex insurance transactions, which would lead some consumers to ignore the disclosures altogether. This entirely frustrates the

[3] The purpose of transparency is to provide full information to insurance customers in connection with the purchase of insurance. None of the measures contemplated in the proposed Order and Stipulated Injunction would increase transparency for consumers who purchase insurance directly from insurance companies or from captive agents.

purpose behind the disclosure, which is transparency to promote greater consumer understanding of the insurance transaction and its costs.

IV. The Order and Stipulated Injunction Should be Modified to Require the Zurich Insurers to Provide the Mandatory Disclosure Form Directly to Their Insureds

Rather than involve independent brokers and agents in the implementation of the Zurich Settlement, the Zurich Insurers should provide their Mandatory Disclosure Form directly to their insureds. Such a direct disclosure process would assure a mechanism for consistency as to how and when its written disclosures are given, and would allow the disclosure to be integrated with the quote or other communication from the insurer relating to new or renewal policies, so that it is presented in context. Certainly, the carrier is in the best position to assure itself and regulators of compliance with the Mandatory Disclosure Form requirements. Consumers, for their part, would benefit because brokers and agents would retain the flexibility to explain comprehensively the nature of the compensation they may receive from insurance companies – just as agents and brokers have flexibility to explain other aspects of the insurance transaction that are necessary to an informed consumer decision, such as policy terms, product types, coverages, services, and the financial strength of the various carriers.

Requiring the Zurich Insurers to make the disclosure directly also eliminates difficult monitoring and enforcement issues. The public interest is not served if the

disclosure requirements in the Zurich Settlement cannot be monitored and enforced effectively. It would be difficult and costly to determine whether the thousands of agents and brokers around the country – none of whom is a party to the Zurich Settlement or the Stipulated Injunction – were complying with the disclosure obligations set forth in the Zurich Settlement. Those who did not comply would not necessarily be subject to this Court's enforcement power. It is far easier and far more effective for the Court, and the settling state Attorneys General, to directly monitor and enforce compliance by the Zurich Insurers.

From a fairness standpoint, the Zurich Insurers are the party best charged with carrying out their own voluntary disclosure obligation. Shifting this obligation to brokers and agents would burden thousands of brokers and agents around the country as they undertake to comply with the Zurich Insurers' obligation. Retaining records to prove compliance would distract agents and brokers and further bog them down in paperwork. The Zurich Insurers are in the best position to comply with their own disclosure commitment and to maintain records sufficient to prove compliance.

There is no reason the Zurich Insurers could not make these written disclosures directly to their insureds. Indeed, under the Three-State Agreement with the Attorneys General of the States of New York, Connecticut and Illinois, the Zurich Insurers agreed to send written disclosures directly to each of its insureds,

informing them of a website established to provide information regarding compensation and a toll-free number established to answer questions regarding compensation. See Stipulation of Settlement, Ex. H (Three-State Agreement) (Docket No. 648-8) ¶ 17. The Zurich Insurers could easily provide their insureds a copy of the Mandatory Disclosure Form as well.

V. Requiring Brokers and Agents to Provide an Alternate Disclosure Form is an Inadequate Solution

As shown above, the requirement that brokers and agents distribute the Zurich-mandated disclosure form to customers would ultimately thwart transparency and be a disservice to consumers of insurance products. It is not the substance of the Mandatory Disclosure Form that creates these problems, it is the requirement that the form be delivered to Zurich Insurers' insureds by independent insurance brokers and agents. Accordingly, substituting an alternate form disclosure in place of the Mandatory Disclosure Form would not redress the issues described above.

CONCLUSION

For these reasons, IIABA, as *amicus curiae*, respectfully requests, pursuant to Rule 23(e)(1)(c) of the Federal Rules of Civil Procedure, that the Court modify the proposed Zurich Settlement and proposed Order and Stipulated Injunction, including Paragraph 18 thereof, to make the Zurich Insurers directly responsible for delivering the Mandatory Disclosure Form to their insureds.

Dated: New York, New York
September 22, 2006

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EXHIBIT 1

STATEMENT OF ALEX SOTO
ON BEHALF OF THE
INDEPENDENT INSURANCE AGENTS & BROKERS OF AMERICA

BEFORE THE

SUBCOMMITTEE ON FINANCIAL MANAGEMENT, THE BUDGET, AND INTERNATIONAL SECURITY

COMMITTEE ON GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

November 16, 2004

Good morning Chairman Fitzgerald, Ranking Member Akaka, and Members of the Subcommittee. My name is Alex Soto, and I am pleased to be here today on behalf of the Independent Insurance Agents & Brokers of America (IIABA) and to provide my association's perspective on broker compensation issues that are the focus of this hearing. I am an officer of the IIABA and have served on our national association's Executive Committee for over three years. I am also President of InSource, Inc., a Miami-based independent agency that offers a broad array of insurance products to consumers and commercial clients in South Florida and beyond.

IIABA is the nation's oldest and largest trade association of independent insurance agents and brokers, and we represent a nationwide network of more than 300,000 agents, brokers, and employees. IIABA represents independent insurance agents and brokers who present consumers with a choice of policy options from a variety of different insurance companies. These small, medium, and large businesses offer all lines of insurance – property, casualty, life, health, employee benefit plans, and retirement products.

IIABA's Reaction to the Marsh Investigation

IIABA condemns in the strongest possible terms bid-rigging, marketplace manipulation, and other anti-competitive conduct, and we are outraged by those who have engaged in illegal practices and tarnished the image of our great industry in the process. We applaud the efforts of state insurance regulators, attorneys general, and other law enforcement officials to swiftly identify and bring to justice anyone proven guilty of these unlawful activities. No system of regulation and oversight will ever prevent all determined bad actors from breaking the laws of the land, but we are extremely pleased state officials are acting aggressively and in a coordinated manner to restore the public's trust in the insurance industry. It is our hope that all individuals who have engaged in this conduct will be punished to the fullest extent of the law.

On a personal level, I am saddened and disappointed that such a small group of my peers might lead some observers to question the commitment of our entire industry to its clients. In my own office, like countless others nationwide, we aspire to offer quality insurance products and professional service, and we seek to do so with honesty and integrity. We place great emphasis on operating with respect and fairness in our business relationships. My agency, however, is not unique in this regard. The vast majority of agents, brokers, and insurance professionals operate consistent with these same principles and morals, and these millions of individuals would not consider for an instant engaging in the type of illicit conduct alleged against a broker in New York.

The Insurance Marketplace

The insurance marketplace is highly competitive, and personal and business consumers are well-served as a result. Insurance buyers have an array of options when they buy insurance. Overall, there are approximately 3.5 million licensed insurance producers (agents and brokers) in this country authorized by state regulators to sell, solicit, or negotiate insurance. Consumers can choose to purchase insurance from captive agents (who sell the products of only one insurer), from insurers that sell insurance directly to consumers, or from one of the nearly 40,000 independent agencies in the country that have access to the products of multiple companies.

The independent agency system plays an especially important role in the marketplace. This system is unique from the other distribution channels in that such agencies maintain relationships with multiple insurers and can offer more choice to customers. In fact, on average nationally, they offer policies from eight personal lines and seven commercial lines carriers per agency. Independent insurance agents and brokers invest substantial effort to identify consumers' wants and needs; understand the complex terms of policies available; assess the products available and present choices to the consumer about coverage, price, service, and financial strength of carriers; and remain available to assist with any questions and changes as needed. Independent agents are not locked into one company's policies or products; since they can access multiple companies, they can help consumers locate coverage that is tailored to fit specific needs and desires.

As an independent agent who sells both business and personal insurance, I witness the effects of this intense competition on the ground floor of the marketplace every day. My current customers are approached and solicited regularly by my competitors in the area, and I also do my best to compete effectively against them to grow more business. Such competition keeps agencies responsive and accountable, and helps ensure that consumers are well-served. If an insurance provider ultimately offers a buyer insurance terms that are below par, prices that are inexplicably higher than others, or service that does not create a value proposition for the purchaser, that buyer will move its business to another agent or channel of distribution.

Regulatory oversight and law enforcement help reduce the possibility of bid-rigging and similar criminal misconduct taking place, but vibrant competition in the marketplace also plays an important role. In nearly every aspect of the insurance marketplace and certainly in main street America, the existence of effective competition serves as a check and a balance to deter the type of illegal conduct alleged against a New York broker. In fact, there are only a handful of large multi-national brokers with the economic position and leverage in the marketplace sufficient

enough to even potentially convince insurers to submit fake or excessive bids, and strong enforcement can address those few instances if they arise.

Insurance Producers and Their Compensation

When most Americans seek insurance coverage for their homes, automobiles, or businesses, they are working with an insurance agent, and not with a broker. The distinction between agents and brokers is important. Insurance agents typically do not get paid by the insurance purchaser, and it is commonly understood that the agent receives compensation from the insurer with which the business ultimately is placed. The compensation generally takes the form of a commission, which is disclosed by insurers to state insurance regulators as part of insurers' rate filings. Agents have written contracts with the insurance companies they can place business with and sometimes possess the ability to "bind" coverage for those insurers. These formal contractual relationships are disclosed to state insurance regulators in the form of appointment filings or via the submission to the states of a list of appointed agents. Agents rarely receive compensation directly from consumers, especially in the personal insurance context, and the acceptance of fees by agents is stringently regulated in those jurisdictions where it occurs.

An insurance broker offers advice directly to a client and solely represents that client in the pursuit and purchase of an insurance policy from an insurer. Brokers do this pursuant to buyer-service agreements with their business customers. These insurance experts locate, customize and secure complex insurance packages to address the interests and particular needs of their clients, and almost exclusively interact with professional risk managers and sophisticated commercial enterprises. A broker, because of his or her unique relationship with buyers, is more likely to be compensated directly by the client in the form of a fee. Given the sophistication of buyers who typically utilize a broker, the nature of the fee and the scope of the services provided are the result of negotiation between the buyer and the broker. In some instances, the broker also receives commission from the carrier for placement of a policy.

There are also insurance producers who operate as brokers when the companies they place business for as agents are unable or unwilling to insure an account of a potential purchaser (i.e. there is no market for the risk in the agency); and, again, this typically occurs with commercial purchasers. In such instances, the producer may act as a broker and attempt to locate insurance through a company or other source with which that producer does not have a contractual appointment. The agent's fee may be paid by the insured or, in some instances, by the intermediary or carrier, and the agent does not typically receive what is known as incentive compensation for this type of work.

In addition to the above mentioned compensation that agents and brokers receive, some producers may also qualify for incentive compensation from insurers when certain specified objectives are met. Sales incentive programs are a legal and legitimate tool used in nearly every industry to reward performance, including those that also rely on commission payments. From refrigerators to cars, and homes to business equipment, compensation that rewards a sales force for excellence is sound business practice. There is nothing inherently wrong with such payments that reward performance excellence. Performance excellence is compensated in virtually every industry, sales or otherwise, whether measured by the amount or quality of business produced,

administrative savings generated, speed or quality of customer service, or other criteria. Unlike some other industries, however, the existence and amount of incentive compensation paid to insurance producers is not based upon a particular insured or particular purchase of insurance but is paid based on the overall relationship between a producer and an insurer.

It is important to note that not all incentive compensation agreements are the same. Placement service agreements (which were at the heart of some of the most egregious market manipulation allegations) and contingent commission agreements are entirely different compensation tools. Unfortunately, the two terms have been used in the media as if they are interchangeable. Placement service agreements (PSAs), which are a relatively new phenomenon, are payments to some brokers for the placement of business with specified carriers based on volume, and are not based on year-end calculations that account for profitability, loss experience or other factors. These agreements are negotiated individually by each broker and carrier that have them. In contrast, contingent commissions, which have been used for decades, are based on year-end calculations that typically consider profitability, loss experience, and other factors. These agreements are based on form agreements between agents/brokers and carriers.

Put simply, PSAs compensate brokers up front for the placement of business, whereas contingent commissions are "contingent" on a number of factors and paid on the back end. Contingent commissions can be affected by a range of factors outside the control of the agency or brokerage. Because contingent commissions are not calculated until after the close of the carrier's year, an agent or broker does not even know if he or she will qualify for a contingent commission until after the year closes.

Each party involved in the insurance transaction benefits from the use of contingent commissions. They provide an incentive to agents and brokers to engage in effective underwriting and to assist customers with risk management. These fees also facilitate the appropriate matching of certain risks with risks acceptable to particular insurance companies, which can lead to greater insurance availability. In the end, by bringing efficiency to the overall marketplace, all participants (the consumer, the insurance company, and the producer) benefit.

Some have alleged that the receipt of incentive compensation by *brokers* can create a conflict of interest or the appearance of one because the broker is also paid a fee by the client and because of the broker's unique relationship with the client. Although incentive compensation agreements are legal under the laws of every state, IIABA, as I will discuss below, advocates transparency and the meaningful disclosure by brokers of all such agreements.

In one way or another, any difference in compensation available through any channel of distribution could theoretically be identified by some as creating an unlevel playing field, encouraging the sale of policies generating the highest fee, irrespective of the desirability of those policies to the insured. In fact, an insured may have a choice between a carrier offering reduced coverage at a lower premium and a carrier offering broad coverage at a higher premium. The amount of commission on these different policies could be the same if the commission rates paid by the carriers differ, or they could be different if the commission rates paid by the carriers are the same. Either way, the buyer will obtain the policy that best meets its needs, and the rate or amount of commission will not be a factor in that decision.

We would be remiss if we did not respond to certain, unfounded allegations by some special interest groups that independent agents delay or discourage consumers from filing claims in the hope of receiving contingent compensation based on the aggregate loss ratios of their business. These are irresponsible and unsubstantiated claims. A responsible agent is not going to delay the filing of a claim if his customer's house burns, car is wrecked, or property is damaged.

The reality of the highly competitive insurance marketplace dictates that retaining an insured's business by providing excellent service is far more effective to assuring profitability than attempting to do so by manipulating an incentive fee based on the timing of reporting or filing an individual claim. When an insurance consumer contacts an agent concerning a claim, this is the optimal time for the agent to show a customer that the agent brings value to the insurance transaction. Delaying or discouraging consumers from filing claims is not only reprehensible because it is unethical and improper, it would not make business sense. Such an allegation also fails to recognize that customers may choose to call claims in directly as well, as is encouraged by many carriers.

Disclosure by Brokers

IIABA believes the best way to guard against conflicts of interest or the appearance of such conflicts is through transparency and disclosure. Any insurance producer acting as a broker in a given transaction should clearly disclose to a buyer the incentive compensation arrangements that exist with the insurer providing the coverage. Disclosure of such compensation by brokers is especially important given the unique role that brokers play in the marketplace. IIABA believes that transparency is the best way to ensure that the laws are followed and that the public's confidence is earned and maintained. With proper disclosure of broker compensation practices, and absent widespread illegal and unethical practices such as bid rigging, IIABA believes that incentive compensation should not be further restricted.

Several weeks ago, the National Association of Insurance Commissioners (NAIC) established an executive-level task force to examine broker activities in the wake of the events uncovered in New York by Attorney General Spitzer and Superintendent of Insurance Greg Serio. One of the reported objectives of the new committee is to develop a national standard governing the manner in which brokers disclose the compensation agreements that exist with insurers. Although our association generally prefers marketplace solutions to outright regulatory mandates, we believe this is an area where a national regulatory standard on broker disclosures is warranted. Accordingly, we welcome the regulators' quick action in this area and believe such a model could be an excellent vehicle for restoring faith in our industry.

IIABA believes that any broker disclosure requirement should have certain key elements, including:

- The disclosure requirement should be transaction-specific and apply to any producer acting in a particular transaction as an insurance broker and acting under the terms of a buyer service agreement.

- The proposal should require brokers to disclose all incentive compensation arrangements (PSAs or contingent commissions) that are related to the transaction.

- The disclosure should be made in writing *prior* to the actual purchase of the contract of insurance.

- The disclosure requirement should be implemented by state officials, who have proven experience and expertise with insurance regulation, but it should be implemented without needless deviation or confusion from jurisdiction to jurisdiction.

Although the move toward greater transparency has already begun in earnest, we believe disclosure of broker compensation arrangements would be a significant regulatory improvement. Such action would further promote transparency, ensure that purchasers are knowledgeable of their broker's compensation agreements, and reinforce the trust between brokers and their clients. Proper disclosure also empowers insurance purchasers and enables them to make informed decisions. Most clients understand this form of compensation and its benefits, and those with concerns will have at least two options: (1) work with their broker to better understand the nature of the compensation or (2) select another broker. The insurance industry as a whole is highly competitive, and the private marketplace provides buyers with a myriad of options when they do not approve of the practices of their particular representative.

Insurance Regulation

There will undoubtedly be some who will use the investigations in New York and elsewhere to justify actions and outcomes that have no connection to the alleged illegal conduct uncovered, and such overreactions could have unintended and damaging consequences for consumers and the marketplace. For example, some observers have suggested that the establishment of federal regulation of insurance is the only way to prevent similar events from occurring in the future. As IIABA assesses the impact of this issue on the way insurance is regulated, we come to four major conclusions: (1) state officials have performed their oversight duties capably to date and they should be commended for their actions; (2) a key way to protect against illegal activity is to ensure that competition thrives and that consumers are empowered with the appropriate information and a broad array of provider options; (3) no system of regulation is perfect, and that is why the IIABA continues to support targeted federal legislation within the context of the existing state-based system; and (4) federal regulation of the insurance industry would not have prevented this criminal misconduct and is not a preferable system of oversight.

First, it would be a mistake to suggest that state insurance regulation is to blame for the actions of a small group of lawbreaking individuals. Regulation is meant to deter illegal acts, not preclude them. Individuals and corporations that violate the law are subject to prosecution after the fact, and that is what is occurring here. State officials have acted aggressively to identify and punish those engaged in improper activities, and additional intensive investigations and inquiries continue today across the country. The ongoing investigations at the state level show that the states are on the job and can be successful in ferreting out illegal activities. The alleged illegal conduct that occurred has come to light as a result of the collaborative efforts of state officials,

and we are pleased that state law enforcement authorities have worked closely with and benefited from the insurance expertise of state regulators.

One of the best ways to help prevent the occurrence of similar abuses in the future is to ensure that we have a truly vibrant and competitive marketplace based on transparency and one where consumers have many options. Anything that distorts that market, including overly burdensome regulation or illegal conduct, is not in the interest of consumers. State insurance regulation has many attributes; however, there are aspects of the system that unnecessarily restrict insurer and producer access to the marketplace and thus limit the options and choices available to consumers. State licensing obstacles make it difficult for insurers and producers to offer their services to customers in multiple states, and the adoption of reform in this area would enhance provider options in the marketplace. In addition, state product rules impose barriers that make it difficult to introduce new products and services, and the industry's ability to be responsive to consumer needs suffers as a result.

As we have for over 100 years, IIABA supports state regulation of insurance – for all participants and for all activities in the marketplace. Yet despite this historic and longstanding regulatory support, we feel that the system needs to be modernized to bring it into the 21st century. Despite our continued support for the state system, we are not confident that the states will be able to resolve all of their problems on their own. For the most part, state reforms must be made by statute, and state lawmakers inevitably face practical and political hurdles and collective action challenges in their pursuit of improvements on a national basis. That is why we feel that there is a vital legislative role for Congress to play in helping to reform the state regulatory system; however, such an effort need not replace or duplicate at the federal level what is already in place at the state level. Congress' work in this area need not jeopardize or undermine the knowledge, skills, and experience that state regulators have developed over decades or replace oversight by those closest to the marketplace. The IIABA supports targeted, federal legislation along the lines of the NARAB provisions of the Gramm-Leach-Bliley Act (GLBA) to improve the state-based system.

This is why the IIABA supports the State Modernization and Regulatory Transparency Act (SMART) discussion draft unveiled by House Financial Services Committee Chairman Mike Oxley and Subcommittee Chairman Richard Baker. The SMART draft calls for targeted federal tools with uniform standards to reform the regulatory system under the continued jurisdiction of state regulators – without creating a federal bureaucracy. The SMART bill would improve state-based regulation, which is important to note because it was, after all, an action under state law, not federal law, that brought this issue to light.

Some observers have suggested that federal regulation of insurance is the necessary response and that such a system would have prevented such abuses from occurring in the first place. The IIABA strongly disagrees with that view. Federal regulation is no panacea, and there is no reason to believe federal oversight would have caused a different result. In fact, there are numerous examples of where federal regulators, including those overseeing segments of the financial services world, have failed to adequately protect consumers. Scandals involving investment banks, mutual funds, and the savings-and-loan industry all occurred within industries subject to federal regulation, and, more recently, federal banking regulators have actively

pursued the outright preemption of many state enacted consumer protection laws. This track record does not suggest that centralized federal oversight would do a better job of protecting consumers than state regulators, who possess decades of experience and insurance expertise.

Some insurance industry participants may attempt to argue that the current investigations make the case for an "optional" federal charter. However, the creation of a system utilizing regulatory arbitrage where one regulator competes against the other in a race to the bottom is not the solution to this problem. An optional federal charter would only serve to weaken state regulation by erecting a parallel federal system with little regulatory power.

Conclusion

The IIABA is deeply troubled by the serious allegations of illegal activities such as bid-rigging raised by Attorney General Spitzer in New York. The few bad actors that may have engaged in such practices betray the public's trust and distort what is typically a highly competitive marketplace. These individuals should be prosecuted to the fullest extent of the law. However, there is a major difference between illegal activities, and long-established, legal, state-supervised business practices utilized in virtually every American industry, such as sales incentive programs.

In the insurance context, this incentive compensation benefits the entire marketplace and serves as an important tool that recognizes the value to insurance companies that agents and brokers add from a frontline underwriting perspective, as well as the value to consumers for producers' work on risk reduction. IIABA recognizes the concern expressed by some that the incentive compensation of brokers, although legal in all states, could lead to conflicts of interest or the appearance of such conflicts. IIABA believes the best way to guard against this concern is through the disclosure of all broker incentive compensation arrangements.

The IIABA also believes that state officials have performed their oversight duties capably to date and that the investigations into broker compensation practices do not suggest the inadequacy of the current regulatory framework. However, IIABA acknowledges that no system of regulation is perfect, and as a result, continues to support targeted federal legislation to improve the state-based system.

EXHIBIT 2

Exhibit A

Zurich Agent/Broker Compensation Policy

Most insurance companies providing commercial coverage in the United States distribute their insurance products through the independent agency and brokerage system. Your agent or broker is an independent businessperson or team of people not employed by Zurich or any other insurance company.

Most agents and brokers choose to be compensated for their services through the insurance companies with whom they place the insurance that they sell to their customers.

Base Commission

Zurich will pay your agent or broker a commission. Zurich establishes its base commission on several factors including the type of insurance policy, the size of the insurance policy, and individual policy underwriting considerations. Each insurance policy has a standard commission which is the most that Zurich will pay. The standard commission for the types of policies Zurich is quoting is:

Policy 1 ____%	Policy 3 ___%
Policy 2 ____%	Policy 4 ___%

If you have chosen to compensate your agent or broker directly or you have not consented to your agent or broker taking a commission, you should speak directly to your agent or broker.

Contingent Compensation
[May be deleted if no agreement with broker to pay contingent commissions]

Zurich may also pay contingent compensation to your agent or broker. Zurich does not pay contingent compensation to all of its agents and brokers, and some agents and brokers choose not to accept contingent compensation from insurance companies. Contingent compensation is paid in addition to the base commission. Contingent compensation is not calculated until the end of the year. The amount will be a percentage of premiums based on several factors that determine how profitable your agent's or broker's insurance is for Zurich including [to be modified if factors changed]:

1. The total premium written for all eligible business in a year
   - Zurich pays a percentage of the eligible premiums in addition to the "Base Commission."
2. Achievement of targeted premium levels
   - Zurich sets reasonable targets of premiums that will be placed with Zurich by your agent or broker each year. If that target is reached, then your agent or broker is paid an additional amount on the eligible premiums.
3. The profitability of the business
   - For each agent and broker, Zurich calculates the ratio of the total value of the claims over the premiums. The resulting ratio generates a payment. Lower ratios generate higher payments

because lower ratios mean that the result is more profitable to Zurich. We do not disclose the actual ratio and payment percentages.

4. Preferred business considerations

   - We have unique agreements with some agents and brokers to place particular types of business with us. These agreements may result in the payment of additional commission for such policies.

The maximum percentage for contingent compensation is 6.75%. The average paid in 2005 was ___%.

Visit Zurich's Web Site

For a more complete explanation of the nature of compensation Zurich pays to agents/brokers—including specific information on the maximum, average and actual ranges of commission paid by Zurich on the specific types of policies we are currently quoting for your company, please go to www.zurichna.com/yourcompany This web site includes a full explanation of the formula for developing contingent compensation if your agent or broker is eligible for contingent compensation from Zurich. Alternatively, you may call 1-800-xxx-xxxx to obtain the information.