

# THE RHA REVIEW

ROUTE TO:

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I TOLD  
YOU SO

## Oh, Those Four Little Words!

By Robert N. Hughes, CPCU, ARM

I suppose the four little words we all most hate to hear are “I told you so,” especially if they come from a parent or spouse. My mother is perhaps the most efficient invoker of the curse that I know. She will lurk for years waiting to pounce until the eventuality she predicted occurs. “Well, you know,” she’ll say then, “I told you so.” And usually she had.

Well, not that I am either your parent or spouse, but guess what ... “I told you so.” Of course, I’m talking about the hottest topic in insurance today, the Marsh-AIG-ACE-Hartford-AON encounter with New York’s attorney general over the issue of contingency fees and/or “market servicing agreements” (MSAs) and “placement servicing agreements” (PSAs). For those of you who do not know, Attorney General Spitzer has sued these companies, alleging that they engaged in illegal “bid rigging” through which business was directed by Marsh and AON to the companies that provided them the most lucrative contingency/MSA/PSA contracts.

It seems that the big boys have not exactly been playing fair. Marsh was apparently able to use its billion-dollar client base to coerce the insurers into giving them extra commission incentives based



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upon both the amount of premium income given the companies and the profitability of that business. Even worse, they strong-armed the insurers into posting false or “dummy” bids in order to give the appearance to the customer that the brokers had “shopped” the market when, in fact, they had conspired with the insurer to rig the price and

had faked competition to make sure that company would be awarded the business. So, for instance, Marsh went to AIG and predetermined what the cost would be for a client’s renewal with no competitive input. Then they told ACE that if they expected to continue to do business with Marsh, they would provide a “complementary quote” which would be higher than the price agreed to between AIG and Marsh, thus giving the appearance to the insured of competition.

So the guys who have been saying to their clients that “we’re the biggest and best and we can do things for you that no other firm can do” really meant “we can do things to you that no other firm can

(Four Little Words, continued inside)

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do.” The guys who have said, “We get you the best coverage for the lowest cost” have been making sure that not only did you not get the lowest cost, but you, in many cases, may have gotten the highest cost. Even worse, the incentive commission arrangements based on loss ratios have given the big brokers a huge conflict of interest in the pursuit of claims payments on behalf of their clients. We have long been curious about why the

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***“Full disclosure by brokers of their total compensation package will almost certainly be mandated from this day forward.”***

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major brokerage firms showed so little interest in assisting their clients in the pursuit of the payment of large claims. Maybe now we have the answer. They didn’t do it because it was costing them big bucks in the loss of contingent commissions.

Now, just in case you might think this would be trivial, Marsh has revealed that its income from such arrangements in 2003 was in the range of \$800,000,000. Its bottom line for the same period was \$1,500,000,000. So the schemes accounted for more than half of their net profit for the year.

Our firm has made no bones about the fact that we have never felt that our clients’ interests were best served by the “big boys.” We have always favored the local or regional “boutique” firms that are better geared to personal service. Admittedly, this approach cannot practically apply to the megacorporation doing international business, but even so, we have always recommended that our larger clients scrutinize the compensation agreements of their brokers and stay closely involved in the negotiations with insurers.

Further, we have always been proponents of fixed-fee arrangements with agents and brokers, although it would not have helped much in this instance, since the brokers evidently accepted incentive commissions in addition to their fixed fees. While we have long suspected that the latter practice was prevalent, we were never able to achieve effective discovery on the issue. Now AG Spitzer has done it for us.

There is much discussion, as you can imagine, as to “where do we go from here.” Marsh has announced a total repudiation of incentive-based commissions. We’ll have to see about that, but if it is real, it could signal a significant change in the way commercial insurance is purchased and placed. Full disclosure by brokers of their total compensation package will almost certainly be mandated from this day forward. This means that

insureds will be able to make objective decisions about the services they want from their brokers and the price they are willing to pay.

The criminalization of big-broker leverage should also signal a new era for the smaller professional agents and brokers. Since it is obvious that a number of persons are going to spend some time enjoying the hospitality of a New York penitentiary, or perhaps a federal facility, I think that compa-

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nies would begin to make an extra effort to eliminate bid rigging and other unfair practices that have given the megabrokers a significant advantage over the smaller firms.

But as if one “I told you so” were not enough, here comes another one. I have been telling those of you who would listen that the excesses of the big insurers and the big brokers would eventually precipitate federal regulation of insurance. Guess what? It is a virtual certainty that a Congressional investigation will arise out of this debacle, and there is going to

(Four Little Words, cont'd. opposite)

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(Four Little Words, from opposite)

be a lot of pressure to repudiate McCarran-Ferguson. The states will resist like wounded animals, of course, because of the lucrative premium tax income they receive from insurance companies. Nevertheless, this is just one more camel's nose under the tent.

Is there a word to the wise here? But of course have I ever failed you? I warn you in advance that my current advice does not differ a great deal from what I've been telling you all these years. First, you need to be involved in your insurance placements ... insist on confirmation of competition and,

if need be, discourse between your company and your underwriters. Second, require that all coverage be quoted net of commissions and negotiate fixed fees with your


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agents and brokers. This is difficult in a few states but not impossible. If you have any suspicions at all, I

would not be beyond requiring sworn affidavits from the underwriters to the effect that all commissions and other compensation arrangements between them and the broker have been fully disclosed. Finally, when choosing a broker, forget about size and concentrate on quality and service. You may find that the folks down the street are just as good and a whole lot cheaper than the big honkers in New York City.

And, don't forget, I did tell you so! 

*Robert N. Hughes is founder, chairman of the board, and chief executive officer of Robert Hughes Associates, Inc.*

## FROM NEAR AND FAR



Florida – The Property Claim Services unit of the Insurance Services Office has posted these estimates of damage caused by the four major storms that struck the United States in August and September. Hurricane Charley was responsible for an estimated 622,000 claims amounting to \$6.8 billion. Frances' cost is expected to reach \$4.4 billion on 552,000 claims. Hurricane Ivan inflicted an estimated \$6 billion worth of damage on 600,000 claims, and the damages from Jeanne will probably reach \$3.25 billion on about 385,000 claims.



Vermont – According to the Vermont Department of Banking, Insurance, Securities and Healthcare Administration, the state now has 700 captive insurance companies on its books. At the beginning of 2004 there were 674.



Dallas – According to VerdictSearch Texas, Allstate Insurance Co. was awarded \$5.9 million on October 1 by a Dallas federal jury against a group of doctors, osteopaths, chiropractors, clinics and others who engaged in a wide-ranging conspiracy to defraud the carrier.



New Jersey – The ISO's Property Claim Services Unit also reported that third-quarter cat losses amounted to \$21.3 billion in insured property damage. Eight windstorm events led to this year's third-quarter losses being the highest in any third quarter. Twenty-one states and Puerto Rico were hit, with Florida taking the brunt of the blow.



London, England – A press release from the United Kingdom's Serious Fraud Office states, "On October 28<sup>th</sup> Robert Damon-Aspen was jailed for two and a half years for deception conducted through his internet-based insurance intermediary business CFT Group Insurance Services." The fraud office also said that he took premiums from more than 5,000 clients without ever getting cover for them at Lloyd's. He issued forged policy documents to cover his fraud.

ROBERT HUGHES ASSOCIATES INC.

508 TWILIGHT TRAIL, SUITE 200  
RICHARDSON, TEXAS 75080  
(972) 980-0088 FAX (972) 233-1548

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Publisher ..... Robert N. Hughes  
Editor ..... John R. Oakley  
Assistant Editor ..... Alice H. Oakley

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For more information, contact  
John R. Oakley, Editor  
508 Twilight Trail, Suite 200  
Richardson, TX 75080  
Tel. (972) 980-0088.

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