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White paper summary: BROKER CONTINGENCY COMMISSION - GOOD OR BAD?

Much has been written about Eliot Spitzer, the former New York State Attorney General, and his actions against major insurance carriers and brokerage firms.

Many sales systems have an incentive structure built in for exceeding production goals. In the insurance industry, contingency commissions are generally paid based on the volume of business placed with a particular insurance company. The fact that a broker has a contingency-type contract with a specific insurance company can be of great value to the insured resulting in a lower price for the insured. Thus, contingency commissions are not inherently bad for the ultimate consumer.

The real issue is one of disclosure. Good business practice dictates the need for full disclosure between the insurance broker and the insured. This should be covered by a broker service contract as part of a well-designed insurance procurement process. For example, any contingency commissions received by the broker can be an offset to fees paid by the insured. The contract should also spell out the type of audits to be preformed to document payments received by the broker.

Another step to assure that the prospective policyholder receives the most cost effective program is to incentivize competing brokers to put forth their best efforts. This competition should be tightly controlled with each step being closely directed by the prospective policyholder.

HOW DO WE PREVENT SURPRISES WITH BROKER CONTINGENCY COMMISSIONS?

The answer is full disclosure of any contingency fee arrangements and an understanding of how they will be handled as specified in the broker service contract between the insured and the insurance broker. Thus, the issue of broker contingency commissions can be addressed simply with forethought on the part of the insured's risk manager or the person responsible for insurance purchasing and the insured's external auditors.

In addition, the external auditors should be made to properly design their confirmation process to cover all fees and commissions. This approach to insurance procurement combined with competitive bidding will assure the best possible price and coverage for the insured and provide a level of comfort for the corporate directors that they are fulfilling their fiduciary duty.

Feel free to contact me with any questions you have regarding insurance, insurance coverage issues, broker service contracts and any other property and casualty questions.

Robert E. Underdown, AIC, ARM, is a nationwide insurance consultant based in Scottsdale, Arizona. He serves corporations in the area of risk management and the legal community as an expert witness in insurance litigation. Mr. Underdown is an expert in agent/broker; insurance company and TPA standards of care and bad faith claims. In addition, he provides trust-owned life insurance audits and portfolio management services for individuals, trustees and other financial professionals. Find out more at www.Insurance-Expert.com or call (480) 216-1364.