Consumer Federation of America

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CFA STUDY FINDS CONTROVERSIAL CONTINGENCY PAYMENTS WIDELY USED IN SALES OF HOME AND AUTO INSURANCE

Contingent Fees to Agents and Brokers Can Drive Up Rates or Lead to Unscrupulous Claims Practices

Washington, D.C. – The Consumer Federation of America today released a detailed study of home and auto insurance payments that found wide use of troubling contingency fees similar to those being investigated by New York Attorney General Elliot Spitzer. The CFA study reveals the same potential for conflicts-of-interest in payments made by insurers to the sellers of personal lines of insurance that Spitzer has uncovered in commercial insurance. (*Contingent Commissions: Implications for Consumers* can be found at *http://www.consumerfed.org/contingent_commissions_study.PDF)*

CFA found extensive use of two types of contingent fees paid primarily to insurance agents: steering and profit-based commissions. Steering commissions are special payments by insurers to sellers of insurance to direct more business to the insurer. Profit-based commissions are paid to agents that sell policies that experience low levels of claims. Both of these payments are offered in addition to regular commissions, which insurers build into the price of all of their policies and are not contingent on meeting special sales or profitability targets.

"Both types of contingent payments in wide use entice agents to do the wrong thing," said J. Robert Hunter, CFA's Director of Insurance. "Steering commissions are dangerous for consumers because agents earn more if consumers pay more, which can lead to higher rates. Profit-based commissions are more lucrative for agents if consumers have lower losses, which can tempt agents to delay the filing of claims or to discourage consumers from filing claims in the first place," he said. "Most insurance agents are honest, but if the compensation system provides an incentive for bad behavior, it is likely to occur."

Large Insurers that Paid Relatively High Contingent Commissions

CFA found that a number of the largest home and automobile insurers in the country paid relatively high contingency commissions in 2003 (the most recent year that comprehensive data is available), as a percentage of the total amount of insurance premium

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sold. Of the 20 largest sellers of personal lines of insurance in the country, the five companies that paid the most in contingency commissions were:

1.	Federal Insurance	2.31% of premium
2.	Travelers C&S	2.18%
3.	Zurich American	1.94%
4.	Allstate Insurance	1.74%
5.	Hartford Fire	1.67%

Insurers that Paid No Contingency Commissions

Of the 20 largest sellers of personal lines of insurance, some paid no contingent commissions. These firms include Farmers Insurance Exchange, GEICO, State Farm Mutual Auto, State Farm Fire and Casualty, and USAA. These are all direct writers of insurance that do not hire agents or brokers, except for State Farm, which uses "captive" agents that serve only State Farm.

Lines of Insurance Where Contingency Commissions are Most Common

CFA also found that contingency commissions are much more common in the sales of some lines of insurance than others. These commissions are used most frequently in the sales of credit insurance (5.66% of total premium sold), as well as in companies that specialize in writing both of the major personal lines – home insurance and auto insurance (1.10%).

Tips for Consumers

"Be especially cautious when dealing with independent insurance agents and insurance companies that pay contingent fees," said Hunter. "The sellers of personal lines of insurance that receive these troubling payments most often are independent agents. These agents work for insurance companies, not consumers. Contingency payments set up a clear conflict-of-interest between the agent and the policyholder that could result in higher rates or unscrupulous claims practices."

CFA also urged consumers to be wary when buying lines of insurance where contingency fees are common, especially credit insurance, and to shop around carefully when buying a policy.

"Our study shows that a number of the biggest insurers do not pay contingency fees, especially the 'direct writers' that do not use brokers or agents," said Hunter. "When you're shopping for a policy, be sure and talk to at least one company that does not pay this type of fee," he said.

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Other tips that CFA offered included:

1. When buying an insurance policy, ask questions to get a complete picture of commission arrangements that your agent or broker is receiving:

- What commission are you earning as a percentage of the cost of the policy you are suggesting I purchase?
- Am I receiving the lowest price among all the insurance companies that you represent for which I qualify?
- What other insurance companies do I qualify for that you represent? What are the prices I would pay at those insurers and what commission would you get with each company?
- Do you have a contingency commission arrangement with the insurer you are recommending? Please fully explain that arrangement to me.

2. Be particularly cautious about insurance companies with profit-based contingent commissions. You do not want to get into a situation where your agent has financial incentives to delay or discourage the filing of a legitimate claim. Ask your agent or broker if the company that sells the policy being recommended to you uses profit-related contingent commissions, and, if so, what are the details of this arrangement.

3. If an agent or broker is defensive about or reluctant to disclose the commission arrangements in use on the policy being recommended, consider going to another insurance company or producer.

4. Make sure you shop carefully for insurance, getting quotes from some companies that do not pay contingent commissions, such as direct writers of insurance.

The Consumer Federation of America is a nonprofit association of 300 consumer groups, established in 1968 to advance the consumer interest through research, education, and advocacy.

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