Consumer Federation of America

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AS SPITZER INSURANCE INVESTIGATION WIDENS, CFA CALLS ON CONGRESS TO UNLEASH THE FEDERAL TRADE COMMISSION, KILL DEREGULATORY PROPOSALS

Group Sales of Insurance and Agent Fees Also Vulnerable to Conflict-of-Interest Abuses that Harm Consumers

In the wake of New York Attorney General Elliot Spitzer's widening investigation into bid rigging, kickbacks and improper payments in the insurance industry, the Consumer Federation of America today called on Congress to repeal a federal law that prohibits the Federal Trade Commission (FTC) from investigating the insurance industry. CFA also highlighted the potential for conflict-of-interest abuses similar to those uncovered by Spitzer in the group health and life insurance markets and by agents that sell insurance to millions of Americans.

"We applaud Attorney General Spitzer for taking on a practice that has been all too common in the insurance industry for decades, the payment of kickbacks by insurers to brokers who are supposed to represent the interests of consumers," said J. Robert Hunter, CFA's director of insurance and a former federal and state insurance commissioner. "Unfortunately, Spitzer has had to pursue this national investigation virtually alone, without assistance from other states or the federal government," he said. "Most of the state insurance commissioners who are charged with overseeing the insurance industry were asleep at the switch while these abuses were occurring. Just as bad, insurance lobbyists convinced Congress over twenty years ago to muzzle the Federal Trade Commissions when problems arose in the industry."

Under the McCarran Ferguson act of 1945, states are given sole authority to regulate insurance. Insurers are also granted an exemption to federal antitrust laws that prohibit anti-competitive practices, such as colluding to set rates. The FTC is forbidden from prosecuting antitrust or consumer protection violations related to the business of insurance. However, until 1981, the FTC was allowed to investigate and study problems in the insurance industry and to then making enforcement recommendations to state regulators. In response to a FTC investigation and report that was very critical of whole life insurance products, Congress

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prohibited FTC investigations on most insurance matters and only allowed the FTC to conduct studies of the industry if specifically requested to do so by a Congressional Committee.[1]

"Ultimately, the FTC should be unleashed to both prosecute unfair and deceptive practices in the insurance industry," said Travis B. Plunkett, CFA's legislative director. "However, in the short term, Congress should immediately allow the FTC to investigate and report on insurance abuses and to offer recommendations for action to the states," he said.

Prominent Federal Insurance Proposal Would Deregulate Insurance and Harm Consumers

CFA urged Congress not to enact proposals championed by the insurance industry and the leadership of the House Financial Services Committee that would deregulate insurance. The most prominent of these proposals is a "discussion draft" released earlier this year by Representative Michael Oxley, the Chair of the Financial Services Committee, and Representative Richard Baker. The proposal increases the federal role in insurance regulation while overriding many of the most important consumer protections that exist at the state level, such as the regulation of insurance rates. It also sanctions additional anticompetitive practices by insurance companies and encourages state regulators to compete among themselves to further lower standards. The draft does not establish minimum federal consumer protections or empower a federal regulator to investigate and prosecute the kind of abuses uncovered in Attorney General Spitzer's investigation. (For more information, see CFA's letter to Congressional leaders at: http://www.consumerfed.org/oxley-baker_proposal.pdf.)

"The Spitzer investigation reveals that even the most sophisticated buyers of insurance can be duped by insurers and brokers in this often uncompetitive market," said Hunter. "By further deregulating the industry, the Oxley-Baker proposal would lead to even more anti-consumer abuses. Federal involvement should increase protections for consumers, not gut them," he said.

Other Scandals in the Insurance Industry May be Lurking

The Spitzer investigation so far has centered upon brokers, who work for the customer, as opposed to agents, who represent insurers. It has also focused on the sale of commercial property/casualty insurance and not on personal lines, such as life, health, auto and home insurance. However, because financial conflicts-of-interest similar to those at the center of the Spitzer investigation exist in the sales of group life and health insurance and some personal policies, similar abuses in these areas may be uncovered.

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[1] The FTC Improvements Act of 1980 allows the FTC to study an insurance issue only upon a specific request by a majority of either the Senate or House Commerce Committees [15 USC 46(i)]. This Act also still allows the FTC to use its investigative and reporting powers to examine a minor set of insurance issues: antitrust activities not allowed under the broad antitrust exemption granted to insurers in the McCarran Ferguson Act.

Businesses often use brokers to undertake bidding to secure "group" life and health insurance for their employees. The same bid systems and potential for abuse exist in these group sales as in the broker-secured property/casualty insurance highlighted in the Spitzer complaint. This means that brokers who are supposed to be representing the businesses that are buying insurance are also taking "contingent" fees from insurance companies based on the amount of insurance that is bought. This kind of conflict-of-interest often leads to higher prices for buyers and hurts employees. Brokers earn more from insurers if their customers pay more. Moreover, if premiums are inflated by contingency fees, employees will pay more for the insurance. If the employer pays the fee, then less money is available to employees, for instance, in the form of salaries.

In the area of insurance that is sold individually (non-group life and health as well as auto and home insurance), most sales involve direct-to-consumer transactions, captive agents (employed by insurers) or independent agents that work for commissions and represent different companies. Compensation provided to independent agents offers the greatest potential harm for consumers. One particular type of contingency commission is especially troubling. Insurers provide agents with a kickback at the end of the year if clients file a low level of claims. If an agent's loss ratio (the percentage of dollars of claims paid to premiums paid by buyers) is better than specified levels, the agent can get more money as a year-end bonus. The lower the agent's loss ratio, the higher the bonus the agent receives. This is an obvious incentive for an agent to delay filing a legitimate claim or to improperly advise a consumer not to file it.

"If the scandals on Wall Street, in the mutual fund industry and now in the insurance industry have taught us anything, it is that consumers inevitably lose when financial conflicts exist," said Hunter. "Most insurance agents and brokers are honest, but if the compensation system provides an incentive for bad behavior, it will inevitably occur. Now that Attorney General Spitzer has uncovered serious abuses in the industry, it is time for insurance regulators to eliminate the conflicts that fostered this unethical and illegal behavior."

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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