

2005

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Recommended Citation

Douglas C. Nelson *Insurance Brokerage Giant Exposed by Consumer Fraud Charges*, 17 Loy. Consumer L. Rev. 237 (2005).

Available at: <http://lawcommons.luc.edu/lclr/vol17/iss2/4>

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CONSUMER NEWS

By Douglas C. Nelson*

Insurance Brokerage Giant Exposed by Consumer Fraud Charges

New York's Attorney General, Eliot Spitzer, is fast developing a reputation as a consumer fraud-busting, industry-changing crusader who gets fast, far-reaching results.¹ Spitzer's latest lawsuit against the insurance brokerage giant, Marsh & McLennan ("Marsh"), provides a window into the previously "entrenched and opaque" insurance industry.² The view is not pretty. Four days after consumers first got a glimpse through this window Marsh's stock price fell nearly forty-eight percent, knocking \$11.5 billion off the company's market value.³ Allegations of bid-rigging, price fixing and payoffs have left Marsh's very survival in doubt and, what's more, the scandal is quickly spreading and implicating the biggest names in insurance industry.⁴

On April 5, 2004, the New York State's Attorneys General's office received an anonymous letter stating that "[Marsh] is receiving major income from directing business to preferred providers . . . the bigger the incentive, the more business they get."⁵ Spitzer's team became increasingly intrigued as he considered the lack of federal regulations governing the insurance industry, and the "notoriously

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¹ See Peter Elkind, *Spitzer's Crusade*, FORTUNE, Nov. 15, 2004, at 129.

² *Id.* Spitzer's civil complaint against Marsh was filed on Oct. 14, 2004. *Id.*

³ Marcia Vickers, *The Secret World of Marsh MAC*, BUSINESSWEEK, Nov. 1, 2004, at 78.

⁴ Elkind, *supra* note 1.

⁵ *Id.*

cozy” relationship state regulators had developed with the industry.⁶

Shortly thereafter, Spitzer’s staff was reviewing Marsh’s internal e-mail and beginning to unravel the insurance industry’s secrets.⁷ What they found not only supported the allegations made by the anonymous tipster, but went further revealing that Marsh, and the insurance industry in general, had a made “kick-backs” and “bid-rigging” a routine business practice.⁸

Insurance brokers, such as Marsh, are hired by corporate consumers to match their insurance needs with the most affordable insurer.⁹ Consumers pay the insurance broker for brokerage services and, curiously, the insurer that wins the business also pays the insurance broker.¹⁰ When and if this fee from the insurer is disclosed to consumers, it is vaguely explained as a payment for “unspecified services.”¹¹

Although Marsh’s marketing materials promise that “our guiding principle is to consider our client’s best interest in all placements,” the company’s internal e-mails reveal that Marsh was guided by a quite different principle—namely, the biggest kickback wins the business.¹² Insurers were actually ranked by the profitability of the kickbacks provided to Marsh. Meanwhile, Marsh brokers were told by a Managing Director via e-mail, “I will give you clear direction on who [we] are steering business to and who we are steering business from.”¹³ Marsh’s internal policies were also shared with insurers who were told in no uncertain terms that the way to increase their sales was to sweeten the deal with Marsh.¹⁴ According to a former Marsh executive, payments from insurers accounted for

⁶ Elkind, *supra* note 1. Unlike other financial institutions such as banks and investment houses, insurance is not federally regulated. *Why Insurance Needs a Cleanup*, BUSINESSWEEK, Nov. 1, 2004, at 128. However, a congressional bill calling for national standards for the industry, called “SMART” for State Modernization & Regulatory Transparency, is currently pending in Congress. *Id.*

⁷ Elkind, *supra* note 1.

⁸ *Id.*

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.*

¹² See Elkind, *supra* note 1.

¹³ *Id.*

¹⁴ *Id.*

one-half of the company's profits.¹⁵

Marsh's kickback program, however, is only part of the story. Preferred insurers got more than "steering" in the form of recommendations and salesmanship from Marsh brokers. In September, Brown's staff uncovered e-mails showing how Marsh made sure its favored insurer would win a particular deal. In one case, ACE USA, an insurer, was prepared to bid \$990,000 for a casualty policy for Marsh's client, Fortune Brands. But e-mails between ACE executives revealed that ACE then revised its bid to \$1,100,000 at Marsh's direction: "Original quote \$990,000 . . . We were more competitive than AIG in price and terms. [Marsh] requested we increase premium to \$1.1M to be less competitive, so AIG does not loose [sic] the business"¹⁶

Spitzer's team found that Marsh routinely demanded inflated bids, which Marsh called these "B quotes," from insurers to give clients the impression that the process was competitive.¹⁷ In one instance, when ACE resisted providing "B quotes" an ACE VP was told, again via e-mail, "I do not want to hear that you are not doing 'B' quotes or we will not bind anything [for ACE]."¹⁸ Remarkably, when one insurer refused to provide a bogus bid, Marsh simply made up an inflated bid and submitted in the insurer's name.¹⁹

The gall of Marsh seemed to know no bounds. In an email exchange with Munich–American Risk Partners, a Marsh broker asked the insurer for a "live body" to make a bogus presentation to a client in order to give the illusion of competition.²⁰ The insurer replied in all caps: "WE DON'T HAVE THE STAFF TO ATTEND MEETINGS JUST FOR THE SAKE OF BEING A 'BODY.' WHILE YOU MAY NEED 'A LIVE BODY,' WE NEED A 'LIVE OPPORTUNITY.'"²¹

The culture at Marsh was notoriously secretive and arrogant.²² Perhaps just the culture needed to foster such massive consumer

¹⁵ Vickers, *supra* note 3.

¹⁶ Elkind, *supra* note 1.

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ Elkind, *supra* note 1.

²² Vickers, *supra* note 3.

fraud. Spitzer, who has been criticized in the past for his willingness to cut deals and settle claims with corrupt companies, flatly refused any further contact with Marsh leadership: “the leadership of that company is not a leadership I will talk to.”²³ Shortly after Spitzer’s comments, Marsh CEO Jeffery Greenberg was removed from his post.²⁴

When Greenberg took over the top position at Marsh in November of 1999, Wall Street lauded Greenberg’s gregarious, outgoing personality.²⁵ Greenberg was expected to be more accessible and more communicative than his secretive predecessor, A.J.C. “Ian” Smith.²⁶ Instead, under Greenberg the company grew even more secretive and aloof.²⁷ While Greenberg’s friends claim that he inherited major problems when he took over, he appeared to be reluctant to change the arrogant culture of Marsh which permitted fraud to fester.²⁸ Former Marsh executives describe Greenberg as an indecisive and detached leader who gave his managers free reign so long as they were meeting their financial numbers.²⁹ But, said one employee: “It’s the kind of place where if you don’t meet or exceed a goal, heads roll.”³⁰

Marsh is also the kind of place where executive interviews include hours of questioning by a company psychiatrist.³¹ These interviews include questions like: “What’s the worst thing that’s ever happened to you?” “What are your views on religion?” “Who do you vote for?”³² A former Marsh executive explains, they are “looking for people who will fit in, lockstep, at the company.”³³ Moreover, employees must sign non-compete agreements each time they exercise stock options and executives that leave the company risk losing deferred compensation which Marsh builds into its

²³ Elkind, *supra* note 1.

²⁴ *Id.*

²⁵ Vickers, *supra* note 3.

²⁶ *Id.*

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.*

³⁰ Vickers, *supra* note 3.

³¹ *Id.*

³² *Id.*

³³ *Id.*

compensation plans.³⁴ As one former executive told a major magazine, “Gee, I’d love to talk to you. There’s a lot to say. But they’ve got my money.”³⁵ Other former executives accuse Marsh of constantly monitoring internal phone calls and using private investigators to spy on former executives.³⁶

Perhaps no executive better personifies Marsh’s arrogance and gall than Marsh’s Executive Director of Marketing, William Gilman.³⁷ According to Spitzer’s complaint Gilman oversaw Marsh’s bid-rigging scheme.³⁸ Insurers dealing with Gilman were expected to abide by “Billy’s Rules” which were memorialized on a plaque that hung in Gilman’s office.³⁹ Billy’s rules were: (1) No “no’s” (meaning insurers were not to tell Marsh “no”); (2) Don’t get stupid (meaning do not question Marsh’s tactics); (3) If you get stupid we will broom your ass; and (4) Never think you own your business, you only rent your business. Marsh owns you business.⁴⁰

Gilman and Marsh were able to wield this kind of power because, after a series of acquisitions, Marsh was dominant in the insurance brokerage industry.⁴¹ By the late 1990’s Marsh controlled forty percent of the world market.⁴² Marsh’s dominance allowed them to dictate pricing, control the way insurance products were packaged and structured, and determine how premiums and payout disbursements are handled.⁴³ As a competitor put it, “[t]hey have both their clients and insurers by the cojones.”⁴⁴

Since Spitzer launched his investigation, Marsh, Aon Corp., and Willis Group Holdings, who together control eighty percent of the insurance brokerage industry, have announced that they will no

³⁴ *Id.*

³⁵ *Id.*

³⁶ Vickers, *supra* note 3. In July, the company purchased a private investigation firm for \$1.9 billion. *Id.* The purchase further fueled suspicions that Marsh was keeping close tabs on its former and current employees. *Id.*

³⁷ *Id.*

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ Vickers, *supra* note 3.

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*

longer accept payments from insurers.⁴⁵ Willis' CEO called the scandal, "the most important event ever for the insurance industry . . . How it responds will define the industry for years to come."⁴⁶

Besides facing drastically reduced stock prices, costly lawsuits, and the threat of losing customers to smaller firms in the wake of this scandal, the big three insurance brokers will also be forced to learn how to conduct business without kick-backs and other questionable tactics which have accounted for as much as one-half of their profits.⁴⁷ In a variation on the cash based kick-back, Spitzer is also investigating Aon for steering business to insurers who would promise to purchase the insurance on their policies, called reinsurance, from Aon.⁴⁸ In other words, consumers were advised to purchase insurance policies not because a particular policy represented the best price and value to the consumer, but because the consumer's policy would be reinsured by Aon.

Unfortunately, the consumer abuses that are starting to come to light are not limited to the big three insurance brokers.⁴⁹ Spitzer's team is starting to close in on "mom-and-pop agencies that sell insurance to small businesses and [individual] consumers" where they have discovered a similar pattern of undisclosed incentives to steer policies to particular insurers.⁵⁰ David Brown, a member of Spitzer's team explains that, "[f]or them, these types of backdoor payments are very, very important . . . They've all grown up on them."⁵¹ He added, "[n]one of us knows what a world with insurance price competition would look like, since its never existed."⁵² Industry estimates of the percentage of revenue that independent insurance agents derive from "contingent commissions" range from two to

⁴⁵ Carrie Coolidge, *Pulling the Plug on Marsh*, FORBES, Nov. 15, 2004, at 126.

⁴⁶ *Id.*

⁴⁷ Vickers, *supra* note 3.

⁴⁸ David Greising & Ameet Sachdev, *Probe, Problems Challenging Aon*, CHI. TRIB., Dec. 12, 2004, at 1.

⁴⁹ Suzanne Woolley, *Insurance: Take a Good, Hard Look; Here's How the Spitzer Investigations of the Industry Could Affect You*, BUSINESSWEEK, Nov. 29, 2004, at 142.

⁵⁰ Elkind, *supra* note 1.

⁵¹ *Id.*

⁵² *Id.*

twenty percent.⁵³

In the absence of federal regulations or legitimate industry self-regulation, corporate and individual consumers alike need to be aware that insurance brokers may be operating with a hidden agenda. Although consumers may avoid the specter of “contingent commissions” by simply electing to deal with insurance agents who sell policies for a single company,⁵⁴ this approach limits consumers’ choices and requires them to become experts in a complex, and historically secretive, industry. Perhaps one day consumers will be able to trust their independent insurance brokers to help them make an informed choice between competing insurers.⁵⁵ In the meantime, let the buyer beware.

Consumer Brings First-Ever RICO Suit Against National Mover

What started out as a routine residential move from Atlanta to Chicago erupted into a first-ever lawsuit against a national mover, Mayflower Transit, Inc. (“Mayflower”), under the Racketeer Influenced and Corrupt Organizations Act (“RICO”).⁵⁶ Although a federal jury ultimately found that the plaintiff failed to prove the RICO portion of her case,⁵⁷ the Federal District Court’s denial of Mayflower’s summary judgment motion put the moving industry on notice that fraudulent movers may be within the reach of consumer RICO actions.⁵⁸

⁵³ Coolidge, *supra* note 45.

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ Andrew Harris, *National Mover Faces RICO Suit*, 26 NAT’L L.J. 33, April 19, 2004, at Col. 1. Racketeer Influenced and Corrupt Organizations Act (“RICO”), 18 U.S.C §§ 1961-1968 (2000).

⁵⁷ Ameet Sachdev, *Racketeering Verdict Rejected; Mayflower Guilty on Contract*, CHI. TRIB., Oct. 29, 2004, at 2.

⁵⁸ “Industry officials can’t recall a racketeering claim being brought to trial against a reputable national moving company. They are closely watching Chen’s case because a judgment in her favor could result in a flurry of copycat suits—sending their liability costs skyward.” Ameet Sachdev, *Client Won’t Budge in Fight Over Move*, CHI. TRIB., Oct. 4, 2004, at 1.