Spitzer Probe Could End One Era, Begin a New One

By Dick Goff

Those cries of anguish you heard from certain quarters of the insurance industry in the wake of recent months' legal action by New York Attorney General Eliot Spitzer could have been the death knell of the industry's "business as usual" approach.

When the nation's most powerful brokerage and consulting firm was targeted by Spitzer largely on the strength of finger-pointing by insurance companies that seemed to have benefited by under-the-table schemes, everything changed. No one knows how long the damage will linger in lost credibility for our industry and the lost confidence of corporate America.

One of the issues left unresolved in the wake of the scandal is: How many times should we be paid?

This is not an easy question, and the answer has been slow to take concrete form. For example, consider the theoretical case of a mythical TPA that traditionally has earned fees for service, either per file, by negotiated annual fee or on the basis of expenses plus agreed profit margin. Nowhere in that list is the word "commissions."

Over time, our TPA strengthens its relationship with its corporate client by performing well, and gains commensurately more control over the business. Soon it's in a position to function as a broker to place stop-loss insurance. The underwriter has no problem in sending a standard commission to the TPA/broker.

The same TPA may also place a reinsurance contract, or even participate in risk itself and both events add to its revenue stream. Meanwhile, the client continues to pay fees according to the contract, and understandably expects the TPA to operate on that basis.

While the ethical shade of our example is intentionally ambiguous, the client may be getting more for his money than if each insurance transaction were being directly contracted as a separate deal or independent transaction. The TPA in this example is doing the best possible job for the client, and perhaps shaving a few percentage points along the way to assure top value.

The problem with this scenario is that the client may not realize what good service he's getting, and may believe that commissions earned by the TPA – when they become known – constitute "double-dipping."

Worse, an overly aggressive TPA/broker can tie up the stop-loss market for that client and decide the best deal from an underwriter based on benefits to himself rather than to the client.

That erosion of trust by corporate customers who don't really understand the nature of the services they receive summarizes the state of mind shared by corporate insurance customers today. While in reality customers may be benefiting from the synergies of interlocking services, their perception is that – by the fact of nondisclosure – there is an ethical lapse that is costing them.

There is a way to clean the slate, blow away the fog. Each player in an insurance market can enjoy complete visibility, as full disclosure becomes the new way of doing business. It's called alternative risk transfer.

Readers of earlier ART Gallery columns will be amazed that the words "alternative risk transfer" didn't show up until almost 450 words were spent. But I had to make my case that ART could be the new "norm" that prevents the sins of nondisclosure and other under-the-table deals.

The basis of transparency is that in an ART structure, every player knows the role and benefits of every other player. Rather than being "sold" on a complex deal whose details lay 90 percent below the surface, an ART corporate client becomes a partner with service providers and underwriters for mutual benefit.

The benefits of being openly creative are greater to an industry service provider than any slight financial advantage of unacknowledged commissions.

Here's how that works. Say a TPA or an MGU approaches a corporate buyer to offer real control of the company's destiny with this invitation: "Get together with other like companies and form a risk retention group. Then put a captive behind it with segregated cells to protect each from any losses of another, and we can all participate in ownership."

Do you think the client's confidence in that service provider would soar? The genius of ART is that all the strategic alliances come out in the open and the client is clearly aware of the value of each player.

Transforming "customers" into "partners" is the new way of doing business, and Eliot Spitzer delivered a big kickstart for that transformation right in the derriere of the old guard.

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