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AAMGA Responds to the NAIC's Request for Insurance Industry Comment on the Proposed Broker Disclosure Amendment to the Producer Licensing Model Act

At its recent Mid Year Meeting, the Board of Directors of the American Association of Managing General Agents (AAMGA) created an ad hoc Task Force on Professional Business Practices. President Joseph Hutelmyer, CIW, charged the group with the mandate of staying abreast and maintaining a database on the domestic and international developments pertaining to insurance commissions. The Task Force will also work with the AAMGA's Governmental Affairs and Communications Committees to keep AAMGA members apprised of their efforts.

The action was taken following the activities emanating out of the continuing investigations by various state attorneys general and regulators, and hearings being held on Capitol Hill, on incidents of illegal bid-rigging, kickbacks and fraud which have recently been disclosed. "For the past 79 years the AAMGA has been in the forefront of ensuring that ethics, trust and integrity are the highest priority and included in every wholesale insurance relationship, transaction and contract," Mr. Hutelmyer stated. "The AAMGA's membership and renewal eligibility includes a mandatory annual certification that the applicant or member, respectively, is or remains in compliance with the AAMGA's strict Code of Ethics. We need to continue facilitating these non-delegable responsibilities so as to foster the confidence and expectations of our customers and investors in the insurance marketplace," he added.

The six principles comprising the AAMGA's Code of Ethics pertain to the financial; intra-organizational/competition; relationships with producers; relationships with insurance carriers; legal/regulatory and community obligations. They are regularly enforced and re-evaluated each year by the AAMGA's Code of Ethics Committee.

One of the recent regulatory efforts includes the National Association of Insurance Commissioners (NAIC) issuance of a draft Proposed Broker Disclosure Amendment to the Producer Licensing Model Act. The NAIC has requested industry and public comment on the Amendment, which will be one of the items on the Agenda of the NAIC's meeting in New Orleans, LA on December 4, 2004. The Amendment states as follows:

**NAIC Proposed
Broker Disclosure Amendment
To The Producer Licensing Model Act**

Section __

Any insurance producer or any business entity related to such producer who is permitted by [statute] to receive any compensation, including commissions, from the insured, shall not accept or receive any compensation, including commissions, from an insurer unless the producer has, prior to insured's purchase of insurance, (1) obtained the insured's written consent that such compensation will be received by the producer or business entity related to the producer and (2) disclosed the amount of compensation from the insurer; and the method for calculating such compensation, including any contingent compensation. If the amount of contingent compensation is not known at the time of disclosure, the producer shall disclose a reasonable estimate of the amount and method for calculating such compensation.

Drafting Note: States that are considering the licensing of business entities should reference subsection 6B of the NAIC's Producer Licensing Model Act and the Uniform Application for Business Entity License/Registration, which address the licensing of a business entity acting as an insurance producer.

Drafting Note: The provisions of this section shall not apply to an insurance producer or any business entity related to such producer that accepts or receives only a nominal fee from the insured.

Section __

An insurance producer must disclose the following, if applicable, to an insured or prospective insured, prior to the purchase of insurance:

- 1. That the producer will receive compensation from the insurer for the sale;*
- 2. That the compensation received by the producer may differ depending upon the product and insurer; and*
- 3. That the producer may receive additional compensation from the insurer based upon other factors, such as premium volume placed with a particular insurer and loss or claims experience.*

Drafting Note: States that are considering the licensing of business entities should reference subsection 6B of the NAIC's Producer Licensing Model Act and the Uniform Application for Business Entity License/Registration, which address the licensing of a business entity acting as an insurance producer.

The AAMGA has issued a response to the NAIC, in order to make certain the position of the wholesale marketplace is clearly articulated – and that the lines of demarcation are made clear and understood as respect the relationships between managing general agents/general agents and their company markets and retail producer customers; in comparison to the relationships between agents/brokers and their policyholder customers. The AAMGA's position also includes a more accurate portrayal of the manner in which profit commissions operate in the wholesale marketplace, in comparison to the manner in which they have been inappropriately assailed in the media. The full text of the AAMGA's position states as follows:



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November 29, 2004

**AAMGA Response to the NAIC
Proposed Broker Disclosure Amendment
to the Producer Licensing Model Act**

The American Association of Managing General Agents (AAMGA) is deeply troubled by the allegations and admissions arising out of the various state attorneys general investigations pertaining to the practice of illegal kick-backs, bid-rigging and fraud in the insurance market. The AAMGA and its members denounce these illegal and unethical actions as they violate the law, betray the public trust and cast an unacceptable shadow over the free-market and entrepreneurial strength of the today's competitive insurance market.

In respect of the NAIC's request for public and industry comment on the Proposed Broker Disclosure Amendment to the Producer Licensing Model Act, the AAMGA wishes to advise that it endorses full broker disclosure of compensation should the transaction between a producer and insured buyer involve the producing broker being compensated by the buyer under the terms of an insured buyer service agreement. We wish to note that AAMGA members serve as wholesale intermediaries between the retail producer and the insurance company and, as such, they have neither direct nor indirect contact with the insured buyer.

In most cases, these transactions occur subsequent to the insurance company's entrusting underwriting and binding authority to the wholesale intermediary. In other words, the wholesale intermediary represents the insurance company as the *de facto* branch office, and is paid a commission to cover these underwriting and production costs. In most cases, the wholesaler shares these commissions with the retail producer.

Many insurance carriers also offer profit sharing commission to their wholesale intermediaries/general agents based on annualized premiums, the achievement of targeted combined ratios and profits that the wholesaler has generated and for which they are responsible. This is analogous to profit sharing that an insurer distributes to employed underwriters. The profit sharing commissions are not a guarantee, as they are lost or reduced when the targets have not been met or when the underwriting year has been unprofitable. There is nothing illegal or unethical about this form of fair compensation and equitable risk sharing.

Therefore, and in light of the foregoing, the AAMGA - while supporting full broker disclosure in a transaction between an insured buyer and its producing broker, where the buyer pays the broker directly for services rendered - respectfully suggests an amendment to the Proposed Broker Disclosure Amendment to the Producer Licensing Model Act. Either an item number 4 should be added exempting managing general agents, general agents, and/or wholesale intermediaries from the Section on compensation, or an additional Drafting Note should be added as follows:

Suggested Drafting Note

The provisions of this section shall not apply to an individual or business entity licensed as an insurance producer who acts only as an intermediary between the insured's or prospective insured's producer and an insurer (i.e. managing general agent, general agent, or wholesale broker).

We thank the NAIC and this Committee for the opportunity to submit these comments, and look forward to answering any questions at the upcoming Task Force on Broker Activities hearing in New Orleans. We look forward to the opportunity of working with the Task Force and the NAIC in delineating the specific activities of managing general agents, general agents and wholesale brokers in the marketplace, and in continuing to facilitate the appropriate, ethical and necessary insurance transactions and professional business practices.

Respectfully yours,



Bernd G. Heinze
AAMGA Executive Director

The American Association of Managing General Agents is an international trade association representing over 250 managing general agencies and general agencies, employing over 8,000 insurance professionals in all 50 states. The membership also includes over 230 associate members consisting of insurance companies, brokers and other professional entities dedicated to advancing the wholesale insurance marketplace with innovative products and services.

AAMGA agency members maintain 287 local, state or regional insurance managing offices with contractual authority to perform managerial functions on behalf of insurers, both standard and specialty, on property and casualty lines of business through the wholesale distribution network. Members provide insurance companies, with underwriting, marketing, and back-office functions and services for specialty lines, standard lines, and excess and surplus lines.

Since 1926 the AAMGA has been regarded as the Association representing the premier members of this segment of the insurance marketplace. A hallmark of the Association is that the membership and renewal eligibility includes a mandatory annual certification that the applicant or member, respectively, is or remains in compliance with the AAMGA's strict Code of Ethics. The six principles comprising the AAMGA's Code of Ethics pertain to the financial; intra-organizational/competition; relationships with producers; relationships with insurance carriers; legal/regulatory and community obligations. They are regularly enforced and re-evaluated each year.

The AAMGA's University is a recognized provider of continuing education and other insurance related courses by all 50 state insurance departments. The University offers those students completing a requisite number of class hours the Certified Insurance Wholesaler (CIW) designation. In addition, those agencies offering a minimum of 8 hours to each full time employee per year are eligible for the designation of a Certified Managing General Agency (CMGA). Both designations must be renewed annually. In 2004 to date, over 3,000 students have attended AAMGA University and business ethics classes across the country.

The AAMGA will present its position formally at the NAIC meeting this weekend, but wanted all members to have an advance copy of these materials for review.

We will also share this position with our industry colleagues at the National Association of Professional Surplus Lines Organizations (NAPSLO); Property Casualty Insurance Association of America (PCIAA); the National Council of Insurance Legislators (NCOIL); the National Association of Insurance Women (NAIW); and other national and state associations. It is essential that we maintain the leadership the AAMGA has developed in shaping the debate and decisions that may impact the ability of wholesale insurance professionals to ethically and properly transact the business of protecting risk exposures, unimpaired by any restrictive regulations precluding the free market and entrepreneurial exercise of freedom of rate and form.

In addition, the AAMGA's Professional Business Practices Task Force will continue following the developments arising out of the on-going investigations, hearings, disclosures and legal proceedings in order to keep you regularly advised. We will value your comments, feedback and suggestions here at AAMGA Headquarters.

In the interim, we will be pleased to respond to any questions you may have concerning the current state of affairs or activities taking place in the state(s) in which your company is transacting business or has an interest.

Kind regards,

A handwritten signature in black ink, appearing to read "Bernd G. Heinze". The signature is written in a cursive, flowing style.

Bernd G. Heinze
AAMGA Executive Director