TESTIMONY OF STEVE MCGILL,
CHAIRMAN AND CHIEF EXECUTIVE OFFICER OF AON RISK SERVICES

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Good morning. My name is Steve McGill and I am the Chairman and Chief Executive Officer of Aon Risk Services, Aon Corporation's worldwide risk and insurance brokerage business.

I would like to thank the Department of Insurance and the Attorney General for holding these hearings and for giving us the opportunity to present Aon's views on these transparency and producer compensation issues, which are very important to our clients.

In formulating this testimony today, we have kept our main focus on what is right for clients. We strongly believe that it is in the best interests of all clients that the Department use its authority to require mandatory, clear and consistent disclosure of the compensation of brokers and agents, whom I'll refer to as "producers", and to apply the same rules to all producers. If all producers fully disclose their compensation, clients can make informed choices, and the competitive dynamics of the marketplace will determine what forms of compensation survive. In such an environment producers that add value to their clients will flourish, and producers that do not add value will not. And this competitive environment will ultimately work to the benefit of clients.

My testimony today is divided into 3 parts:

- First, I will provide a brief description of the current state of the marketplace three years after the reforms undertaken by the then-Attorney General and Department of Insurance.
- Second, I will explain why we believe the Department should take steps to enhance transparency across the board for all producers.
- Finally, I will make some specific comments on contingent commissions and other forms of compensation.

The Marketplace

Out of some 30,000 broker and agent companies in the U.S, Aon is proud to have been voted Best Retail Broker in 2007 by the readers of Business Insurance. We represent clients ranging from small-town family businesses to the largest corporations in the world, seeking protection in nearly every line of business. Our focus on our clients, including earning their trust through transparency, has been a key component to our success as a company. A decade ago we worked with the leading risk management bodies in the U.S. and the U.K., RIMS and AIRMIC, to encourage debate about how the industry should operate to enhance producer transparency. And we are proud to be leading the industry today in the transparent practices that you, members of the panel, were instrumental in putting in place.

For the very smallest clients in the insurance industry, the market is highly commoditized, with products being offered by a combination of producers and direct insurers. At the other end of the scale are Fortune 1000 firms that are typically very sophisticated organizations, with dedicated risk management departments familiar with the workings of the insurance market. Most of these clients have their producers working for fees or disclosed commissions.

In between these two segments is a third segment. Often referred to as the middle market, it contains a substantial number of clients who frequently have no dedicated risk manager and are often unfamiliar with the nuances of the insurance market and the remuneration producers receive. We believe that the greatest potential for conflicts of interest and market inefficiencies exists in this middle market segment.

It is fair to say that after the high-profile investigations in the industry in 2004, it was widely anticipated that there would be a significant increase in transparency and a significant reduction in contingent commissions. However, while four of approximately 30,000 producers in the U.S. gave up contingent commissions and adopted full transparency, much of the rest of the industry remained in a time warp. Not only did contingent commissions not decline, but, according to A.M. Best data, contingent commissions on property and casualty business in the U.S. actually increased from $3.70 billion in 2003 – the year before the regulatory investigations began - to $4.56 billion in 2006. In fact, since the end of 2004, when the biggest four brokers ceased earning contingent commissions, insurers have continued to pay billions of dollars of contingent commissions to producers who are not required to disclose them.

Moreover, while fair and open competition benefits clients by driving innovation, best practice and professionalism, not all producers are competing under the same set of rules. The insurance marketplace has been distorted by the growth of contingent commissions coupled with a lack of transparency among most producers. The vast majority of producers — some of them companies making tens of millions of dollars a year or more — are not required to disclose their compensation. This allows them to create the illusion that they earn less than transparent brokers by taking comparatively low fees or base commissions while accepting undisclosed contingent commissions.

As a result, the current two-tier system does not promote clients' interests, because non-transparent producers can win clients based on false premises rather than by offering true benefits. This two-tier system thus undermines the very values that regulators seek to advance: transparency, client consent, and client benefit.

Aon's Views on Transparency Reform

At Aon, we believe in the fundamental principles that a client deserves to know whether its producer is working for the client or an insurer, which insurers the producer approaches, how much the client will pay, and how the producer will be compensated. This is essential to enable the client to make informed choices, to avoid an actual or potential conflict of interest by the producer, and to deliver the best and most competitive outcomes for clients.

We therefore strongly urge the Department to use its statutory authority to put in place comprehensive transparency and consent standards that apply to all insurance producers doing business in the State of New York. These standards should at a minimum require producers to disclose to clients, in plain, unambiguous written language prior to binding:

- whom the producer represents;
- all quotes sought and received, including the terms of each quote and all compensation to be received in conjunction with each quote; and
- the types of contractual and other relationships they have with the insurers approached, including the nature and level of any contingent commissions.

Producers should also be required to obtain their client's consent to the total compensation the producer will receive prior to binding the selected quote.

This basic information is at the core of the relationship between a client and its producer, and we believe that no producer should be afraid to tell its clients whether it is working for the client or someone else, what it's doing, how much it's getting paid, and by whom.

However, some producers oppose providing their clients with this sort of basic information. One argument they put forward is that clients don't really want to know this information and don't ask for it. We respectfully suggest that clients may not be forceful in seeking this information precisely because they don't know what they don't know, and that many would in fact be very interested to discover just how their producers are compensated and how much they make. In the U.K. market, for example, a very recent survey indicated that 50% of clients significantly underestimated how much their producers actually earn.

Our own experience under enhanced transparency rules is that, when clients are told about their producers' compensation, it generates a healthy dialogue that leads to a stronger relationship and better outcomes for clients. At the very least, enhanced transparency allows clients to make more informed choices about their insurance alternatives.

It is particularly important to require enhanced transparency for the benefit of smaller or mid-market clients who are perhaps less able to ask the right questions and are thus most in need of regulatory assistance. The clients who are the most sophisticated insurance buyers – being large companies with their own in-house risk management professionals – are the ones whose producers provide the most detailed information. By contrast, the clients most in need of transparency are often served by non-transparent producers. These clients are thus left in the dark as to whether their producer approached the markets best suited to provide them with cost-effective coverage, or only approached the markets with whom it had lucrative compensation arrangements. These smaller and mid-market clients, who most need the information, should not be denied the benefit of any transparency rules you adopt.

A second argument from opponents of transparency is that any disclosure should be voluntary, or should be required only when clients request the information. This argument is also not convincing to us. Put simply, voluntary disclosure has been tried in the past, and experience shows that it has not resulted in producers providing enough meaningful information to their clients. We know that the Superintendent has expressed a preference for principles-based regulation, and voluntary compliance by regulated entities, whenever possible. In this case, however, we don't believe that it is realistic to leave to producers themselves the questions of what they should disclose and how and when they should disclose it. The fact is that, since 2004, when the Attorney General and Department of Insurance focused the industry's attention on compensation arrangements, very few producers have voluntarily adopted full transparency.

As for the proposal that information should be disclosed only when requested, this has also been tried, again without success. In the last three years, experience has shown that many clients know much less about the nuances of the market than their producers. This creates an imbalance where one party holds all the information, and the other may not even know the right questions to ask.

Another argument you may hear is that mandatory disclosure is too costly and burdensome for producers. Aon's experience after three years of transparency, routine disclosure and client consent is that the fixed costs of telling clients the basic information about their insurance alternatives and our compensation under each alternative are relatively small. Every producer already possesses this information, and ought to be able to share it with its clients. And, in any event, the argument that transparency is too burdensome for producers puts the focus in the wrong place. The focus here should be on benefits to the client, not inconvenience for producers, and in our opinion these benefits outweigh the costs.

In summary, we believe strongly that the Department should adopt new standards requiring producers to provide their clients with basic compensation information, and that these standards should apply across the board to all producers in the marketplace. The current system, under which some but not all producers tell their clients what they make, undermines transparency and compensation reform by driving clients to non-transparent brokers who continue to accept undisclosed contingent commissions.

Aon's Views on Compensation Reform

While the vast majority of producers seek to act in their clients' best interests, a client must be armed with the knowledge to make informed judgments about its producer's own interests before evaluating and acting upon the producer's recommendation. Without disclosure, the suspicion that a producer may be receiving compensation that could lead it to place its own profit ahead of its client's interests undermines the crucial bond of trust between producer and client, and weakens the reputation of the whole industry.

As I said earlier, we believe that full industry transparency and consent is the best protection against the potential conflicts of interest that arise in a commission-based marketplace. Therefore, in our view, the Department should at a minimum require that all forms of producer compensation be disclosed in a clear and effective manner. Once this is in place, the pressures of the marketplace should ultimately determine what forms of compensation survive. As Supreme Court Justice Louis Brandeis (a New Yorker, by the way) once said, “sunlight is the best disinfectant.”

Turning to the questions the Department and Attorney General have raised about contingent compensation, Aon does not believe that such compensation poses an “irreconcilable conflict of interest,” to use the words in one of the questions. Nor does Aon believe that contingent commissions unavoidably result in “steering” clients toward less favorable insurers in order to maximize a producer’s revenues. Indeed, the risks of potential conflicts of interest and steering exist in other, appropriate forms of compensation, such as base commissions, which often vary among insurers even in the same line of business. Generally speaking, the more disclosure, the lower the risk that potential conflicts will become actual conflicts.

The incentives created by contingent commission arrangements, however, are not as easy to disclose clearly and comprehensibly. Most obviously, the amount of future producer remuneration is by definition unknown at the time of binding and therefore cannot be disclosed precisely. But in addition, the factors that could influence a producer to steer a placement – such as whether the producer is approaching a threshold that would trigger increased payment, or whether the contingent is based on profitability and may therefore dampen the producer's enthusiasm for claims advocacy – are complex and not easily communicated. In fact, in Australia, the Australian Securities and Investments Commission, which your offices prompted to study these issues in 2005, found that contingent commission agreements create special disclosure challenges. So if the Department is considering allowing New York producers to continue taking contingent commissions, it should attempt to develop particularly detailed disclosure requirements that would allow clients to confidently assess any potential conflicts.

And, of course, whatever rules New York now decides to adopt limiting permissible forms of compensation, they should be consistent for all producers.

Conclusion

This is an industry that I am proud to be a part of. Over the last 30 years, I have competed against small, medium and large producers. The vast majority of these firms, and the vast majority of individuals in these firms, work with integrity and with the best interests of clients uppermost in their minds in what is a highly competitive industry.

The reforms proposed in 2004 were designed to eliminate market problems, raise standards in the industry, reinforce the spirit of a free market, and reduce conflicts of interest in terms of serving clients. We agree with these objectives. Aon therefore recommends reinforcing the spirit of consumer advocacy and a free market by having every producer compete on the same terms and in the same manner, with required transparency in a simple and effective form. All producers should disclose whom they work for, what they do, how they do it, and what they are paid. This will enable clients to make more informed choices, and will also reinforce the competitiveness of the marketplace and the standards of excellence and professionalism in the industry.

Thank you, and I will be happy to answer any questions you may have.