Bid-rigging scandal envelops top insurance broker in US

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New York Attorney General Eliot Spitzer filed a civil suit on October 14 against the world's largest insurance broker, Marsh & McLennan, charging the US firm with bid-rigging and other practices that enhanced its income at the expense of its clients. Marsh's insurance brokerage unit has recorded annual revenues of $6.9 billion.

The company's chairman and chief executive officer, Jeffrey Greenberg, resigned this week after the company's stock plummeted 42 percent in the short time since Spitzer filed his lawsuit.

Share values among large brokers, and insurance stocks in general, have declined sharply. Following Spitzer's lead, Connecticut Attorney General Richard Blumenthal announced an investigation into possible bid-rigging and price-fixing by insurance companies and brokers that provide health insurance, auto insurance and employee benefits.

This is the latest in a series of scandals to shake the financial services industry in the United States. Most recently, some of the nation's largest mutual fund managers were cited for allowing large customers to trade after hours, to the detriment of average customers.

Another unit of Marsh & McLennan, Putnam Investments, which is one of the nation's largest mutual fund providers, agreed to pay a $110 million fine in that case. Yet another Marsh unit, Mercer Consulting, was implicated in a Securities and Exchange Commission investigation into a $139 million pay package awarded to William Grasso, the former head of the supposedly non-profit New York Stock Exchange.

Only two years ago, some of the nation's largest investment banks, including Citibank, were fined $1.4 billion to settle charges of providing false and misleading investment advice to their customers. The banks had been touting the stocks of companies from which they hoped to gain additional business.

Marsh, with 63,000 employees worldwide, controls some 40 percent of property and casualty insurance broking for large corporate clients. Aon Corp., in second place, controls another 30 percent. Aon is also under investigation.

The concentration of business in the hands of only two brokers gives them enormous market clout with both insurance companies and clients, for whom the brokers are supposed to serve as a trustworthy go-between. The monopoly situation was ripe for abuse.

Based on e-mail evidence, Marsh is charged with submitting fake bids to its clients. Clients were led to think they had obtained competitive bids, when, in fact, Marsh got friendly insurance companies to provide high bids to give the illusion of competition. The insurers who went along were assured of their own turn at the trough the next time around.

In addition to commissions and normal fees, Marsh received extra payments from the insurers under incentive agreements based on their volume of business. The broker would rig the bids or otherwise steer client companies to insurers who paid the broker the largest incentives.

The amount of income raked in through such incentive payments was enormous. Marsh reported receiving $842 million in such revenues in 2003, whereas Aon took in some $200 million. Many clients said they were unaware of the incentives until Spitzer filed the lawsuit, although Marsh claims that it disclosed such payments to clients, at least in general terms.

Implicitly acknowledging the impropriety of the practice, both Marsh and Aon agreed to stop accepting incentive payments within days of the lawsuit. Spitzer

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is also investigating “tying” and other “pay-to-play” practices that are questionable under anti-trust laws.

In another implicit admission of wrongdoing, Marsh issued a press release the day after naming a new president that avowed the company would ensure that “the best interests of its clients are served and that every transaction is executed in accordance with the highest ethical and professional standards.”

With Greenberg’s resignation, Spitzer has agreed to forgo criminal charges against the company. It was widely speculated that a criminal indictment against Marsh would lead to its demise, as occurred with Arthur Andersen, the accounting firm that had certified Enron’s financial statements.

To date, three individuals have pleaded guilty to criminal misdemeanors in the scandal—two executives at American International Group (AIG), which is headed by Greenberg’s father, and one at ACE Ltd. in Bermuda, headed by Greenberg’s brother Evan. It is expected that senior executives at Marsh, five of whom have been dismissed to date, will eventually face charges.

Greenberg himself is reportedly negotiating his severance package. Last year, he was paid salary, bonus and other cash compensation amounting to $5 million, plus grants of options and restricted stock.

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