Now that crusading New York Attorney General Eliot Spitzer has set his sights on the insurance industry, do banks with insurance operations have much to fear? If the current scandal widens to other commercial banks that have recently acquired insurance subsidiaries, might even the most law-abiding combinations be forced to return to the status quo, pre-banking deregulation? Or, at the least, will punitive fines be levied, severely damaging the balance sheets of offending companies? Will the whole affair stimulate shareholder suits?

Not necessarily, in our opinion.

The problems began just weeks ago, with allegations that the large insurance brokerage houses had engaged in illegal contingent-fee kickback and bid-rigging schemes, highlighting the ongoing conflict of interest that arises when brokers are paid by both retail clients and insurers whose policies they place. The nation’s largest insurance brokerage, Marsh & McLennan of New York, is alleged by Mr Spitzer to have collected $800m in contingent-fee kickback and bid-rigging schemes in 2003 alone. Two other leading brokerage firms have come under investigation for similar practices, and the widening investigation has now engulfed several insurance companies, in the US and in Europe, that may have participated in the bid-rigging schemes. One of these is ING, the Dutch bank subpoenaed last month regarding its insurance sales practices.

Let’s look at the damage so far. When the bad news broke, the companies implicated by Mr Spitzer saw their stock prices plummet and their executives pressured to resign. When the charges against Marsh became public, its shares fell by about half within days, taking the broader markets with it. Its CEO was forced to step down to save the company (though not individuals within it) from criminal prosecution. Those insurance issuers in Mr Spitzer’s sights also saw their market values dive, including the American International Group, arguably the world’s most admired insurance company. As for ING — the only bank under investigation — its shares dropped some 5.2% on the news that it had been subpoenaed, which triggered a broader decline in insurance stocks across Europe.

However, once the targeted companies appeared to be cooperating with investigators, share prices quickly levelled off and in some cases began to recover. Quick compliance may stave off further pressures, such as the threat of antitrust scrutiny in the highly concentrated brokerage sector of the insurance market. Notwithstanding the ING inquiry, there is no reason to believe that most banks with insurance subsidiaries will be implicated.

The other good news for the insurance industry is Mr Spitzer’s own recent history. Perhaps because he is politically ambitious, he tends to move quickly to bring equilibrium to the industries that have incurred his wrath. Rather than inflict damage on corporations or their employees through trials and punishing fines, he extracts public promises to change behaviour through negotiated settlements. Other industry regulators are likely to follow his lead.

A likely scenario is that Mr Spitzer will opt for a return of some money to wronged clients, and a few well-targeted individuals may plead guilty to crimes or go to jail. While brokers may be at risk for suits brought by wronged clients, the spillover to insurers is less likely. And judging from the fines levied on the wider investment banking and mutual fund industry for their much worse misdeeds, while not insignificant, they were hardly debilitating to the companies that paid them. If anything, Mr Spitzer seems to go out of his way to resolve matters swiftly and to limit the financial damage to accused companies and shareholders if they co-operate.

Insurers must signal that they will scramble to eliminate any conflicts of interest and better monitor sales practices. If that happens — and if Mr Spitzer is true to form — industry order will be quickly re-established and consumer and investor confidence restored. For many companies — including user-friendly bank-related insurance operations — a reputation for fair dealing may even command a premium.

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The Broker column is named after Brendan Bracken, the founding editor of The Banker in 1926 and chairman of the modern-day Financial Times from 1945 to 1958. This column reflects his enormous contribution to the open discussion and understanding of international finance and banking. It focuses on providing views and perspectives on how to improve the global financial system.