

WHEN MAY BROKER-AGENTS CHARGE FEES?

By Stephen L. Young, Senior Vice President & General Counsel, IBA West

Insurance producers licensed as California fire and casualty **broker-agents may charge fees.**

But knowing when such fees may-and may not-be charged is not enough. It is also important to know what guidelines should be followed to ensure that full disclosure has been provided to, and informed consent obtained from, customers paying fees.

Charging Fees <https://www.ybac.net/tcmssolutionsite/Default.aspx?tabid=789>
1 of 5 3/3/2010 9:12 AM

The ground rules themselves are not overly complicated, but identifying them can be, because they come from a variety of different sources, including a legal opinion issued by the California Department of Insurance in 1997, broker fee regulations applicable to fees charged by brokers in personal lines of insurance, miscellaneous provisions of the California Insurance Code, and a handful of judicial decisions construing "agency" authority and distinctions between "brokers" and "agents."

The purpose of this paper is NOT to provide legal advice, but instead to offer a brief summary of the "rules" and to provide sources of additional information.

This is the "bottom line":

(A) If a producer is appointed, and lawfully acting as an agent of an insurance company, he may charge fees in addition to commission ONLY if:

1) The fee is for a service that is unrelated to the agent's "transaction" of insurance (as that term is defined in CIC Section 35); OR

2) The service in question does relate to the transaction, but is something that the insurer does not ask or expect its agents to perform; in other words, a service materially above and beyond what the insurer expects of its agents.

(B) On the other hand, if a producer is lawfully acting as a broker, she may charge fees in addition to commission for any service whatsoever.

Any broker or agent charging a lawful fee is required to obtain the consumer's consent in advance after disclosure of all material facts related to the service and the fee—including the fact, if true, that the producer receives a commission from the insurer.

Q: My license from the State of California says I am a "broker-agent." In practical terms, how do I know whether I'm acting as an "agent" or a "broker" in a particular case?

A: The title of the license is largely irrelevant. Producers continue to act in specific CONTRACTUAL capacities, such as "agent," "broker," or "solicitor." Acting as an agent requires at least one insurance company to have contractually appointed the producer to be its agent. This appointment can be evidenced in several ways. In almost every case, a written agency agreement will outline the agent's authority duties. In addition, pursuant to California Insurance Code Section 1704, the insurer must file a notice of agency appointment (sometimes called an "action notice") with the CDI.

Acting as a broker effectively requires at least one insurance consumer to seek the producer's services. In addition, a broker must obtain a "broker's bond" and file proof thereof with the CDI.

Acting as a solicitor requires licensure as a broker-agent, employment by an agency or brokerage (either as an "employee" or independent contractor), and inclusion of the licensee on the organization's list of authorized transactors.

By definition, if an insurance company has filed an "action notice" on a given producer, that producer cannot legally be considered a "broker" in dealings with that insurer.

Q: What is a so-called "defacto agent" and why is that term significant?

A: The Latin word, "defacto," means "in fact, though not in name." CDI and others have alleged that some insurers have been circumventing premium taxes and permitting illegal fees by using "defacto agents"; i.e., producers who are called "brokers" in name, but whose contractual relationship with the insurer is virtually indistinguishable, in fact and at law, from an agency relationship.

The Mercury Insurance group is now defending a case (Krumme v. Mercury) in which private plaintiffs have alleged that the insurer has wrongly permitted its agents to charge fees by mischaracterizing them as "brokers." The plaintiffs allege that the "brokers" are defacto agents because (among other reasons) they have binding authority, receive commissions, and are subject to virtually all of the limitations requirements placed on Mercury agents.

Every situation is factually unique, and the law in this area is not well-defined-at least yet-so it is difficult to identify the specific combination of facts or circumstances that could subject a broker or insurer to liability for "defacto agency."

However, the presence of binding authority is one key factor. There is no law at present suggesting that the mere presence of binding authority, with nothing more, is sufficient to transform a legitimate brokerage relationship into one of defacto agency. But the greater the functional similarity between an insurer's broker and its agents, the greater the threat of defacto agency.

Charging Fees <https://www.ybac.net/tcmssolutionsite/Default.aspx?tabid=789>
2 of 5 3/3/2010 9:12 AM

Q: What penalties or liabilities do a "defacto agency" face?

A: It depends on who brings the allegation, and what damages (if any) they seek. For example, an insurer might terminate a brokerage contract and claim it had not authorized the broker to charge fees. The insurer might seek restitution if it was held liable for nonpayment of premium tax (on the amount of the improper fee, which would be treated as part of the premium) or unfair rate discrimination (since the "premium" might vary dramatically, depending on whether fees were added and if so, in what amount).

If CDI brought an allegation, it might seek license suspension or revocation in addition to restitution and/or fines. If private plaintiffs filed suit, they theoretically could assert "bad faith" causes of action, which if proven could justify non-economic or punitive damages, in addition to reimbursement of fees paid, attorneys' fees, court costs, etc..

Q: How do I protect myself against "defacto agency" allegations?

A: First, evaluate your brokerage contracts carefully, and seek outside counsel if necessary. Work with your insurers to replace binding authority or other agency-like contractual clauses, with substituted provisions. Ask your insurers to indemnify and hold you harmless for any and all "defacto agency" allegations or claims. Second, evaluate your fee-charging practices. "Agents" may charge fees only in limited circumstances. "Brokers" are not similarly constrained. If a producer charged fees only in cases where he could lawfully charge the fee as an agent, then it wouldn't matter whether he was later found to be a "broker," an "agent" or a "defacto agent." The fee would be permissible in each event.

Q: How is "transaction of insurance" defined and why should I care?

A: The definition of "transact" as applied to the business of insurance is very important

for at least two reasons: 1) it defines the activities that (with only limited exceptions) require licensure by CDI; and 2) in the case of insurance agents, it defines the activities that they are expected to perform as agents-which means they cannot add a fee to the commission paid by the insurer. (The only exception to that prohibition would be in cases where the insurer also consented to the fee being charged. However, any insurer giving its consent would probably face liability for unfair rate discrimination and nonpayment of premium taxes).

"Transact" includes any of the following: (a) solicitation; (b) negotiations preliminary to execution of the insurance contract; (c) execution of a contract of insurance; or (d) transaction of matters arising out of the contract after its execution.

That means, for example, that an "agent" could not charge a fee for searching the market, comparing policies, or recommending insurers (assuming that the producer was actually acting in an agency capacity at the time those services were being provided), for placing a policy, or for processing endorsements, issuing certs, or submitting notices of claims. A "broker" could charge fees for any or all of those activities (provided that full disclosure was made and informed consent was obtained in advance), but an "agent" could not.

Q: What are examples of services unrelated to the transaction of insurance?

A: Examples may include, but are not limited to, the following.

(1) A person licensed as a broker-agent also works as a certified financial planner. The broker-agent sells an auto policy to a consumer and places it with an insurer that has appointed the broker-agent as its agent. The agent also offers to provide fee-based financial advice. The latter is unrelated to the former. A fee could be charged for financial planning, but not for placement of the auto policy.

(2) A person licensed as a broker-agent offers to search the market, compare policies, and/or recommend insurers for a particular customer, but does not attempt to sell a policy to that person. A fee could be charged for the consultation. Note, however, that if the broker-agent then turned around and sold a policy discussed during the consultation to that consumer, it is possible that the Department would view both transactions as related; if so, a fee could be charged only if the broker-agent was acting as a broker during the subsequent transaction, and if all the other disclosure and consent requirements were satisfied.

Q: What are examples of services that relate to the transaction of insurance, but involve something "above and beyond" what the insurer asks or expects of its agents?

A: Examples may include, but are not limited to, the following.

(1) A broker-agent sells a policy as an "agent" of a particular company. The "agent" then offers to do a comprehensive risk management evaluation of all or part of the Charging Fees <https://www.ybac.net/tcmssolutionsite/Default.aspx?tabid=789>
3 of 5 3/3/2010 9:12 AM
policyholders' operations or properties or activities. Assuming the evaluation is not required by the insurer, the "agent" could charge a fee for that service, even though it may relate to or have an effect on the policy sold.

(2) A broker-agent sells a policy as an "agent" of a particular company. As the policy comes up for renewal, the broker-agent offers to conduct a comprehensive search of the marketplace to determine whether better coverage or price terms can be obtained from a different insurer; the policy is in fact moved to another insurer with whom the producer is also appointed as an agent. Assuming that a comprehensive search and

comparative analysis is actually undertaken, it might be possible to justify a fee for that service-after all, the original insurer in most cases would not ask its agent to search the market or move the policy to a competing insurer.

The safer approach, however, would be to refrain from charging the fee unless the producer had a true broker relationship with the new insurer. Note also that if the agent's "search of the market" involved nothing more than use of a computerized rating software program, which typically does not require the expenditure of significant time or effort, or if the agent places substantially all accounts with one insurer, the CDI might question whether material professional services were actually provided.

Q: If I wish to charge fees, either as a broker or as an agent, what must I disclose?

A: At a minimum, producers charging fees must disclose-in advance-the amount of the fee, the services to be provided for the fee, the limitations (if any) on refundability of the fee (such as a provision that fees are considered fully earned at the inception of the policy and are non-refundable), and all other material facts, including the fact, if true, that the producer is (or may be) receiving a commission from the insurer; it is not the amount, but rather the fact, of commission or other compensation from the insurer that must be disclosed in advance.

In personal lines of insurance, brokers charging fees are also required: 1) to distribute, and obtain initials of the applicant or policyholder on, a mandatory one-page disclosure sheet on broker fees; 2) to distribute a CDI consumer pamphlet on automobile and/or dwelling insurance; and 3) to use a broker fee agreement that is not inconsistent with a sample agreement drafted by the Department.

Q: How do I obtain the consent of applicants or policyholders to charge fees?

A: In personal lines of insurance, as explained in the answer to the preceding question, brokers are required by law to use a written fee agreement and to obtain the initials of the applicant or policyholder on a CDI disclosure sheet.

However, even in commercial lines, producers would be well-advised to always use free-standing written fee agreements. While it is technically true in commercial lines that consent may be given orally, or inferred from payment of an invoice on which a fee is itemized, neither of those methods provides the broker with conclusive proof that the consumer had been informed of all the material terms related to the fee, and had provided advance consent thereto. A well-drafted fee agreement ensures not only full disclosure to consumers, but also protection for the producer from false accusations that a fees were not disclosed or understood or agreed upon.

Q: Is there any limit on the amount of fees I may otherwise lawfully charge?

A: No. However, prudence dictates restraint. Unreasonably high fees raise at least an inference that consumer consent, if obtained at all, may not have been fully informed. The overwhelming majority of brokers and agents find unreasonably high fees and sharp fee practices, by a small minority of their competitors, to be morally repugnant. The majority knows well that if producers do not effectively police themselves in this regard, regulators or legislators may go overboard doing it for them.

Q: Am I required to adopt a mandatory, uniform fee schedule?

A: No. However, a fee schedule consistently applied might help insulate producers from potential claims alleging unfair discrimination.

Q: Am I legally prohibited from charging fees on particular insurance products?

A: Yes. The California Insurance Code prohibits brokers or agents from charging fees for placing minimum-limits policies with the California Automobile Assigned Risk Plan (CAARP), and the California Fair Access to Insurance Requirements (FAIR) Plan. Fees may be charged by brokers (but not agents) for securing supplemental limits or

coverages.

Q: Where can I get more information?

A. (1) A 1997 legal opinion from the California Department of Insurance on producer fees is available on the IBA West website at <http://www.ibawest.com/pdf/Articles/Bulletin806AgentFees.pdf>.

(2) The broker fee regulations are codified at Sections 2189.1 - 2189.8 of the California Charging Fees <https://www.ybac.net/tcmssolutionsite/Default.aspx?tabid=789>
4 of 5 3/3/2010 9:12 AM

Code of Regulations. To obtain regulations on-line, consult the "roadmap" titled, "Finding California Insurance Regulations," by clicking [here](#).

(3) Provisions of the California Insurance Code are also available on-line. To obtain statutes electronically, consult the document, "Finding California Insurance Statutes," by clicking [here](#).

(4) To read the most recent California appellate court decision on the distinction between brokers and agents, IBA West members may call our toll-free Member Services Department, at 800-772-8998, and request a copy of the opinion in Marsh v. City of Los Angeles, a 1978 case holding that agents, but not brokers, were exempt from municipal business tax ordinances.