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## New York Revises and Adopts Producer Compensation Disclosure Rule

The New York Insurance Department (the “Department”) has adopted its producer compensation disclosure regulation (the “Regulation”). The Regulation, which was published in the February 10, 2010, issue of the New York State Register, will be effective January 1, 2011. In our prior *Client Alert* discussing the last draft of the Regulation published by the Department in December 2009 (the “December Draft”), we noted that the Department had reportedly received over 2,000 comments on the December Draft. See “[Producer Compensation Transparency Rule Nears Enactment in New York](#).” Based on these comments, the Department revised several provisions in the December Draft. We discuss the Regulation below, noting the changes from the December Draft.

### Required Disclosures

An insurance producer selling an insurance contract in New York must disclose the following information to the purchaser orally or in a “prominent writing” at or prior to the time of application for the insurance contract [*note: The December Draft also applied to an insurance producer “renewing” an insurance contract.*]:

- (1) a description of the role of the insurance producer in the sale [*note: The December Draft required disclosure of “whether the insurance producer represents the purchaser or the insurer for purposes of the sale.” The language in the Regulation now allows a producer to avoid making a bright line distinction between acting as an agent or a broker (e.g., the producer could now disclose that the producer acts for the purchaser for some purposes and for the insurer for other purposes). However, the Regulation provides no guidance as to what constitutes adequate disclosure of the producer’s “role” in the transaction.*];
- (2) whether the insurance producer will receive compensation from the selling insurer or other third party based in whole

or in part on the insurance contract the producer sells;<sup>1</sup>

- (3) that the compensation insurers pay to the insurance producer may vary depending on a number of factors, including (if applicable) the insurance contract and the insurer that the purchaser selects, the volume of business the producer provides to the insurer or the profitability of the insurance contracts that the producer provides to the insurer;<sup>2</sup> and
- (4) that the purchaser may obtain information about the compensation expected to be received by the producer based in whole or in part on the sale, and the compensation expected to be received based in whole or in part on any alternative quotes presented by the producer, by requesting such information from the producer.<sup>3</sup>

If the disclosure is provided orally, the insurance producer must also disclose this required information by a prominent writing no later than the issuance of the insurance contract.

“Compensation” is defined broadly to include anything of value, including money, credits, loans, interest on premium, forgiveness of principal or interest, trips,<sup>4</sup> prizes, or gifts, whether paid as commission or otherwise. Compensation does not mean tangible goods with the insurer name, logo or other advertisement and having an aggregate value of less than \$100 per year per insurer.

### Additional Disclosure at Purchaser’s Request

If the purchaser requests more information about the producer’s compensation (see item 4 above) the producer must disclose the following information to the purchaser in a prominent writing:

- (1) a description of the nature, amount and source of any compensation to be received by the producer or any parent, subsidiary or

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- affiliate based in whole or in part on the sale;
- (2) a description of any alternative quotes presented by the producer, including the coverage, premium and compensation that the insurance producer or any parent, subsidiary or affiliate would have received based in whole or in part on any such alternative coverage;<sup>5</sup>
  - (3) a description of any material ownership interest the insurance producer or any parent, subsidiary or affiliate has in the insurer issuing the insurance contract or any parent, subsidiary or affiliate;
  - (4) a description of any material ownership interest the insurer issuing the insurance contract or any parent, subsidiary or affiliates has in the insurance producer or any parent, subsidiary or affiliate; and
  - (5) a statement whether the insurance producer is prohibited by law from altering the amount of compensation received from the insurer based in whole or in part on the sale.<sup>6</sup>

If the purchaser requests more information about the producer's compensation: (i) *prior to issuance of the insurance contract*, such disclosure must be provided to the purchaser at or prior to the issuance of the insurance contract (or within five business days if time is of the essence to issue the contract); and (ii) *after issuance of the insurance contract but less 30 days after issuance*, the insurance producer must disclose to the purchaser in a prominent writing the information required above within five business days.

For purposes of this additional disclosure, if the nature, amount or value of any compensation is not known at the time of the disclosure, then the insurance producer must include in the disclosure:

- (1) a description of the circumstances that may determine the receipt and amount or value of such compensation; and
- (2) a reasonable estimate of the amount or value, which may be stated as a range of amounts or values.

**Record Retention**

An insurance producer must retain a copy of any written disclosure provided to the purchaser for not less than three years after the disclosure is given, unless the insurance producer has a written agreement with the insurer that the insurer shall retain such a copy [note: *Compared to the December Draft, the Regulation adds this new exception to the producer's record retention requirement where the producer has an agreement for the insurer to retain a copy of the disclosures.*]. Insurers are also required to maintain the amount of compensation paid to insurance producers in accordance with insurance company record requirements (NY Regulation 152).

If oral disclosure is provided to the purchaser to meet the "Required Disclosure" requirements, the insurance producer must retain for at least three years a certification that the oral disclosure was provided or an audio recording of the oral disclosure.

**Transactions Not Subject To Regulation**

The Regulation is not applicable to:

- the placement of reinsurance;
- the placement of insurance with a captive insurance company;
- an insurance producer that has no direct sales or solicitation contact with the purchaser, which may include wholesale brokers or managing general agents;
- a sale of insurance by a person who is not required to be licensed as an insurance producer;
- renewals, except that if the purchaser requests more information about

the producer's compensation less than 30 days prior to a renewal or less than 30 days after a renewal, the insurance producer must disclose to the purchaser in a prominent writing the information noted above within five business days [note: *The December Draft excepted "renewals when the producer has no sales or solicitation contact with the purchaser in connection with the renewal." The renewal exception in the Regulation is broader but adds a requirement that the producer respond to certain purchaser requests for disclosures in connection with renewals.*].

**Conclusion**

In our prior client alert on the December Draft, we noted some criticisms of the Regulation. While some of the concerns have been addressed, others have not. For example, one trade group believed that the definition of "compensation" was overly broad, but the revised Regulation did not narrow the scope of the definition.

We also want to emphasize that the revised Regulation does not prohibit contingent commissions. Rather, in the Regulatory Impact Statement accompanying the published Regulation in the New York State Register, the Department states that "[t]here is nothing inherently improper about incentive-based compensation arrangements between an insurer and the producer, but due to the differences in each insurer's compensation arrangement, a potential conflict of interest may arise ... ." The Department goes on to state that the Regulation is intended to address this potential conflict of interest. As we pointed out in our prior client alert on the December Draft, this position seems inconsistent with the settlement agreements that the New York Attorney General, and in some cases the Department, entered into with several large insurance brokers and

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insurance companies. Such settlement agreements prohibited the brokers from receiving contingent commissions and prohibited the insurers from paying contingent commissions for certain lines of insurance.

Locke Lord Bissell & Liddell LLP has significant experience in producer compensation issues and assisting insurers and brokers in complying with these issues and will continue to follow developments in this area.

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### *Endnotes*

- 1 The December Draft similarly required disclosure “that the insurance producer will receive compensation from the selling insurer based on the insurance contract the producer sells (if applicable).”
- 2 The revised Regulation clarifies that these factors may not be applicable to a particular sale.
- 3 The revised Regulation clarifies that disclosure is required for expected compensation based “in whole or in part” on the sale.
- 4 The revised Regulation substitutes “trips” for “vacations.”
- 5 The revised Regulation changes the last word from “quotes” with “coverage.”
- 6 The revised Regulation clarifies the requirement is based “in whole or in part” on the sale.

### **About the Authors**

Anthony B. Sherman is a partner at Locke Lord. Mr. Sherman regularly advises clients on insurance and service contract transactional and regulatory issues.

Timothy S. Farber is an associate at Locke Lord. He practices in the area of corporate law, where his practice focuses on general corporate law, mergers and acquisitions, securities and insurance regulatory matters. Mr. Farber has experience representing issuers and underwriters in debt and equity financing matters for both public and private companies.