LLB&L Client Alert

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Producer Compensation Transparency Rule Nears Enactment in New York

The comment period for the New York Insurance Department's (the "Department") proposed regulation concerning producer compensation disclosure (the "Regulation") has now expired. The stated purpose of the Regulation is to regulate the acts and practices of insurers and their producers with respect to transparency of compensation paid to insurance producers and their role in insurance transactions in New York. The Regulation was published in the New York State Register on December 2, 2009, and was subject to a 45-day comment period, which has now expired. The Department received many comments (reportedly over 2,000). The Department may now promulgate the regulation unchanged, amend it or withdraw it.

Required Disclosures

The Regulation requires an insurance producer selling or renewing an insurance contract in New York disclose the following information to the purchaser orally or in a "prominent writing" not later than application for the insurance contract or the renewal:

(1) Whether the insurance producer represents the purchaser or the insurer for purposes of the sale;
(2) The insurance producer will receive compensation from the selling insurer based on the insurance contract the producer sells (if applicable);
(3) The compensation insurers pay to insurance producers may vary depending on a number of factors, including 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; and
(4) The purchaser may obtain information about the compensation expected to be received by the producer for the sale and for any alternative quotes presented by the producer by requesting such information from the producer.

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, vacations, 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 Regulation requires that the producer disclose the following information to the purchaser in a "prominent writing:"

(1) Description of the nature, amount and source of any compensation to be received by the producer or any parent, subsidiary or affiliate based in whole or in part on the sale;
(2) 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 quotes;
(3) 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) 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) Statement whether the insurance producer is prohibited by law from altering the

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amount of compensation received from the insurer for the sale.

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 no later than 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 than 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) Description of the circumstances that may determine the receipt and amount or value of such compensation; and
(2) 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. 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; and
- Renewals when the producer has no sales or solicitation contact with the purchaser in connection with the renewal.

Criticisms

While the proposed Regulation is less onerous than some earlier drafts (*e.g.*, in the current draft, the more detailed disclosure only occurs upon purchaser request), there have been many criticisms of the draft including by groups such as the Independent Insurance Agents and Brokers of New York ("IIABNY"). The main areas of concern are as follows:

- Role Disclosure - The Regulation requires producers to disclose "whether the producer represents the purchaser or the insurer for purposes of the sale." The IIABNY believes the requirement has been over-simplified, particularly for independent agents, which may act as agent and broker simultaneously, depending on the coverage requested. While independent agents may by statute be representatives of the insurers, they must act in the best interest of the customer at all times to maintain the relationship.
- Timing of the Notice - The Regulation requires disclosure "not later than application for the insurance contract or renewal." The IIABNY believes this provision is too vague because it is difficult to precisely determine when an application is made (*i.e.* with the first phone inquiry or a signed application).

- Applicability to Renewals - The Regulation requires the same disclosure for renewals as for newly written policies. The IIABNY feels that this provision is cumbersome and adds no real value for the consumer while adding additional expense for producers.

- Definition of Compensation - The IIABNY believes the definition of "compensation" is overly broad, which makes compliance difficult for producers. Specifically, selling a single policy might have only a negligible difference on the contractual incentives a producer receives from an insurer. Many of the items listed in the definition are dependent on a number of factors not known until the end of a calendar year.

The IIABNY has taken the necessary steps to commence a legal action to challenge the rule should it be adopted.

Contingent Commissions Not Prohibited

In 2004, former New York Attorney General Eliot Spitzer, insurance regulators and states attorneys general in numerous other states, including Connecticut and Illinois, conducted investigations into contingent commissions. After a series of inquiries regarding client steering, bid-rigging and other alleged anti-competitive practices against insurers and brokers, settlement agreements were negotiated with state authorities. State attorney generals have entered into agreements with large insurance brokers such as Marsh, Aon and Willis which ban contingent commissions.

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Some had advocated complete bans on the payment of contingent commissions, while others pushed for increased mandatory disclosure. The NAIC responded by adopting model statutory wording requiring disclosure of producer compensation from insurers. Various states have adopted statutes and regulations incorporating or modifying the model wording.

The Regulation provides no ban on specific types of compensation, including contingent commissions. This may be inconsistent with the settlement agreements some large companies such as Marsh, Aon and Willis have entered into with the New York Attorney General prohibiting receipt of contingent commissions. New York's former insurance superintendent, Eric Dinallo—who initiated the formulation of new producer compensation disclosure rules—stated, after leaving office in 2009, that a segmented market where some are banned from taking the commissions and others are not, is not a good situation. Connecticut Attorney General Richard Blumenthal has reportedly stated that he was in discussions with brokers to institute a "level playing field" on producer compensation rules. In addition, as of October 2009, the Illinois Attorney General and Illinois Director of Insurance agreed to amend a consent order to permit Arthur J. Gallagher to once again accept contingent commissions after a nearly four-year ban. Passing this Regulation and permitting contingent commissions may be an indication that New York will follow Illinois' lead in amending settlement agreements which prohibit such payments in order to create a level playing field for everyone.

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.

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.

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