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California Proposes Revamped Insurance Producer Disclosure Regulations

The California Department of Insurance has recently published for public comment revised regulations dealing with the disclosure obligations of insurance producers. These revised rules were modified to address industry and consumer comments received earlier this year in response to the Department's original draft regulations, which appeared in October, 2004. As originally drafted, the regulations addressed two key types of broker malfeasance: (1) failure by a broker to disclose all "material facts" relating to the broker's receipt of income arising from an insurance transaction on behalf of the client; and (2) failure by a broker to place its client's business with a "best available insurer." For a more detailed description of the original draft regulations, see Lord, Bissell & Brook's October 2004 client alert entitled "California Proposes New Insurance Broker Conflict of Interest Regulations."

In January of 2005 the California Department held a public hearing and workshop in which the Department received both written and oral testimony from nearly two dozen industry organizations, as well as numerous consumer groups on the prospective regulations. Industry testimony was generally very negative, emphasizing various perceived defects in the regulations, including but not limited to: (1) the Department's adoption of broad "fiduciary duty" standards for brokers that extended well beyond the limited common-law and statutory fiduciary duties applicable to brokers' handling of premium funds; (2) the "best available insurer" standard being hopelessly subjective and ambiguous; and (3) the regulations' expansive use of the term "client" including not only insureds but also to any "prospective insured with whom the broker transacts or may transact insurance."

Whether in response to industry opposition, or upon further analysis of the challenges the regulations would almost certainly face in running the gauntlet of the Office of Administrative Law—where the Department would have to show that there was legitimate statutory authorization for the issuance of the regulations—the Department has now issued a revised, and significantly scaled-back, version of its regulations. Most significantly, the

Department has abandoned any notion of "best available insurer," and has focused instead on more specific disclosure requirements for insurance intermediaries who undertake to act on behalf of the insured or who obtain multiple quotes in connection with an insurance placement.

NEW DISCLOSURE OBLIGATIONS

Under the revised regulations, a "producer" (which is the new term used in the regulations for any insurance intermediary holding a license from the Department, whether styled as an agent, broker, solicitor or otherwise, and regardless of the line of insurance offered) must advise a client, prior to "signing an agreement or receiving a fee," whether the producer will seek a quote from one insurer or more than one insurer. The regulations are silent as to whether this same duty of disclosure applies where the producer simply procures a policy on behalf of the client

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without signing a producer agreement or receiving a fee from the client, which would be a fairly common scenario.

If the producer does advise the client that the producer will seek quotes from more than one insurer, and further undertakes to make a recommendation to the client regarding the quotes received, the producer must disclose to the client, at or prior to the time the recommendation is made: (1) whether the producer is acting on behalf of the insurer or the client in connection with the placement of insurance (under the regulations, a producer who accepts a fee from a client is conclusively deemed to be acting on behalf of the client); and (2) the amount of compensation the producer will receive if the client purchases insurance with any insurer recommended by producer. If the amount of compensation cannot reasonably be known at the time this disclosure is made, the producer can disclose the method by which any such compensation will or may be calculated.

The regulations further require that a producer who advises a client he is acting on the client's behalf, or who accepts a fee from the client, may not accept any compensation from a third party (including, presumably, any commission from an insurer) for the insurance placed on behalf of the client without first obtaining the consent of the client.

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The regulations provide that a producer who advises the client that the producer will seek quotes from more than one insurer must reveal the number of quotes obtained and, with respect to each quote, the name of the insurer, the premium amount, and amount of compensation the producer will receive from the insurer (or basis on which it will be calculated if the amount cannot be determined at the time of the quote).

Finally, the regulations contain an interpretational provision that disclaims any intent to limit a producer's duty to disclose other material facts not expressly required by the regulations, or to disclose such facts in circumstances other than those required by the regulations. This provision seems obviously designed to preclude producers from using the regulations in a defensive posture to fend off claims that they had a legal duty to make additional disclosures under certain circumstances.

Because the Department's revised insurance producer regulations are promulgated under the authority of the California Unfair Practices Law, any violations of the rules will be considered to be unfair trade practices, which can lead to fines of up to \$10,000 per incident, issuance of a cease and desist order, and/or the revocation or suspension of a broker's license. It is therefore important that insurance producers, and the insurers with whom they deal, become acquainted with these proposed rules and consider actively participating in the upcoming rule-making process. According to Department staff, written comments on the revised regulations are due by May 2, 2005.

Taken as a whole, it seems fair to say that the California Insurance Department's revised regulations represent a significant improvement over their original draft rules, and probably do not go much beyond the scope of disclosure that a number of prominent commercial insurance brokers have already publicly adopted as their new disclosure standards in the wake of the barrage of regulatory and class action attacks they have recently faced based on alleged conflicts of interest.

SENATE BILL 938

However, lest producers or insurers think that the California Department's proposed regulations represent the last word in California on the duties of producers with respect to their clients, the industry need look no further than Senate Bill 938, recently introduced by Senator Joseph Dunn (D-Santa Ana). SB 938, which Commissioner John Garamendi has already stated publicly he strongly supports, would significantly expand the common-law duties of brokers to their clients, and would codify these expanded duties, thus providing grounds for expanded liti-

gation against insurance producers. Among other things, SB 938 would enshrine in statute a number of specific duties of commercial insurance producers to their clients, including making reasonable inquiries to determine the client's preferences concerning price, quantity and quality of coverage, the quality of the insurer with respect to customer service, and the quality of the insurer with respect to financial strength, and then imposing a duty on the producer to act reasonably to obtain coverage that meets these expressed desires. As to each quote presented to the client, the producer would have to explain how the quote addresses each of the client's expressed desires with respect to each of the previously listed criteria.

Rather ominously, SB 938 dictates that the amount a licensee charges a client for a service or group of services shall be commensurate with the amount the licensee charges other clients for an equivalent service or group of services, and shall be proportional to charges imposed when more or less service is provided. To some observers, this sounds a lot like rate regulation for brokers, and an open invitation for the plaintiffs bar to pursue whole new theories of liability against insurance producers.

And in case insurers think they can largely disregard this particular piece of legislation, the statute would impose detailed rules describing under what circumstances an insurer must appoint an insurance producer as its agent, thus raising the specter of imputed liability to an insurer arising from the producer's acts.

Finally, SB 938 would grant the California Insurance Commissioner broad rulemaking authority to "implement, interpret or clarify" the statute, and to promulgate such rules on an emergency basis, and would further mandate that the Office of Administrative Law consider the rules to be "necessary for the immediate preservation of the public peace, health and safety, and general welfare."

The prospects for passage of SB 938 are at present unclear. Certainly a great deal of industry opposition is being mounted to defeat it. However, given all of the recent developments in California in the regulatory, legislative and judicial arenas dealing with the duties of insurance producers to their clients, it is imperative that the industry stay actively involved not only in monitoring these developments but also in proactively working to frame the public dialogue.

ABOUT THE AUTHOR

Since joining Lord, Bissell & Brook LLP in 1982, partner Carey Barney has devoted his practice to counseling clients on a variety of corporate and transactional matters, with a particular emphasis on insurance industry issues.

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