

A GUIDE TO COMPENSATION DISCLOSURE

Prepared by



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Note: This Guide is not intended to provide specific advice about individual legal, business, or other questions. It was prepared solely to act as a guide and is not a recommendation that any particular course of action be followed. You should consult an attorney or other expert before taking further action. Due to the overly litigious nature of today's society, use of the disclosure clauses herein is no guarantee that you will not be sued and does not necessarily protect you from potential liability or regulatory action.

INTRODUCTION

In today's litigious climate, agents and agencies in many states are experiencing an increase in suits by clients and legal action by State regulators and others concerning the relationships among the agent and agencies, the clients, and the insurer. One need only look at the actions by the Attorney General in New York, who brought charges against several agents and brokers in that state, to recognize the seriousness of the problem. As a result of the interest in this subject, FAIA has received many inquiries from its members seeking guidance about what actions, if any, they should take relative to the compensation disclosure issue. While the actions in other states are primarily focused on broker activities, Florida agents should not consider themselves without risk. Therefore, FAIA believes it is prudent to examine the issue and determine if there are any steps one can take to minimize exposure.

As Florida agencies evaluate their business practices and procedures, two issues arise: (1) whether, and to what extent should they make disclosure to their clients about compensation practices; and (2) what, if anything, should be disclosed about the efforts agents undertake on behalf of their clients? Of course, each agency must determine for itself whether to make such disclosures and how to make them. Every agency has unique characteristics, relationships, and operating procedures, and the disclosure policies of each agency must fit its particular needs. These needs and considerations are based on such factors as applicable statutory and regulatory requirements of the State, contractual relationships with insurers, and the relationships with current and potential clients. For example, Florida law has provisions governing when, and how, agents may charge fees in certain circumstances, and certain insurance companies have contractual requirements that may differ from some of the suggestions listed below. **Again, each agency should take appropriate steps to ensure that they are operating consistently with applicable law and contractually assumed criteria. If in doubt, an agency should consult appropriate legal counsel.**

POSSIBLE ELEMENTS OF A COMPENSATION DISCLOSURE

There are a variety of approaches to making a compensation disclosure, ranging from a short and simple form to those that include a much greater level of detail. In order to assist FAIA members who elect to develop a compensation disclosure practice, a list of possible topics and some specific ideas are set forth below. Ultimately, however, the development of such a disclosure is an agency-specific decision.

I. Introductory Statements and the Benefits of Utilizing Independent Agents

A compensation disclosure statement offers the agency an opportunity to describe the benefits and services that you offer as an independent agent, and these points can be used to help set the tone for your particular disclosure. **However, it is important not to promise something your agency is either unwilling or unable to provide.**

This is particularly true in today's litigious society. For example, you may do most or all of your business with a particular insurer. If your disclosure document states you "search the market" or words to that effect, a plaintiff's attorney could try to argue that this statement was misleading, if you, in fact, did not search the market but only the market(s) available to you. Think of the market for wind coverage in certain coastal markets where Citizens is the only available market. Is it misleading to say you will "search the market" if Citizens is your only market? Therefore, it is essential that any and all statements accurately reflect your agency's practice.

The following are some examples of possible introductory statements.

1. You are a highly valued client, and our firm takes pride in the services we provide to you. Acting as an independent insurance agent, we are able to offer you excellent service and competitive prices because we can access insurance coverage, in most cases, from more than one insurance company.

[or]

2. Our agency does business with multiple insurance companies, so we can usually offer you a variety of coverage choices and customize a plan to meet your specialized needs.

[or]

3. Our agency is not beholden to any one insurance company. Therefore, we are usually better able than agents who represent only one company to assist you in identifying and securing the combination of coverage, price, and service that meets your particular needs.

II. Statements Concerning Commissions & Other Forms of Compensation

- A. A compensation disclosure statement also offers an opportunity for your agency to clarify how commissions are ordinarily paid. Since the way commissions are paid varies greatly from carrier to carrier, **it is essential that any and all statements accurately describe your agency's practices.**

The following are some examples of possible statements concerning how commissions are calculated and paid in the normal course of business.

1. Our compensation comes from the insurance company writing your policy, in the form of a sales commission, which is determined by the insurer and is part of—but not in addition to—the premium you pay. That premium is subject to review by state regulators and cannot be inadequate, excessive or unduly discriminatory.

[or]

2. Our agency is paid a commission for selling and serving your account. The amount is based on the standard commission schedules established by each of the companies we work with, and is subject to review by the state regulator to ensure that it is neither excessive, inadequate or unfairly discriminatory.

[or]

3. For efforts in writing your business, our agency is compensated primarily by standard commissions. Standard commissions are based on schedules developed by each insurer and are calculated as a percent of the premium. They are not additional separate charges to be paid by you in addition to the premium.

[or]

4. Our agency is compensated on a commission basis by the insurance company that writes your insurance. This commission percentage is set by the company, not by us, and is included as a part of the insurance premium you pay.

[or]

5. In most cases, our agency is paid a commission, which is fixed or based on a percentage of the premium that you pay for your policy.

- B. In some instances, an agency may be paid additional compensation in the form of incentive rewards or bonuses. They range the gambit from a bonus or higher level of commission, all the way down to a company paid trip or even a Christmas ham or turkey. While insurance companies are the most frequent source of such payments, other third parties such as premium finance companies may also provide compensation for referrals. Should this apply to your business, and should you choose to disclose it, **remember that it is essential that any and all statements accurately describe your agency's practices.**

The following are some examples of what may be included in a compensation disclosure when compensation beyond the normal commission may be involved.

1. Our agency may also be eligible for various forms of incentive compensation, including contingent commissions and other awards and bonuses, from the insurer. Incentive compensation is based upon a variety of factors that may include the level of premium written, retention of business, growth, overall profitability, or other performance measures established by the insurers with whom we do business. It is important to note that any such bonus is paid by the insurer, and is not an additional cost to you.

[or]

2. Our agency may be eligible for additional commission and incentive compensation—paid for by the insurer, not you—based upon the volume, profitability, growth, retention, and other factors of the business we place with that insurer. This may include payments of money, cooperative marketing allowances, trips with executives of the insurer and paid for by them, and other financial or business awards or incentives.

[or]

3. Our agency's compensation might also include incentives in addition to the standard commission, but such incentives are normally calculated on the basis of overall business submitted to an insurer, often over multiple years. It is usually impossible to know at the time we place any individual policy whether the policy will contribute to, or detract from, our potential eligibility for future additional compensation from the insurer.

[or]

4. In addition, if the overall volume and loss experience of all of the policies we write with a particular insurer warrant it, we may qualify for an additional commission or other types of compensation, on a basis determined by the insurer and paid for by them. Any such compensation is factored into the overhead of the insurer and does not otherwise have any impact on the price you pay for insurance.

[or]

5. Our agency may also receive compensation through incentive or profit-sharing arrangements with insurance companies with which we place business. Eligibility for and the amount of this contingency compensation is based on pre-established thresholds that considers the overall profitability of the business we place with the insurer, as well as additional factors such as volume and retention of business. This incentive compensation is never tied to any individual policyholder, and there is no meaningful method to determine in advance the impact that any particular policy has on these payments. If in any given year our agency does not meet the profitability thresholds outlined above, we are not eligible for any incentive compensation.

[or, if your agency does not receive incentive compensation, you may wish to affirmatively say so by including a phrase such as the following:]

6. The agency receives no additional compensation from insurers or any other party for placement of your policy. The only compensation we receive is the standard commission described above.

III. Statements Concerning Fees paid By Clients

Unlike many other states, Florida law and regulation strictly limits when and how an agent may charge a separate fee to the client. The general rule of thumb is that, if the service is one that would normally be considered part of the acquisition cost of placing the policy with the carrier, then that service is deemed to be a part of the premium the client is paying. Thus, no separate fee is allowed to be charged.

Certain services have been singled out by statute as items for which a separate fee can be charged, even though they appear to be part of the “acquisition” process. Examples include charges for obtaining a motor vehicle report (MVR) and a policy fee for placing PIP/PD-only policies.

Finally, nothing in Florida law or regulation prohibits an agent or agency from charging a separate fee for providing services that are above and beyond the normal acquisition process. An example of this type of fee could be the providing of safety consultation services relating to a workers' compensation policy. In the event that such a fee is charged, the client should agree it to in advance and a separate invoice and contract should be used.

The following are examples of statements regarding the payment of fees by clients

1. We do not charge you anything for the placement of your policies. We are compensated solely by the insurance company in the manner previously described.

However, we may charge certain fees specifically authorized by statute, such as to cover the cost of obtaining a motor vehicle report.

[and]

2. We may also charge for services that are above and beyond those necessary to place the policy. If so, it will only be with your prior knowledge and consent, and we will provide you with a separate contract and invoice for that service.

[and/or]

3. We may receive a fee from a premium finance company for placement of your premium finance contract. This fee is included in the total charges you pay to the premium finance company.

IV. Statements Limiting the Scope of Services Provided

As mentioned earlier in this document, Florida, like most other states, is becoming ever more litigious. It is not unusual for an agent to be sued for something they are perceived to have done, or not done. Therefore, an important goal of any compensation disclosure statement is to inform the customer of material facts they can evaluate in order to make an informed decision regarding choice of producer, choice of insurer, and choice of policy. As is the case in all other parts of the disclosure statement, it is critical that all statements in any such disclosure be as accurate as possible.

- A. If your agency does, in fact, search most, if not all of your carriers in order to find the best fit for your client, then any disclosure should so state.

The following are examples of possible disclosures on this point.

1. Our agency does business with a variety of competing insurance companies, and we will attempt to obtain quotes from among those insurers that we believe to be suitable, based on the preferences and needs you have communicated to us.

[or]

2. Our agency will attempt to obtain quotes from more than one insurer for your consideration. However, we cannot investigate every available product that might suit your needs. We will attempt to answer any question you may have regarding the different quotes, insurers, or policies that we do obtain, if any, but be aware that YOU make the final decisions on which insurance products you wish to purchase, along with the types and amount of coverage, deductibles, and other material terms relating to your insurance needs.

- B. If your agency has made the business decision to limit most of your searches to a lesser number of carriers, then you should consider a different type of disclosure.

The following is an example of a disclosure for a limited search.

1. Our agency has the ability to obtain policies from a variety of competing insurers. However, we have made a business decision to submit most or all of our applications for [personal automobile] [personal lines] [commercial lines] [workers' compensation] [liability] [property] [property and liability] [etc...] to [one] [two] [three] particular insurer[s], if we believe [that company] [those companies] and [its] [their] products are suitable for the insurance needs you have communicated to us.

V. Statements Giving Additional Information

Many experts believe that if you give your customer complete, accurate information on which the customer can base an insurance purchase decision, you accomplish two important goals. First, you have a more satisfied consumer, and second, you are less likely to have a successful lawsuit brought against your agency. This is especially true in light of today's high-profile cases alleging agents and agencies have inappropriately, and secretly, steered business to a particular carrier in order for the agency to receive a higher rate of commission or other compensation.

Even though Florida law does not require it, some agencies could make the business decision to reveal in advance, not only the amount of commission—either as a percent or in actual dollars—received, but also all of the work they must do to earn that commission. Your agency should decide for itself, in light of its unique business relationships and needs, whether it wishes to make that additional disclosure.

In either event, your agency should be willing to honestly answer any questions your customers have about any aspects of the professional services you render. If a customer has questions or concerns, it is far better for the agent to know that up front, where he/she has an opportunity to address those issues. Toward that end, your agency may wish to expressly say it welcomes questions.

The following are some sample clauses.

1. For more specific details about compensation relating to your policy, please contact your agent.

[or]

2. If you would like more information about our compensation or have any other questions, please contact us.

[or]

3. We are happy to provide you with additional details about our services, our relationship with your insurance company, or our compensation.

[or]

4. For additional information on the nature of our compensation or our services, please inquire.

VI. Concluding Statement

As is the case with other documents you supply to your customers, a properly crafted disclosure statement gives you the ability to “sell” yourself and your products. Therefore, a well-written conclusion may, in fact, turn the disclosure into a positive experience for the customer. Not only will they feel better informed and have their questions answered, they will also understand how much you value their business.

The following are some examples.

1. Thank you for choosing us and allowing us to serve your insurance needs.

[or]

2. Thank you for trusting our agency with your insurance needs. We understand the vital role that insurance plays in providing you with financial security and peace of mind.

[or]

3. Our agency is grateful to have you as a client, and we welcome any suggestions you have to assist us in serving you better. We appreciate your business.

SUMMARY

Agents in Florida, like their counterparts in other states, face growing pressure to inform our clients about the amount and method of their compensation. Doing nothing to address this emerging issue may soon lead to litigation by your clients, extensive regulation at the state or national level, or over-reaction by the Legislature; perhaps even all three.

One course of action may be to take the step of voluntary disclosure on your own initiative. At the very least, a properly crafted compensation disclosure statement may prevent expensive litigation; at its best, it may prevent even more regulation or onerous legislation.

This document was patterned after an excellent Disclosure Guide developed by IBA West, to assist its members in facing similar problems. Since California is a “brokerage” state, we modified it to better reflect the environment in Florida; however, we used much of their materials, and give them credit for its development.

We also tried to make our guide read like a “Chinese menu,” which allows our members to pick and choose among a number of sample clauses and examples. The possible elements of a disclosure guide could include any or all of the six “statements”:

- I. Introductory Statements and the Benefits of Using an Independent Agent
- II. Statements Concerning Commissions
- III. Statements Concerning Fees Paid by Clients
- IV. Statements Limiting the Scope of Services Provided
- V. Statements Giving Additional Information
- VI. Concluding Statements

All six statements have specific goals in mind and an agency should evaluate each in determining whether or not to include them in their agency's disclosure statement, should the agency make the business decision to produce such a statement.

SAMPLE STATEMENTS

The following are sample statements, which could be developed using the six items mentioned on the previous pages. These are meant as examples only and should not be construed as appropriate for all agencies. **It is essential that any and all statements accurately describe your agency's practices.**

Sample Statement 1

Items used: I 1, II A 1, III 1, IV A 1, V 1, VI 1

You are a highly valued client, and our firm takes pride in the services we provide to you. Acting as an independent insurance agent, we are able to offer you excellent service and competitive prices because we can access insurance coverage, in most cases, from more than one insurance company. Our compensation comes from the insurance company writing your policy, in the form of a sales commission, which is determined by the insurer and is part of—but not in addition to—the premium you pay. That premium is subject to review by state regulators and cannot be inadequate, excessive or unduly discriminatory. We do not charge you anything for the placement of your policies. We are compensated solely by the insurance company in the manner previously described. However, we may charge certain fees specifically authorized by statute, such as to cover the cost of obtaining a motor vehicle report. Our agency does business with a variety of competing insurance companies, and we will attempt to obtain quotes from among those insurers that we believe to be suitable, based on the preferences and needs you have communicated to us. For more specific details about compensation relating to your policy, please contact your agent. Thank you for choosing us and allowing us to serve your insurance needs.

Sample Statement 2

Items used: I 2, II A 4, II B 2, III 2, IV A 2, V 2, VI 2

Our agency does business with multiple insurance companies, so we can usually offer you a variety of coverage choices and customize a plan to meet your specialized needs. Our agency is compensated on a commission basis by the insurance company that writes your insurance. This commission percentage is set by the company, not by us, and is included as a part of the insurance premium you pay. Our agency may be eligible for additional commission and incentive compensation—paid for by the insurer, not you—based upon the volume, profitability, growth, retention, and other factors of the business we place with that insurer. This may include payments of money, cooperative marketing allowances, trips with executives of the insurer and paid for by them, and other financial or business awards or incentives. We may also charge for services that are above and beyond those necessary to place the policy. If so, it will only be with your prior knowledge and consent, and we will provide you with a separate contract and invoice for that service. Our agency will attempt to obtain quotes from more than one insurer for your consideration. However, we cannot investigate every available product that might suit your needs. We will attempt to answer any question you may have regarding the different quotes, insurers, or policies that we do obtain, if any, but be aware that YOU make the final decisions on which insurance products you wish to purchase, along with the types and

amount of coverage, deductibles, and other material terms relating to your insurance needs. We are happy to provide you with additional details about our services, our relationship with your insurance company, or our compensation. Thank you for trusting our agency with your insurance needs. We understand the vital role that insurance plays in providing you with financial security and peace of mind.

Sample Statement 3

Items used: I 3, II A 5, II B 6, IV B 1, V 3, VI 3

Our agency is not beholden to any one insurance company. Therefore, we are usually better able than agents who represent only one company to assist you in identifying and securing the combination of coverage, price, and service that meets your particular needs. In most cases, our agency is paid a commission, which is fixed or based on a percentage of the premium that you pay for your policy. The agency receives no additional compensation from insurers or any other party for placement of your policy. The only compensation we receive is the standard commission described above. Our agency has the ability to obtain policies from a variety of competing insurers. However, we have made a business decision to submit most or all of our applications for [personal automobile] [personal lines] [commercial lines] [workers' compensation] [liability] [property] [property and liability] [etc...] to [one] [two] [three] particular insurer[s], if we believe [that company] [those companies] and [its] [their] products are suitable for the insurance needs you have communicated to us. For additional information on the nature of our compensation or our services, please inquire. Our agency is grateful to have you as a client, and we welcome any suggestions you have to assist us in serving you better. We appreciate your business.