

To All Members of the Insurance Brokers and Agents of the West:

As you know, California Insurance Commissioner John Garamendi has spent much of the last year attempting in various ways to assert that insurance agents and brokers have broad and onerous "fiduciary" duties toward their customers that go well beyond the duties imposed by current law.

IBA West has been at the forefront of the insurance industry's unified opposition to Mr. Garamendi's unwarranted attempts to impose these unprecedented new legal duties—and potentially crippling liability for punitive damages—on agents and brokers. IBA West also remains strongly opposed to the creation of any new laws or regulations requiring brokers or agents to make mandatory disclosures of compensation.

This is not an area in which blunt, "one size fits all" remedies make sense or serve the public interest. Insurance brokers and agents don't want or need legislators, politically ambitious regulators, or plaintiffs' lawyers telling them what they should disclose to their customers. We enjoy our customers' trust because we have worked hard to earn it, and know we wouldn't remain in business without it.

However, members of the Association have expressed deep concern over—and have asked for assistance in responding to—several developments that have the potential to create new legal, political, and marketplace challenges for insurance brokers and agents:

- Criminal indictments of leading insurance executives, and substantial cash settlements paid by large brokers, have resulted in widespread media attention to producer compensation.
- Politically ambitious regulators—thwarted in their attempts thus far to obtain greater, but unnecessary, powers of enforcement—remain steadfast in their desire to adopt new regulations that would impose significant new obligations and liabilities on brokers and agents. They have issued extraordinarily sweeping subpoenas requiring brokers to reveal intimate details regarding their customers and their compensation, and have threatened to use their criminal enforcement powers to bring "test cases" against licensees.
- Traditional distinctions between "broker" and "agent" have arguably broken down to the point where, in many instances, the capacities can sometimes be construed to be factually and legally almost indistinguishable. While the blurring of these lines may be of little or no consequence to consumers, this development is fraught with peril for producers given CDI rules that turn on whether a licensee is deemed to be acting in one capacity or the other.
- Plaintiffs lawyers are suing insurers for permitting brokers to charge fees in addition to receiving commissions—and also suing brokers for allegedly failing to disclose commissions and other compensation paid by insurers, and in so doing are attempting to make new law that could be imposed on all producers.
- Certain insurers have begun to disclose directly to consumers the fact, and in some instances the amount, of compensation they pay brokers or agents.
- Larger broker-agents have also begun to disclose the fact, and in some cases the amount, of compensation they earn from insurers.

IBA West has consistently opposed, and will continue to oppose, attempts by politicians to impose mandatory disclosure requirements upon agents and brokers.

However, members of IBA West have repeatedly asked for assistance in determining whether they should voluntarily provide more information to their customers, and if so, for help in drafting sample disclosure clauses for their evaluation.

Consequently, the IBA West Board has provided this Guide to Compensation Disclosure for our members. Its suggestions are not intended as a statement of current legal requirements. They are not intended even as a declaration of a recommended or "best" practice. Instead, the guide is nothing more than a list of considerations for members to evaluate should they decide, in light of their own professional circumstances, to provide more information to their customers.

These guidelines are completely voluntary. Individual brokerages and agencies are free to ignore or modify these guidelines to fit their own circumstances. The Guide provides a "cafeteria line" of options, and every agent and broker retains the right to pick and choose as many, or few, or none, of the options as they deem appropriate.

The sample disclosure clauses have been drafted and reviewed by legal counsel. While the guide is not intended to provide legal advice—and members should consider obtaining their own legal advice before deciding how, or whether, to proceed—there are important legal implications involved, and agents and brokers need to exercise caution in describing their services.

Watch for new Insurance Skills Center classes on the legal duties of broker-agents. Consult the IBA West Legal Memorandum on Insurance Producers' Duties, or professionals of your own choosing, for more information.

The "Guide to Compensation Disclosure" was unanimously recommended by a diverse task force of IBA West members, and adopted by your Board of Directors at its meeting on Oct. 20. I hope you will find it useful.

I believe personally that better disclosure can:

- Provide more information to insurance consumers about the services their independent insurance agent or broker can provide--the more consumers know about the independent agency system, the more likely they will be to choose an independent agent or broker.
- Weaken the hand of politicians who would attempt to milk the Marsh/Spitzer controversy for their own advantage—an industry that regulates itself, and pays attention to consumers' interests, is in the best position to defend against overtly political attempts to over-regulate.
- Enhance the credibility and professionalism of insurance proposals submitted to customers--insurance is a highly competitive business and broker-agents who voluntarily choose to disclose a few simple facts about insurer relationships will have a competitive advantage over broker-agents who don't.

Letter to IBA West Members
20 October 2005
Page 3

- Create a potential legal defense to the attacks of plaintiffs' lawyers—broker-agents who engage in voluntary disclosure are likely to be a less inviting target of litigation than broker-agents who don't.

It is my continuing privilege to serve as your President. Please do not hesitate to contact me if I, or IBA West, can ever be of service.

Very truly yours,

A handwritten signature in black ink, appearing to read "Stanley Simpson". The signature is written in a cursive style with a large, sweeping initial "S" on the left side.

Stanley Simpson
President

Enc.

IBA West Guide to Compensation Disclosure

1 November 2005

NOTE: This guide is not intended to provide specific advice about individual legal, business, or other questions. It was prepared solely as a guide and is **not a recommendation** that a particular course of action be followed. If specific legal or other expert advice is required or desired, the services of an appropriate and competent professional should be sought. **Use of the disclosure clauses contained in this guide will NOT necessarily insulate members from potential liability.**

Introduction

As insurance agents and brokers evaluate their business practices and procedures, an issue for producers to consider is whether and to what extent to make disclosures concerning their compensation and their relationship with the insurance purchaser. As a result of the interest in this issue, the Insurance Brokers and Agents of the West (IBA West) has received many inquiries from members seeking guidance about what actions to take relative to compensation disclosure. Although IBA West does not and cannot provide any recommended policy or procedure, this short guide was developed to assist agents and brokers as they evaluate both existing and potential disclosure practices and determine how best to address this issue for their businesses.

Of course, each business must determine for itself whether to make such disclosures and how to make them. Every firm has unique characteristics, relationships, and operating procedures, and the disclosure policy of a business must fit its particular needs. These needs and considerations will be based on such factors as applicable statutory and regulatory requirements in various jurisdictions, contractual obligations with insurers, and relationships with current and potential policyholders. California Department of Insurance regulations impose specific additional disclosure requirements on brokers who charge fees in personal lines of insurance, and certain insurance companies have contractually assumed, or imposed, requirements that also extend beyond the sample language provided below. Every brokerage and agency should take the appropriate steps to ensure that they are operating consistently with applicable law.

Possible Components of a Compensation Disclosure

There are a variety of possible approaches to making a compensation disclosure, ranging from a short and simple form to those that include greater levels of detail. In order to assist 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 a business-specific process.

Introductory Statements / Benefits of Utilizing Independent Agents and Brokers

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

For example, nothing prohibits an insurance producer from electing to do most or all of its business with a particular insurance company. In such cases, however, plaintiffs' lawyers could try to argue that it was potentially misleading for that producer to advertise that he "searches the market," or words to that effect. Likewise, as the recent problems in the California workers' compensation marketplace revealed, circumstances outside the control of producers can limit available options. It is essential that any and all statements accurately describe your firm's practices.

IBA WEST GUIDE TO COMPENSATION DISCLOSURE

PAGE 2

Examples of introductory points that a firm might consider including in its compensation disclosure follow below:

- You are a highly valued customer, and our firm takes pride in the services we provide to you.
- [and]
- Acting as an independent insurance agent or an insurance broker, 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]
- Our firm does business with multiple insurance companies, so we can offer you a variety of coverage choices and customize a plan to meet your specialized needs.
- [or]
- Our firm is not beholden to any one insurance company. As a result we are 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 .

Commissions

This section describes some of the common characteristics of standard commissions or percentage commissions paid to your firm for placing business with an insurer. Remember, it is essential that any and all statements accurately describe your firm's practices

Examples of points concerning commissions that a firm might consider including in its compensation disclosure follow below:

- The insurer that underwrites your policy pays our firm a sales commission.
- [or]
- Our firm does not charge any fees for placing your policy. Our compensation comes from the insurance company (or companies) writing your policy (or policies), in the form of sales commission which is determined by the insurer and is part of—but not in addition to—the premium you pay.
- [or]
- Our firm is paid a commission for selling and servicing your account. The amount is based on the standard commission schedules established by each of the companies we work with.
- [or]
- For our efforts, we are compensated primarily by standard commissions. Standard commissions are based on the commission schedules developed by each insurance company and calculated as a percentage of the premium.
- [or]
- Our firm 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]
- In most cases, our firm is paid a commission, which is fixed or based on a percentage of the premium that you pay for your policy.

IBA WEST GUIDE TO COMPENSATION DISCLOSURE

PAGE 3

Additional Commissions and Incentive Compensation

Additional commissions and incentive compensation are received by many agents and brokers. While insurance companies are most frequently the source of such payments, other third parties—such as premium finance companies, or other businesses that may receive referrals from agents or brokers—may on occasion also provide compensation for referrals or other services. Be aware that California law expressly prohibits “kickbacks” from auto repair facilities or other businesses whose expenses are reimbursed, directly or indirectly, by insurance companies.

Craft this disclosure carefully; it is essential that any and all statements accurately describe your firm’s practices. For example, if your firm has an agreement with a particular insurer that provides that you will receive additional compensation if certain targets are met, it could be considered to be inaccurate to state that you “may be eligible” for contingent compensation, as opposed to stating that you are eligible if certain conditions are satisfied.

Examples of points concerning this form of compensation that a firm might consider including in its compensation disclosure appear below:

- Our firm may also be eligible/is 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, growth, overall profitability, or other performance measures established by the insurers with whom we do business.

[or]

- Our firm may be eligible/is eligible for additional commission and incentive compensation from the insurer with which a policy is placed, based upon the volume, profitability, growth, retention, and other factors of the business we place. This may include payments of money, cooperative marketing allowances, trips with executives of the insurer paid for by the carrier, and other financial or business awards or incentives.

[or]

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

[or]

- In addition, if the overall volume and loss experience of all the policies we write with a particular company warrant it, we may qualify/we will qualify for additional commission or other types of compensation, on a basis determined by the insurance company and paid 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]

- We may also receive compensation through incentive or profit-sharing arrangements with insurance companies with which we place business. Eligibility for and the amount of contingency compensation is based on pre-established thresholds that consider the overall profitability of the business we place with insurers and other factors. 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 a given year our firm does not meet the profitability thresholds outlined above, we are not eligible for any incentive compensation.

[or]

IBA WEST GUIDE TO COMPENSATION DISCLOSURE

PAGE 4

- The firm also receives compensation, from time to time, for referrals we make to other businesses, such as [premium finance companies][other insurance agents or brokers][...].
- [or]
- The firm receives no additional compensation from insurers or any other party for the placement of your policy. The only compensation we receive is the standard commission described above.
- [or]
- Any additional or incentive compensation we receive from the insurer is paid to the firm, and not to the individual employee of the firm who is working with you to obtain the insurance products or services you have requested.

Fees Paid by Clients

Some agents and brokers elect not to charge any fees for their services. Others choose to charge fees for policy placement and/or other services, either in addition to or in lieu of compensation from the insurer.

Under general contract law, customers must be informed about, and give their consent to pay, all fees in advance. Whenever a fee is being charged, producers must disclose the fact and amount of such fees they are charging, and other material facts may also need to be disclosed—although there is no clear consensus on what facts are deemed “material.” Under California regulations that apply to brokers charging fees in personal lines, one fact deemed material is whether or not the fee is considered “fully earned” and therefore “non-refundable.”

Whenever fees are being charged, producers should consider making mandatory and other disclosures in writing—even in cases where a written fee agreement is not legally required. While oral disclosure of fees may, in at least some cases, satisfy minimum requirements of contract law, it is obviously more difficult to “prove” that an oral disclosure was given than to produce a copy of the written disclosure that the customer was given prior to the time the services were performed.

Insurance producers transacting insurance in California also need to be aware:

1. *That the California Department of Insurance (CDI) has repeatedly expressed its opinion that broker-agents acting as “**brokers**” may charge fees to customers in addition to receiving commissions from the insurer, but that broker-agents acting as “**agents**” may charge fees only in limited circumstances.*
2. *That CDI has adopted regulations that require broker-agents acting as “brokers” who charge fees in personal lines to use a mandatory fee agreement and make certain other disclosures to customers, including the fact, if true, that the broker receives compensation from the insurer*
3. *That producer contracts, between insurance companies and the broker-agents with whom they transact, sometimes include provisions that prohibit or limit producers from charging fees.*

All producers charging fees, whether acting as “agent,” or “broker,” or in any other capacity, should consult with appropriate professionals to determine the requirements of current law, and also review their contracts with carriers to determine which, if any, require disclosure to the policyholder when the agent or broker is being paid a fee by the policyholder. If any such disclosures are required, procedures should be established by the agent or broker to remain in compliance with the agreement.

Examples of points concerning fees that a firm might consider including in its compensation disclosure include:

- The insurance company with which your policy is being placed does NOT pay this firm for the placement. Our sole compensation is the fee, which has previously been disclosed to you, and to which you have given your consent.

IBA WEST GUIDE TO COMPENSATION DISCLOSURE

PAGE 5

[or]

- In addition to the fee we are charging you, which has previously been disclosed to you, and to which you have given your consent, we also may receive compensation from the insurance company in the form of a sales commission or incentive compensation, both described generally above.

[or]

- We do not charge you anything for placement of your policies. We are compensated solely by insurance companies, in the manner previously described. However, we may charge you fees for other professional services that you ask us to perform.

[or]

- We charge you nothing for our professional services. We are compensated solely by the insurance companies with whom we do business, in the manner previously described.

Statements Concerning Representation

The sample disclosure clauses presented above avoid titles such as “agent,” and “broker,” and also avoid phrases such as, “the companies we represent,” or “on your behalf,” and the like. Some firms may wish to include a statement that describes their position in the marketplace and their relationship to the customer. However, broker-agents should exercise extreme caution in making any statements along these lines.

There are several reasons this caution is prudent:

1. *California courts have frequently observed that insurance agents and brokers often operate, in fact, as “dual agents” to one extent or another. For example, even if a policy is placed pursuant to an agency agreement, the “agent” has a statutory duty to refund unearned premium to the customer; likewise, a “broker” is deemed to act “on behalf of” the consumer, but has a statutory duty to remit premium payments to the insurer.*
2. *Traditional distinctions between “broker” and “agent” have arguably broken down to the point where, in particular instances of civil litigation, the capacities can sometimes be construed to be factually and legally almost indistinguishable. While the blurring of these lines may be of little or no consequence to consumers, this development is fraught with peril for producers given CDI rules that turn on whether a licensee is deemed to be acting in one capacity or the other.*
3. *Seemingly innocuous statements in advertisements or conversations, such as “we represent you,” or “we shop the market to find you the best terms at the best price,” or “we’ve got you covered,” or any infinite number of related variables, can be misinterpreted in today’s litigious climate as a voluntary assumption of heightened legal duties—which potentially expose licensees to greater liability than the law normally imposes upon broker-agents. The simple rule of thumb is: Anything you say or suggest in this regard “can and will be used against you.”*

A discussion of the relevant California law in this area is available to IBA West members, but is not intended as legal advice for any particular member or situation. Members would be well-advised to consult with an attorney, or other professional of their choosing, before including any statements regarding representation in their disclosure.

Statements Limiting the Scope of Services Provided

One important goal of any customer disclosure statement is to inform the customer of material facts the customer should evaluate in order to make an informed decision regarding choice of producer, choice of insurer, and choice of policy. It is important, therefore, that all statements in any such disclosure be as accurate as possible.

IBA WEST GUIDE TO COMPENSATION DISCLOSURE

PAGE 6

As suggested previously, producers should consider informing customers of any important limitations in the services they will be providing.

For example, if the agency or brokerage has made a business decision to place all or most of its policies with a particular insurer or insurers, then the firm should not be advertising or suggesting that it will “search the marketplace” or words to that effect. To the contrary, a statement that more accurately describes the firm’s efforts should be considered.

Another example: Under California law, insurance broker-agents are not generally held to be responsible for determining the amount of insurance a consumer needs, or even the types of insurance the consumer needs. Reminding customers of THEIR obligations can help protect broker-agents from liability.

Here are samples of possible disclosures on this subject:

- Our firm 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. We will tell you about any quotes we receive.

[or]

- Our firm has the ability to obtain policies from a variety of competing insurers. However, we have made a business decision to submit most or all 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.

[or]

- Our firm will attempt to obtain quotes from more than one insurer for your consideration and will provide you with the quotes we obtain. However, we cannot investigate every available insurance product that might suit your needs. We will attempt to answer any questions 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, and the type and amount of coverage, deductibles, and other material terms related to your insurance needs.

[and/or]

- Our firm will attempt to obtain one or more quotes for insurance coverage suitable for the needs and preferences you have communicated to us, and will provide you with the quotes we obtain that we believe suit your needs. Please remember, however, that YOU are ultimately responsible for determining which insurance company you want to underwrite your policy, what coverages you need for your protection, the amount of insurance you need, and other issues.

Comparison of compensation among quotes provided

If a broker-agent provides more than one quote to a customer, and if the compensation that the broker-agent will receive differs materially depending on which quote the customer accepts, it could be argued that this difference should be disclosed in advance to the customer, in order to avoid any appearance that the broker-agent’s advice, if any, was influenced by the amount of compensation being offered by the insurer.

IBA WEST GUIDE TO COMPENSATION DISCLOSURE

PAGE 7

Here are samples of possible disclosures on this subject:

- The commission our firm would receive from [Insurer A] is somewhat/significantly greater than the commission we would receive from [Insurer B or C]. Our advice to you is based on what we think is suitable for the needs you have communicated to us , not on the amount of commissions we will receive.

[and/or]

- Our firm has an agreement with [Insurer A] that provides that we will receive additional compensation if certain thresholds are met, as described above. We do not have such agreements with [Insurer A or Insurer B]. Our advice to you is based on what we think is suitable for the needs you have communicated to us , not on whether we will receive any incentive commissions.

Additional Information

The more information broker-agents provide their customers, the less susceptible the broker-agent is to legal attack. Conversely, the less information a broker-agent elects to share, the more susceptible the broker-agent is to allegations of inappropriate “steering” or breach of legal duty.

Some broker-agents have made a business decision to disclose the amount, in addition to the fact, of compensation they receive from insurance companies. Because current California law does not require the amount of insurer compensation to be disclosed, IBA West believes every brokerage and agency should decide for itself, in light of its own unique business relationships and needs, whether it wishes to make that additional disclosure.

In either event, broker-agents should be willing to answer any questions their customers have about any aspect of the professional services being rendered by the broker-agent. If a customer has significant questions or concerns, better the broker-agent know that up front and have an opportunity to address those issues. Toward that end, broker-agents may wish to expressly welcome questions.

Here are possible sample clauses:

- For more specific details about compensation relating to your policy, please contact your agent or broker.

[or]

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

[or]

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

[or]

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

IBA WEST GUIDE TO COMPENSATION DISCLOSURE

PAGE 8

Conclusion

A firm may choose to close its disclosure statement with additional information about the firm, or other information. Examples of points that a firm might consider:

- Thank you for choosing us and allowing us to serve your insurance needs.
- Thank you for trusting our firm with your insurance needs. We understand the vital role that insurance plays in providing you with financial security and peace of mind.
- Our agency is grateful to have you as a customer, and we welcome any suggestions you have to assist us in serving you better. We appreciate your business.