FEDERATION OF REGULATORY COUNSEL, INC.

SURVEY OF THE CURRENT INSURANCE REGULATORY ENVIRONMENT FOR AFFINITY MARKETIG ARRANGEMENTS

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Agents and insurers in the life and property and casualty markets have always faced the challenge of finding potential new customers and converting them to insureds. For many years, insurers and producers have used affinity marketing relationships to generate leads and new business, but recently the authors have observed a renewed interest in these lead- generating arrangements. While marketing insurance to the customers or members of a non-insurance business is an obvious opportunity for agents and producers, there are a number of legal issues which must be addressed by all parties to an affinity marketing agreement in order to comply with state insurance producer licensing laws. In this article we will provide a summary of the types of affinity marketing arrangements which we have seen being used by insurers and agents, an overview of the applicable producer licensing law and the potential legal and regulatory issues they pose, and offer some best practices for helping insurers, agents and other businesses structure compliant and mutually beneficial affinity marketing arrangements.

Affinity Marketing Arrangements

In today's economy, businesses are looking for ways of finding and exploiting new sources of revenue to grow profits. For insurers and insurance agents, this means finding new potential customers and new distribution channels for existing insurance products. For many other businesses, this means finding new ways to monetize their existing customer base. Affinity marketing arrangements are one way both insurance and non-insurance businesses can work together to achieve these goals. In a typical affinity marketing arrangement, a business and insurance producer sign a contract providing that the non-insurance business will provide the insurer or producer access to its customer base in exchange for payment from the insurer or producer. We have encountered a wide variety of non- insurance businesses entering into such arrangements, including banks, non- profit groups and professional associations. These and other types of affinity marketing agreements are, in our experience, a growing trend across many types of business.

There are a number of potential means for an insurer or insurance producer to compensate its affinity marketing partners. Insurers or producers might pay a referral fee to their marketing partners for each customer or member which requests a quote. Such referral fees are often limited in amount by state law.[1] The payment of a fixed referral fee may not yield enough cash flow to make an affinity marketing arrangement worthwhile for the non-insurance business; or conversely cost the insurer or producer too much if sales do not follow. Accordingly, many such arrangements seek to provide for the producer to share commissions with the non-insurance business partner. Such an arrangement can be substantially more lucrative, and therefore appealing, for a potential partner business as well as cost effective for the producer as he/she is paying only for successful sales. This is particularly true for arrangements with trade groups and professional associations for the marketing of commercial insurance, where commissions are often substantially higher than those for personal lines business.

Producer Licensing and Compensation Laws

Commission-sharing, while often desirable in affinity marketing arrangements from a business perspective, is frequently subject to state laws governing producer licensing, despite substantial relaxation of laws by many states. Today, a majority of states permit the sharing of commissions with unlicensed persons (such as affinity marketing partners) who do not sell, solicit, or negotiate insurance. Some other states do not allow commission-sharing, but do permit insurance producers to pay referral fees to unlicensed persons who do not sell, solicit, or negotiate insurance. Despite these widespread provisions, there are still a handful of states which do not explicitly permit referral fees or commission- sharing. Knowing the particular laws and regulations of the state or states in which a producer and non-insurance partner propose to engage in affinity marketing is critical to ensuring that both parties are in compliance with the varying laws of each state.

The Sale, Solicitation, and Negotiation of Insurance

All states prohibit unlicensed persons from selling, soliciting, or negotiating insurance. Accordingly, any non-insurance business entering into an affinity marketing arrangement must not sell, solicit, or negotiate insurance. The NAIC's Producer Licensing Model Act ("PLMA")[2] defines sell, solicit, and negotiate as follows:

- "Negotiate" means the act of conferring directly with or offering advice directly to a purchaser or prospective purchaser of a particular contract of insurance concerning any of the substantive benefits, terms or conditions of the contract, provided that the person engaged in that act either sells insurance or obtains insurance from insurers for purchasers.[3]
- "Sell" means to exchange a contract of insurance by any means, for money or its equivalent, on behalf of an insurance company.[4]
- "Solicit" means attempting to sell insurance or asking or urging a person to apply for a particular kind of insurance from a particular company.[5]

In our experience, most states take a broad view of all three definitions. Nearly any activity which constitutes more than a mere referral to a licensed insurance producer, including describing insurance coverage, advocating the purchase of insurance, or discussing the cost of insurance coverage, will be viewed by insurance regulators as constituting at least the solicitation of insurance.[6]

Commission-Sharing

A majority of states have adopted Section 13(D) from the PLMA,[7] which permits an insurance producer to share commissions with non-licensed persons (such as an affinity marketing partner) so long as the unlicensed person does not sell, solicit, or negotiate insurance. At present, those states[8] are: Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, District of Columbia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas,[9] Maine, Maryland, Michigan, Minnesota, Missouri, Nebraska, Nevada, New Hampshire, New Jersey, Oklahoma, Oregon, Rhode Island, Vermont, Washington, and Wyoming.

In these states, a producer may enter into an affinity marketing agreement with an unlicensed business and may pay that unlicensed business a share of its commission on policies sold as a result of the affinity marketing arrangement, /so long as/ the partner business does not sell, solicit, or negotiate insurance.

Referral Fees

A number of other states have not adopted Section 13(D) of the PLMA but do allow producers to pay referral fees to unlicensed persons, so long as the unlicensed person receiving referral fees does not sell, solicit, or negotiate insurance, and provided the referral fee is not contingent upon the sale of an insurance product,

which would be viewed as a proxy for commission. Generally, referral fees must be paid for each referral and may not be contingent on whether or not a potential insured applies for or purchases insurance coverage from the producer.[10] Also, many states which allow only referral fees mandate that the amount of a referral fee be fixed, unlike commissions, which are generally a percentage of the premium paid on an insurance policy.[11] The following states permit only referral fees to be paid by insurance producers (including those transacting life and property and casualty insurance):[12] Florida, Kentucky, Louisiana, Ohio, South Carolina, South Dakota, Tennessee, and Virginia.

Additionally, New York allows life insurance producers to pay referral fees, but not commissions, to unlicensed persons who do not sell, solicit, or negotiate life insurance.[13] New York's law is not clear on whether referral fees are allowed for property and casualty insurance.

In states which allow referral fees, but not commissions, insurance producers and their affinity marketing partners must be careful to follow the letter of the law in each state because each state imposes slightly different requirements on referral fees. In fact, notwithstanding the letter of the law or regulations published in the various states, it is advisable to contact each insurance department at least informally prior to implementing a particular fee arrangement in each state, as the regulators sometimes interpret the laws in a manner that is not always readily apparent from the text of the law or regulation.

Other Regulatory Regimes

While the majority of states allow producers to pay either a share of commissions or referral fees to affinity marketing partners, a handful of states have laws on the subject which are unclear or which appear to generally prohibit both commission-sharing and the payment of referral fees. Those states are:[14] Alaska, Georgia, Massachusetts, Mississippi, North Dakota, Texas, Utah, and Wisconsin.

Particularly in these states, caution is required in the structuring of any affinity marketing arrangement. For example, Mississippi has adopted § 13(D) of the PLMA;[15] however, its law also prohibits commission-sharing and allows for limited referral fees.[16] This sort of uncertainty places any affinity marketing arrangement at risk of regulatory scrutiny.

Conclusion

As the above survey of applicable state law demonstrates, the increasing uniformity of producer licensing laws has not yet brought the law governing permissible referral activities and commission-sharing into harmony in all 50 states. As a result, every affinity marketing arrangement must take into account the varying laws of the state or states in which it is to be implemented. Additionally, careful attention must be paid to ensure that the arrangement does not require or lead to the non- insurance partner to engage in any activities which constitute the sale, solicitation, or negotiation of insurance.

State insurance regulators, even in those states which allow commission-sharing, are sensitive to any insurance sales conducted by unlicensed persons, including those who are engaged in affinity marketing. It is therefore important, when counseling any party to an affinity marketing arrangement, to make sure that only licensed insurance producers sell insurance. For example, if an association is participating in an affinity marketing arrangement, employees of the association must not do anything that could be construed as sales or marketing themselves; all such activity must be undertaken by a licensed insurance producer. Accordingly, the contract between the insurer or licensed insurance producer and any unlicensed affinity partners must strictly prohibit any sales activities by the unlicensed person (and its employees). Particularly in those states which allow commission-sharing, regulators are aware that the receipt of commissions could be an incentive for businesses and their employees to engage in sales and marketing. It is important in any such arrangement to stress the need for training regarding what constitutes permissible activities and what constitutes the sale,

solicitation or negotiation of insurance. Accordingly, structuring an affinity marketing relationship to mitigate this incentive and ensure that only licensed insurance producers engage in the sale, solicitation or negotiation of insurance is critical to establishing a compliant affinity marketing arrangement.

Endnotes

1. *See, e.g.,* Tenn. Code § 56-6-118, which limits referral fees to $25.00.

2. NAIC Model #218.

3. *Id.* at § 2(K).

4. *Id.* at § 2(M).

5. *Id.* at § 2(N).

6. In 2000, in conjunction with adopting the PLMA, the NAIC published a two-page summary of permissible and impermissible activities undertaken by unlicensed persons. A review of that document, *Implementation Guidelines for the Producer Licensing Model Act* (August 27, 2000), illustrates the limited scope of permissible activities.

7. The PLMA's exact language is: "An insurer or insurance producer may pay or assign commissions, service fees, brokerages or other valuable consideration to an insurance agency or to persons who do not sell, solicit or negotiate insurance in this state, unless the payment would violate [insert appropriate reference to state law, i.e. citation to anti-rebating statute, if applicable]."

8. Ala. Stat. § 27-7-35.1; Ariz. Stat. § 20-298; Ark. Code § 23-64- 513; Cal. Ins. Code § 1631; Colo. Rev. Stat. § 10-2-702; Conn. Stat. § 38a- 702l; 18 Del. Code § 1714; D.C. Code § 1131.13; Haw. Rev. Stat. § 431:9A- 113; Idaho Stat. § 41-1017; 215 Ill. Comp. Stat. 5/500-80; Ind. Code § 27-1- 15.6-13; Iowa Stat. § 522B.12; 24-A Maine Rev. Stat. § 1420-L; Md. Code INS § 10-130; Mich. Comp. Laws § 500.1240; Minn. Stat. § 60K.48; Mo. Stat. § 375.076; Neb. Rev. Stat. § 44-4060; Nev. Rev. Stat. § 683.361; N.H. Rev. Stat. § 402-J:13; N.J. Stat. § 17:22A-41; Okla. Stat. § 36-1435.13; Or. Stat. § 744.076; 8 Vt. Stat. Ann. § 4796. Note that Pennsylvania allows commission-sharing for commercial lines business only. 40 Penn. Stat. § 310.72.

9. Kansas only explicitly allows insurance producers to share commissions with financial holding companies. Kan. Stat. § 40-4910.

10. *See, e.g.*, La. Rev. Stat. § 22:1598 ("Any compensation received by the person making a referral...shall not be in the form of a sales commission and shall not be based on the application by the customer or purchase of insurance."); Va. Code § 38.2-1821.1(B)(8)(c) (requiring referral fees not to "depend on whether the referral results in the purchase of insurance by the customer).

11. *See, e.g.,* S.D. Codified Laws § 58-30-174 (requiring referral fees to be "a fixed dollar amount that is not related to the amount of commission or premium").

12. Fla. Stat. § 626.112; Ky. Stat. § 304.9-425; La. Rev. Stat. § 22:1598; Ohio Rev. Code § 3905.18; S.C. Code § 38-43-200; S.D. Stat. § 58- 30-174; Tenn. Code § 56-6-118; Va. Code § 38.2-1812. For personal lines insurance, Pennsylvania permits only referral fees. 40 Penn. Stat. § 310.72.

13. N.Y. Ins. Code § 2114.

14. Alaska Stat. § 21.27.370; Ga. Code § 33-23-4; Mass. Gen. Laws ch. 175 § 177; Miss. Code §§ 83-17-7 and 83-17-73; N.D. Stat. § 26.1-26-04; Tex. Ins. Code § 4005.053; Utah. Stat. § 31A-23a-504; Wis. Stat. § 628.61.

15. Miss. Code § 83-17-73.

16. Miss. Code § 83-17-7.