

STATE OF CALIFORNIA  
DEPARTMENT OF INSURANCE  
45 Fremont Street, 21st Floor  
San Francisco, California 94105

File No. RH04039144  
Date: October 18, 2004

**INITIAL STATEMENT OF REASONS**

**INTRODUCTION:**

The Insurance Commissioner (“Commissioner”) proposes to adopt a regulation regarding the fiduciary duties owed to a client by insurance salespeople who represent consumers (“brokers”). Specifically, the regulation requires brokers to disclose income they receive in handling a transaction for a client. The regulation also makes it an unfair act for a broker to fail to inform a client about a “best available insurer” or to steer a client away from that insurer. This adoption will only occur after the Commissioner considers all comments, objections and recommendations regarding the proposed regulation. If adopted, the regulation will add Article 5.9, including sections 2184.1 through 2184.4, to Title 10, Chapter 5, Subchapter 1, of the California Code of Regulations (“C.C.R.”).

**DESCRIPTION OF THE PUBLIC PROBLEM ADDRESSED BY EACH SUBDIVISION /  
THE SPECIFIC PURPOSE AND NECESSITY OF EACH SUBDIVISION**

California Insurance Code (“C.C.R.”) § 790.03(b) defines the following to be an unfair method of competition and an unfair and deceptive act or practice in the business of insurance:

Making or disseminating or causing to be made or disseminated before the public in this state, in any newspaper or other publication, or any advertising device, or by public outcry or proclamation, or in any other manner or means whatsoever, any statement containing any assertion, representation or statement with respect to the business of insurance or with respect to any person in the conduct of his or her insurance business, which is untrue, deceptive, or misleading, and which is known, or which by the exercise of reasonable care should be known, to be untrue, deceptive, or misleading.

The proposed regulation clarifies that a broker who fails to disclose to a client all material facts surrounding the broker’s receipt or potential receipt of income from a third party, which income derives in whole or in part from a transaction on behalf of the client, constitutes a violation of § 790.03(b). The regulation also defines “broker,” “client,” “income,” and “material fact.”

C.I.C. §790.02 prohibits persons involved in the insurance industry from engaging in a trade practice that is determined by administrative adjudication (§ 790.06) or rulemaking (§790.10) to be an unfair method of competition or an unfair or deceptive act or practice in the business of insurance. The proposed regulation constitutes a determination that it is unfair for a broker to place his or her own financial or other interest above that of his or her client.

Each section of the regulation is summarized below.

Section 2184.1

Section 2184.1 states that the regulation applies to all insurance transactions. This section is necessary because without it ambiguity would exist as to which types of insurance transactions the regulation applies.

Section 2184.2(a)

Section 2184.2(a) defines "broker" to mean a person, including an agent appointed pursuant to Insurance Code section 1704, who represents, purports to represent, or allows a client reasonably to assume he represents, the client in an insurance transaction. This section is necessary because without it ambiguity would exist as to which types of insurance producers the regulation applies, and under what circumstances.

Section 2184.2(b)

Section 2184.2(b) defines "client" to mean the insured or prospective insured with whom a broker transacts or may transact insurance. This section is necessary because without it ambiguity would exist as to whether the regulation applies only to existing insureds who obtained coverage through a particular broker or also to persons considering becoming insureds through a particular broker.

Section 2184.2(c)

Section 2184.2(c) defines "income" to mean receipt of anything of value. This section is necessary because without it ambiguity would exist as to whether the regulation applies only to cash, or also to services, promises, and other items of value.

Section 2184.2(d)

Section 2184.2(d) defines "material fact" to mean a fact that will more likely than not influence either the particular client or a reasonable client in forming his estimate of the disadvantages of a proposed agreement or relationship, or in making his inquiries. This subdivision also imposes on a broker the burden of proving that a fact alleged to have been material is not material. This definition of "material fact" is necessary because without it brokers would bear the burden of having to disclose all income, no matter how minimal, even

when that income could not possibly be of concern to a particular or reasonable client. The imposition of the burden of proof on the broker is necessary to avoid a loophole by which brokers could avoid making disclosures that reasonably should be made on the grounds that the income was not clearly material.

#### Section 2184.2(e)

Section 2184.2(e) defines “best available insurers” to mean the most suitable insurers for the client based on coverage, service, financial security and price, that is willing to provide the requested coverage through the broker. This section is necessary because the term is used in section 2184.4(b) and, if not defined, would be ambiguous.

#### Section 2184.3

Section 2184.3 states that a broker who fails to disclose to a client all material facts surrounding the broker’s receipt or potential receipt of income from a third party, which income derives in whole or in part from a transaction on behalf of the client, violates § 790.03(b). This section is necessary in order to require disclosure of income and invoke the remedial provisions of the Unfair Practices Act (§ 790 *et seq.*) if income is not disclosed.

#### Section 2184.4(a)

Section 2184.4(a) states that a broker who places his or her own financial or other interest above that of his or her client violates § 790.02. This section is necessary in order to clarify for brokers and consumers that brokers owe a fiduciary duty to their clients and to invoke the remedial provisions of the Unfair Practices Act (§ 790 *et seq.*) if a broker violates this duty.

#### Section 2184.4(b)

Section 2184.4(b) states that a broker violates § 790.02 if, with either new or renewal business, he or she fails to provide the client with the proposal of a best available insurer, advises a client to select an insurer other than a best available insurer, advises a client not to select a best available insurer from among multiple insurers suggested to the client, or fails to obtain a quote from an insurer the broker knows might be a best available insurer. This section is necessary in order to clarify for brokers that certain types of conduct that constitute breaches by brokers of their fiduciary duty are an unfair act.

### IDENTIFICATION OF STUDIES AND REPORTS

The Department relied on news articles, lawsuits, and interviews with several insurance industry members in preparing the regulation.

## CONSIDERATION OF ALTERNATIVES

No alternatives have thus far been presented to or considered by the Department. Any alternatives suggested to the Department during the public comment period will be considered and addressed in the Final Statement of Reasons. The regulation does not mandate the use of specific technologies or equipment. The Department has not identified any alternatives that would lessen any adverse impact on small businesses.

## EVIDENCE REGARDING IMPACT ON BUSINESS

Insurance brokers already are required by agency case law to disclose to their clients income they receive from transactions on behalf of those clients. The Department has determined that the regulation will not have a significant adverse economic impact on businesses that currently comply with this existing fiduciary obligation. This regulation merely codifies that requirement in the context of insurance transactions, and provides the Department with a means of enforcing the requirement. However, some brokers who currently violate their fiduciary obligation to disclose outside income derived from transactions on behalf of their clients may, as a result of complying with this regulation, be asked to rebate some of that income to their clients. This will result in money being transferred from businesses that have in the past violated their fiduciary duty of disclosure to consumers who have been entitled to that money all along.

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