

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

NOTICE OF PROPOSED RULEMAKING

DATE: October 18, 2004

REGULATION FILE: RH04039144

SUBJECT OF PROPOSED RULEMAKING

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.”).

PUBLIC HEARING DATE AND LOCATION:

A public hearing will be held to permit all interested persons the opportunity to present statements or arguments, orally or in writing, with respect to the proposed regulation at the following date, time, and place:

Date and time: **Thursday, January 6, 2005
10:00 A.M.**

Location: **California Department of Insurance
22nd Floor Hearing Room
45 Fremont Street
San Francisco CA 94105**

Access to hearing rooms

The building and room to be used for the public hearing are accessible to persons with mobility impairments. Persons with sight or hearing impairments are requested to notify the primary contact person (listed below) in order to make special arrangements, if necessary.

PRESENTATION OF WRITTEN COMMENTS

A person may submit written comments without, or in addition to, attending the public hearing. Written comments and questions should be addressed to the below primary contact person.

Primary contact person

Jon Tomashoff, CPCU, Senior Staff Counsel
California Department of Insurance
45 Fremont Street, 21st Floor
San Francisco, CA 94105
Telephone: (415) 538-4119
Facsimile: (415) 904-5490
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Backup contact person

Jose Aguilar, Assistant Chief Counsel
California Department of Insurance
45 Fremont Street, 21st Floor
San Francisco, CA 94105
Telephone: (415) 538-4141
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E-mail comments preferred

The Department of Insurance encourages the transmission of written comments in Word™ or PDF format by E-mail to tomashoffj@insurance.ca.gov. Comments sent to a different E-mail address will not be accepted. The Department will promptly acknowledge receipt of comments sent by E-mail.

Deadline for written comments

All written materials must be received by the Insurance Commissioner, addressed to the primary contact person at the address listed above, no later than 5:00 p.m. on December 21, 2004. Any written materials received after that time will not be considered.

Comments transmitted by facsimile

The Commissioner will accept written comments transmitted by facsimile provided they are legible and directed to the attention of the primary contact person at the above facsimile number. Comments sent to a different facsimile number will not be accepted.

Advocacy or witness fees

Persons or groups representing the interests of consumers may be entitled to reasonable advocacy fees, witness fees, and other reasonable expenses, in accordance with the provisions of Subchapter 4.5, Title 10, of the California Code of Regulations, in connection with their participation in this matter. Interested persons should contact the Office of the Public Advisor at the following address, in order to inquire about the appropriate procedures:

California Department of Insurance
Office of the Public Advisor
300 Capitol Mall, 17th Floor
Sacramento, CA 95814
(916) 492-3559

A copy of any written materials submitted to the Public Advisor regarding this rulemaking must also be submitted to the primary contact person for this hearing, listed above. Please contact the Office of the Public Advisor for further information.

AUTHORITY AND REFERENCE

The regulation will implement, interpret, and/or make specific the provisions of California Insurance Code (“C.I.C.”) section 790.02, and 790.03(b) and (c). C.I.C. § 790.10 provides the authority for the regulation.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

C.I.C. § 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 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 (per § 790.06) or rulemaking (per §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.

PROPOSED SECTIONS

Each section of the regulation is summarized below. The actual text of the regulation, along with an Initial Statement of Reasons explaining the specific purpose of each section, and the rationale for the determination that each section is reasonably necessary to fulfill the purpose for which it is proposed, together with a description of the public problem, administrative requirement, or other condition or circumstance that each adoption is intended to address, is set forth on the Department website: www.insurance.ca.gov.

- Section 2184.1 states that the regulation applies to all insurance transactions.
- 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.
- Section 2184.2(b) defines “client” to mean the insured or prospective insured with whom a broker transacts or may transact insurance.
- Section 2184.2(c) defines “income” to mean receipt of anything of value.
- 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.
- Section 2184.2(e) defines “best available insurers” to mean the most suitable insurers for a client based on coverage, service, financial security and price, that is willing to provide the requested coverage through the broker.

- 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 Insurance Code section 790.03(b).
- 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.
- 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.

DISCLOSURES REGARDING THE PROPOSED ACTION

MANDATES ON LOCAL AGENCIES OR SCHOOL DISTRICTS

The regulation does not impose any mandate on local agencies or school districts.

COST OR SAVINGS TO STATE AGENCY

The regulation will result in no cost to any state agency. By clarifying section 790.03(b), the regulation may result in an unquantifiable savings in Department staff time that otherwise would be deployed to handle litigation over the meaning of the section.

COST TO ANY LOCAL AGENCY OR SCHOOL DISTRICT

There are no costs to local agencies or school districts for which Part 7 (commencing with Section 17500) of Division 4 of the Government Code would require reimbursement.

OTHER NONDISCRETIONARY COSTS TO OR SAVINGS TO ANY LOCAL AGENCY

None

COSTS OR SAVINGS IN FEDERAL FUNDING TO THE STATE

None

SIGNIFICANT, STATEWIDE ADVERSE ECONOMIC IMPACT DIRECTLY
AFFECTING BUSINESS, INCLUDING THE ABILITY OF CALIFORNIA
BUSINESSES TO COMPETE WITH BUSINESSES IN OTHER STATES

The Commissioner has made an initial determination that while the adoption of this regulation would not have a significant, statewide adverse economic impact directly affecting business, it may have a significant adverse economic impact directly affecting certain businesses, specifically insurance brokers (as defined in the regulation). The regulation will not alter the ability of California businesses to compete with businesses in other states.

The regulation will not involve any new or increased fee, assessment or charge. It will not require the purchase of any new equipment, structures or supplies, or the hiring of additional staff, other than possibly a supply of disclosure forms. Compliance should be simple, with existing business employees requiring merely a few minutes to read and understand the regulation. Thereafter, affected businesses will likely use a standard one or two paragraph disclosure form to comply with the regulation. This form will likely be based on boilerplate provided by insurance agent and broker trade associations or competitors, thus negating significant legal counsel costs. The regulation will not create any time delays that will increase interest, inventory or other time-sensitive costs. Since the disclosure will have to be made to each client, the annual ongoing costs to a business will depend on the number of clients. The Department estimates that the disclosure will require one or two minutes of staff time per client for the vast majority of personal and commercial clients. Relative to the total amount of time involved in a typical insurance transaction, one or two minutes is insignificant.

Insurance brokers receive commissions from insurance companies. Under existing case law, brokers, as fiduciaries of their clients, must disclose their commission to their clients, and also obtain their clients' consent to retain the commission. Many brokers are unaware of this fiduciary duty. Other brokers deliberately fail to disclose their commission to avoid client concern that the commission is too large, especially when the client is also paying a "broker fee" to the broker. The regulation, by codifying existing case law in a brief and simple rule, will educate brokers about their duty to disclose. Consumers, who for the first time will routinely receive the disclosures as a result of the regulation, will be better informed about the price they pay, directly and indirectly, for using a broker. That information, in some cases, will be used by consumers to negotiate a lower broker fee, or a rebate of some of the broker's commission. In short, the regulation will give consumers more bargaining power with their brokers. Consumers who use that power will reduce their cost of insurance. Correspondingly, brokers who reduce their fees or rebate some of their commissions will derive less revenue.

Insurance brokers currently face lawsuits based on their past failures properly to disclose income to clients. In all likelihood, business will incur the abovementioned costs associated with improving disclosure to clients as a defense to these suits. Consequently, a strong argument can be made that the costs of and any revenue decrease related to complying with the regulation would arise even without the regulation.

The regulation will not impose any reporting requirement, but will, in conjunction with an existing regulation that mandates that brokers keep copies of documents generated during an insurance transaction, require brokers to maintain any written disclosures they provide to clients.

The regulation will not affect the ability of California businesses to compete with businesses in other states because any insurance broker, whether located within or outside of California, will have to comply equally with the regulation in transacting insurance with persons located in California.

POTENTIAL COST IMPACT ON PRIVATE PERSONS OR ENTITIES/BUSINESSES

As explained immediately *supra*, the regulation may reduce the cost of insurance to consumers, while slightly increasing transaction costs for virtually all brokers, and decreasing revenues for some brokers.

EFFECT ON JOBS AND BUSINESSES IN CALIFORNIA

The regulation will not result in the creation or elimination of jobs, nor the creation, elimination or expansion of businesses.

IMPACT ON HOUSING COSTS

None

BUSINESS REPORTING REQUIREMENT

The proposed regulation will not require businesses to file any report with any government agency. The regulation will require brokers to report their income to their clients.

IMPACT ON SMALL BUSINESS

The regulation will affect small businesses in the manner described above in the section “Economic Impact on Businesses and the Ability of California Businesses to Compete.”

ALTERNATIVES

The Commissioner must determine that no reasonable alternative considered by the Commissioner or that has otherwise been identified and brought to the attention of the Commissioner would be more effective in carrying out the purposes for which the regulation is imposed or would be as effective and less burdensome to affected private persons than the proposed regulation. The Commissioner invites public comment on alternatives to the regulation.

COMPARABLE FEDERAL LAW

There is no existing federal regulation or statute comparable to the regulation.

TEXT OF REGULATION AND INITIAL STATEMENT OF REASONS

The Department has prepared an initial statement of reasons that sets forth the reasons for the regulation. The initial statement of reasons, and the text of the regulation, is available on the Department's website. Instructions for accessing the website page containing these documents are provided below.

Upon request, the initial statement of reasons will be made available for inspection and copying. Requests for the initial statement of reasons or questions regarding this proceeding should be directed to the primary contact person listed above by e-mail.

The file for this proceeding, which includes a copy of the proposed regulation, the statement of reasons, the information upon which the proposed action is based, and any supplemental information, including any reports, documentation and other materials related to the proposed action that is contained in the rulemaking file, is available for inspection and copying at 45 Fremont Street, 21st Floor, San Francisco, California 94105, between the hours of 9:00 a.m. and 4:30 p.m., Monday through Friday. Arrangements to view the file should be directed to the primary contact person listed above by e-mail.

AUTOMATIC MAILING

A copy of this notice, including the informative digest, which contains the general substance of the regulation, will automatically be sent to all persons on the Insurance Commissioner's mailing list.

WEBSITE POSTINGS

Documents concerning this rulemaking are available on the Department's website, and can be located as follows. On the Department of Insurance home page, www.insurance.ca.gov, in the search field, enter "RH04039144" (the Department's regulation file number for this regulation). Then, click on the "Go" button to display links to the various filing documents.

MODIFIED LANGUAGE

If the Commissioner decides to adopt a regulation that differs in any substantial manner from the text that was originally provided to the public, the full text of the revised regulation will be available to the public for at least 15 days prior to its adoption. (If the revisions vary from the original text to such an extent that the public was not adequately placed on notice that the revisions could result from the original text, the Department will initiate an entirely new rulemaking.) Interested persons may request a copy of the revised regulation from the primary contact person listed above, and provide comment on the revisions to that contact person, within 15 days prior to adoption.

OBTAINING THE FINAL STATEMENT OF REASONS

A copy of the final statement of reasons may be obtained by contacting the primary contact person listed above.

Dated: October 18, 2004

JOHN GARAMENDI
Insurance Commissioner

By _____
Jon Tomashoff, CPCU
Senior Staff Counsel