Bulletin No. 80-6

Date: April 1, 1980

To: All Admitted Insurers, Surplus Line Brokers, Insurance Producers and Other Interested Persons

Subject: Brokers' Fees and other Similar Fees

This bulletin is designed to summarize for insurance producers and insurers information relating to brokers fees, service fees, and other fees and charges made to insureds in this state. The information set forth herein is not a new administrative construction of the law, but is a restatement of the law as it exists and as previously interpreted and applied by this office.

1. ALL PAYMENTS BY THE INSURED WHICH ARE A PART OF THE COST OF INSURANCE ARE PREMIUM AND SUBJECT TO PREMIUM TAX.

The California courts have held that all payments by the insured which are a part of the cost of insurance are premium, including any and all sums paid to an insurance agent. Groves v. City of Los Angeles, (1953) 40C 2d 751, 256 P 2d 309; Allstate v. the State Board of Equalization, (1959) 169 CA 2d 165, 336 P 2d 961.

In the Groves case an agent paid only 1% of the face amount of the bond to the insurer, and retained the balance for services in arranging for the bond. The City of Los Angeles sought to impose a gross receipts tax, under an ordinance that specifically exempted insurance premiums, on the balance not paid to the insurer. In Groves, the Supreme Court stated:

"We believe also that there is no escape from the conclusion that the full sum received by him from the one desiring the bail bond is the gross premium for the bond.

*** The question should not turn on whether the amount charged for the bond is broken down to specific items for their convenience. *** The essence of the matter is that the amount paid by the insured for the bond is the premium... *** And a mere bookeeping method cannot thwart the law."

"What the agent receives, in legal effect the insurer receives. The so-called "fees" received by the bail agent do not result in a reduction of the cost to the insured."

In the Allstate case, the court reiterated that the premium is the sum total which the insured is required to pay. "The entire cost to the policyholder arising out of the issuance and performance of the contract of insurance constitutes the taxable premium."

The foregoing should leave no doubt that all sums collected by insurance agents constitute taxable premium and must be reported as such.

2. AN AGENT MAY NOT CHARGE FEES NOT AUTHORIZED BY INSURER.

General rules of agency law prohibit an agent from charging sums not authorized by the agent's principal. Should an insurer authorize its agents to collect "fees" such fees would have to be reported as premium by the insurer, and would, of course, have to comply with the anti-discrimination statutes. Therefore, an insurer cannot permit each of its agents to determine which fees that agent will charge because to do so would surely result in rate discrimination. This principle applies equally to insurance agents and life agents.

3. BROKERS WHO ARE APPOINTED AGENTS ARE ACTING AS AGENTS OF COMPANIES WHICH HAVE APPOINTED THEM.

California Insurance Code Section 1731 provides that if a person is licensed to act as an insurance broker and as an insurance agent, he shall be deemed to be acting as an insurance agent in the transaction of insurance placed with those insurers for whom a notice of appointment has been filed with the Insurance Commissioner. Therefore, in such a case it would be inappropriate for the broker to charge a fee which was not authorized by the insurance company which is his principal.

4. A BROKER'S FEE MUST BE AGREED UPON IN ADVANCE.

The broker must obtain prior approval from the insured of any broker's fee arrangement. This requirement is not based on any specific Insurance Code provision, but is a fundamental principle of the law of contracts as such law has existed in this State since the year of 1872. In brief, a contract is an agreement (Civil Code 1549). It is essential to the existence of a contract that there be consent (Civil Code 1550). The consent of the parties to a contract must be free, mutual, and communicated by each to the other (Civil Code 1565).

A contract is a voluntary agreement and intention to enter into it should be formed freely and voluntarily. To add a fee to the price of insurance without the prior disclosure to and consent of the insured renders such contract voidable by the insured as being either fraudulent, imposed with undue influence, or entered into by mistake.

A broker's fee billed after the insurance is placed could be paid by the insured out of apprehension that to protest will jeopardize the

insurance coverage, because the insured is unaware that the alleged obligation is not proper and enforceable, or because of the insured's erroneous belief that the fee is being charged by the insurer. We need not speculate as to why such billings might be paid without protest. It should be clear from the foregoing that billing brokers' fees without prior agreement by the insured is an improper practice. An insurance producer, standing in a fiduciary relationship to the insured, may not engage in such practices. It is equally objectionable to disguise brokers' fees to a client by characterizing them as "inspection fees" when no inspection is required by the insurer, or as "policy fees" when no policy fees have been authorized by the insurer.

5. BROKER'S DUTY TO DISCLOSE.

While an insurance broker may charge a fee for special services rendered to his client provided the client has agreed to pay such fees prior to the rendition of the services, California case law has held that such a person acting in a dual capacity, i.e., for an insured and an insurer, must fully disclose to both principals the nature of his contract with the other, including the remuneration to be received from each. Glenn v. Rice, (1917) 174 C 269, 162 P 1020. This means that both the insurer and the client are entitled to know that the broker will be compensated by each of them. The reason for this rule, according to the court, is that one "who acts in a dual capacity puts himself in a position where his duty to one principal may conflict with his duty to the other and where his own interest may tempt him to be unfaithful to both principals--a position which is against sound public policy and good morals.

*** The infirmity of his contract does not arise from his actual conduct in the given case, but from the policy of the law, which will not allow a man to gain anything from a relation so conductive to bad faith and double-dealing. *** He must show knowledge by both parties."

6. BROKERS'FEES - POSSIBLE PREMIUM TAX CONSEQUENCES.

Although the judicial decisions cited above (Paragraph No. 1) did not involve fees charged by insurance brokers, the language of the courts casts doubt upon the right of a broker to collect fees when nothing is done by the broker over and above the routine placement of the insurance. Those decisions distinguished State Farm Mutual Automobile Insurance Company v. Carpenter, 31 CA 2d 178, 87 P 2d 867, on the ground that the fee charged by State Farm to become a member of an insurance organization was not premium because the sum paid was not what was actually given by the insured for his insurance. The decisions indicate that fees charged by brokers for doing nothing other than taking and submitting an application to a known market would be subject to premium tax. However, fees for unusual services could be payment for other than the insurance and, therefore, not subject to premium tax. While we know of no case where the State has attempted to establish a premium tax liability for routine broker's fees, insurers and brokers are hereby forewarned of that possibility.

7. LIFE INSURANCE AGENTS MAY NOT CHARGE FEES.

The California Insurance Code under general provisions defines certain licensed categories as follows:

"A life agent means an insurance agent authorized by and on behalf of a life, disability or a life and disability insurer to transact life, disability or life and disability insurance."

"'Life insurance analyst' means a person who for a fee or compensation of any kind paid by or derived from any person or source other than an insurer:

(a) On behalf of another person transacts life insurance with, but not on behalf of, an insurer; or,

(b) Advises, purports to advise, or offers to advise any person insured under, named as beneficiary of, or having any interest in the life insurance contract, in any manner considering that contract or his rights in respect thereto.'"

"'Insurance broker' means a person who, for compensation and on behalf of another person, transacts insurance other than life with, but not on behalf of, an insurer.'"

It is apparent from those definitions that a life insurance analyst is the life insurance equivalent of an insurance broker. There is no provision for life insurance broker other than insofar as the life insurance analyst covers the category. The definition of insurance broker clearly excludes life insurance from its authorized scope of activity. There are no life insurance brokers and none is permitted. Those who wish to receive a fee or compesation of any kind paid by or derived from any person or source other than an insurer, or who purports to advise or offers to advise any person insured under, named as beneficiary of, or having any interest in, a life insurance contract in any manner concerning that contract or his rights in respect thereto, must be licensed as a life insurance analyst.

The Insurance Code prohibits the joint licensing of a person as a life insurance agent and as a life insurance analyst. One could not be licensed as a life insurance analyst while retaining a life and disability agents license.

There are life insurance agents who provide advisory services such as estate planning, employee benefit plans, investment counseling, etc., which might not be directly related to the solicitation of life insurance. Sometimes, fees are charged for these services while are paid by the client. Frequently, however, the life insurance agent's recommendations include insurance which that agent actually places. In such cases, this office has consistently taken the position that the primary objective in the services provided is the sale of insurance and that, therefore, a separate charge for those advisory services is unlawful.

8. POLICY FEES ARE NOT BROKERS' FEES.

A policy fee may be a minimum earned premium or an initial flat charge made by an insurer to cover its expenses in preparing and issuing a policy. It is part of the premium charged by the insurer and must be reported as such. Policy fees may only be required by the insurer, and may only be in the amount determined by the insurer. It is clearly deceptive for an insurance producer to add a fee disguised as a policy fee which has not been authorized and imposed by the insurer.

9. PRODUCERS TRANSACTING WITH OTHER PRODUCERS ARE NOT EXEMPT.

These rules apply to producers who commonly, albeit inaccurately, describe themselves as "wholesaling" producers, i.e., producers who deal with other agents or brokers and who are not themselves in direct contact with the buyer of insurance. Certainly, such producers

have the same duty of disclosure to those dealing with them as do those dealing directly with the insuring public. Such a producer, wishing to charge a broker's fee has the resonsibility to determine that the consent of the insurance buyer is obtained prior to the placement of the coverage. Such a producer must make full and accurate disclosure to the person with whom he deals, and must instruct that person to make, in turn, full disclosure to and receive the consent of the client prior to imposing a broker's fee.

In conclusion, while it is not possible to address all of the possible circumstances under which fees, lawfully or unlawfully have or are being charged, it is hoped that the foregoing will suffice to serve the need for advice of those insurers and producers honestly seeking to operate within the purview of the law and who may have been unclear as to their rights and obligations.