

Assessment of Public Comments for the Adoption of 11 NYCRR Part 30 (Regulation 194)

Insurance producers generally receive compensation from insurers or other producers by one of two types of methods. The first is a flat percentage commission based on premium volume, paid at the time of sale. There may be different flat rates paid for new and renewal business. The second is a contingent commission, which may be paid in addition to flat percentage commissions, and which typically is based on profit, volume, retention, and/or business growth. Contingent commissions are not payable on a per policy basis, but are allocated based on the performance of the entire portfolio of business placed with a particular insurer. The contingent commission schedule is known to producers at the beginning of a given period of time (usually one year), but contingent commissions actually earned are calculated some period after business is placed and loss experience is observed. The amount of compensation paid may also vary from producer to producer, depending upon the relationship between the producer and the insurer or other producer, though the compensation paid usually will not change the actual premium to the consumer.

Defenders of incentive-based producer compensation argue that competition in the marketplace can address any conflicts because consumers can comparison shop among producers. Producers that do not offer insurance providing the best combination of coverage, service and price will lose business to those that do. However, consumer representatives emphasized in discussions with the New York State Insurance Department that consumers who purchase insurance through an insurance producer may not comparison shop for the most favorable coverage, service and price because they are often encouraged to rely on the producer to comparison shop the market for them.

From 2005 to 2007, the Attorney General and the Superintendent entered into enforcement settlement agreements and regulatory stipulations concerning allegations of improper steering in response to incentive-based compensation with a number of major brokers and insurers. In response to the New York investigation, the National Association of Insurance Commissioners in 2004 amended its Producer Licensing Model Act to include requirements that brokers (but not agents) disclose compensation to purchasers. The New York Insurance Department also circulated a draft disclosure regulation in 2007. The work done on that draft and the comments received have been incorporated into the current draft.

In July 2008, the New York State Insurance Department, in tandem with the Attorney General's Office, held public hearings in Buffalo, Albany and New York City and conducted extensive outreach to consumer groups, industry and other stakeholders for more than a year. The Department has publicly exposed two informal draft regulations (in January 2009 and July 2009) and sought comment on each. The Department has also held six "working group" meetings with stakeholders in various lines of insurance and dozens of other formal and informal meetings and phone calls with consumer and industry representatives. Through this process, the Department has considered a number of different courses of action including (1) banning or limiting certain types of producer compensation; (2) full disclosure of all producer compensation for every insurance transaction; (3) requiring disclosure only for producers who are paid directly by the purchaser and by the insurer; (4) requiring disclosure of producer compensation only upon the request of the purchaser; (5) requiring that producers disclose only their role in the transaction and the source of their compensation with no disclosure of the compensation amount; and (6) taking no regulatory action and/or promoting voluntary disclosure of compensation by producers.

After this exhaustive process, the Department has determined that this final draft regulation hereby adopted is the best way to ensure that consumers better understand the role that insurance producers play in the insurance transaction, the compensation those producers receive, and any potential conflicts of interest that may arise as a result, while imposing as little cost as necessary on the producers and insurers. On November 12, 2009, the Department received approval from the Governor's Office of Regulatory Reform to proceed with a proposed regulation. The proposed rule was published in the State Register on December 2, 2009, and the 45-day public comment period expired on January 16, 2010.

A summary of the comments provided to the Department in response to the: (1) July 2008 public hearings; (2) January 2009 informal draft regulation; and (3) July 2009 informal draft regulation, were previously included in the regulatory impact statement for the proposed regulation, available online at www.ins.state.ny.us.

In response to publication of the proposed regulation in the December 2, 2009 State Register, the Department received more than 2,200 comments. Many of the comments are from stakeholders that had commented previously and are similar or identical in nature to those stakeholders' previous comments. Below is a summary of the comments provided to the Department by the various stakeholders. This summary of comments focuses primarily on comments that have not been previously submitted by the same stakeholder, and which, generally speaking, have not already been considered by the Department.

More than 1,900 of the comments received were form letters from members of the National Association of Insurance and Financial Advisors - New York State (NAIFA-NYS). While these form letters support the language in the proposal, which directs that the producer must disclose whether the producer represents the consumer or the insurer, and that the producer will receive compensation from the selling insurer, they question the need to reveal, upon request from the consumer, the amount of compensation, since the limits on compensation are already set by the provisions of Section 4228 of the Insurance Law. The letters also oppose the requirement, in the proposal, that producers inform consumers that they may obtain specific information about the producers' compensation, because such requirement would not be an effective deterrent to a producer who is not acting in the best interests of his/her client. They also argue that prompting the consumers in this way would distract consumers from more important matters concerning the terms of the policy.

As discussed previously in the Regulatory Impact Statement published on December 2, 2009, Section 4228 establishes a maximum level of producer compensation for certain life insurance transactions. But that ceiling does not eliminate the potential conflicts of interest that the proposal is designed to address, because producers can still receive various types and levels of compensation from various insurers. As also discussed previously, the Department believes that without the "prompt" language set forth in Section 30.3(a)(4), consumers will have no way of knowing that they have the right to additional information concerning a producer's compensation. While the Department agrees that policy terms and overall premium are more important than producer compensation in most transactions, it is still important that consumers understand the role and potential conflicts of interest of their intermediaries. Therefore, no changes were made in response to these comments.

The Department also received more than 250 comments from individual brokers and agents, most of them members of the Professional Insurance Agents and the Independent Insurance Agents and Brokers of New York (collectively, the "independent agents").

Most of these independent agents have commented that the proposal will be burdensome and costly to small agencies and brokerages, which will have to track and calculate compensation on a per policy basis. The proposal, however, does not require such tracking or calculations. In most insurance transactions, producers will simply provide consumers in general terms with a description of their role in the transaction and the nature of how they are compensated. In a subset of transactions, consumers will request more information, and the producer will in those instances have to give a more detailed explanation of the factors that go into the compensation that the producer receives based on the sale and the amount received. If the amount is not known at the time, the producer can provide a reasonable estimate of what the amount may be, which may be stated as a range of amounts or percentages. Thus, the costs of compliance with the proposal have been minimized.

Many of the independent agents also argue that the proposal only makes sense for brokers who collect fees from their clients, because other consumers understand that the producer is getting paid by the insurer. As discussed more fully in the previously published Regulatory Impact Statement, however, most consumers do not understand the producer's role in the transaction. In fact, many consumers are told and often believe that the producer represents their interests. Therefore, the Department continues to believe this proposal serves a vital need in the marketplace in educating consumers. Accordingly, no changes were made in response to these comments.

A number of independent agents also have compared insurance producers to sales people in other industries, including those who sell cars, appliances and shoes. They argue that because these sales people do not have to disclose their gross margins on every sale, similarly insurance producers should not have to disclose their compensation. The Department believes that consumers of sophisticated financial products like insurance are entitled to understand the role of the insurance producer in the transaction, and request information relating to the compensation the producer may receive. Accordingly, no changes were made in response to these comments.

Many independent agents also have insisted that the proposal must apply to all agents and brokers, even those who work for so-called "direct writers" (i.e., insurers who sell their products directly to the public). Yet the proposal already applies to such agents and brokers. Therefore, no change was required.

There are many independent agents who argue that the definition of "compensation" in the proposal is too broad and may encompass agent salaries. The substantive provisions of the proposal, however, refer to compensation "based in whole or in part on the sale," and therefore clearly refer only to commissions and other sales-based compensation. Therefore, no change was made in response to these comments.

Many independent agents argue that they have rarely had consumers request compensation information, and assert that the Department has few documented complaints relating to producer compensation. The Department believes, however, that few consumers inquire or complain because few are aware of producer compensation structures and how they may create conflicts of interest for producers. Thus, no changes were made in response to these comments.

A number of independent agents argue that stating whether they represent the insurance consumer or insurer in a transaction is difficult because in most instances there is at least

some dual agency. The Department agrees that producers may represent insurers for certain purposes like collecting premium, while at the same time representing consumers for certain other purposes, particularly if the producer has represented to the consumer that the producer is the consumer's "trusted choice" or that the producer will look after the consumer's interests. Therefore, the Department has changed the proposal, so that it now requires that the producer provide an explanation of the producer's role in the transaction without a specific requirement that the producer state who he/she represents.

Finally, many independent agents complain that applying the proposal to all renewals creates an undue compliance burden, because many renewals are automatic and involve minimal contact between the producer and the consumer. The Department agrees with the independent agents on this issue and has largely excepted renewals from the final version of the proposal. The only remaining requirement concerning renewals is that if the consumer affirmatively requests information about the producer's compensation within 30 days of renewal, the producer must provide the information.

Trade associations comprised of financial advisors and life underwriters submitted a joint letter, on behalf of life insurance agents. The commenters state that the marketplace for life insurance, disability insurance and annuities is much different than the property and casualty marketplace, where the Department and the Attorney General investigation found most of the problems concerning incentive-based compensation. The commenters request that life insurance products be removed from the scope of the proposal or, alternatively, that disclosure consist only of notification to consumers explaining that producers represent insurers in selling insurance and receive compensation based upon sales. The commenters argue that, in any event, the proposal would not effectively deter a producer who is not acting in the best interests of his/her client.

As discussed previously in the published Regulatory Impact Statement, deterring misconduct by producers is only one goal of the regulation. The regulation is also designed to make sure consumers are fully informed about the nature of the producer's compensation and any potential conflicts of interest that may arise therefrom. There will always be regulated persons who decide to break the law, but that is not an argument against prudent regulations that achieve an important purpose. Nor are the conflicts that arise from incentive-based compensation limited to the property and casualty marketplace alone. Those conflicts are no less present in the life insurance marketplace. The Department has considered the uniqueness of life insurance products, as well as the potential difficulties life insurers and producers will have in complying with the regulation. However, the Department has determined that the goal of making producer compensation transparent to insurance consumers outweighs these concerns. In fact, in some respects the regulation should be less burdensome for life insurance producers who are already under legal obligations to make disclosures that in some instances are more extensive than what this regulation requires. Accordingly, no changes were made to the proposal in response to these comments.

One property and casualty insurer commented that direct writers should not have to provide disclosure because consumers understand that the insurer's direct sales representatives (DSR's) are working for the insurer. The insurer argues that due to its corporate structure, all New York DSR's are licensed as agents but they do not receive compensation based on the sale of an insurance contract.

DSRs are covered by the regulation to the extent that their sales people are required to be licensed producers, and any salesperson who receives any type of compensation (including year-end bonuses) based in whole or in part on the sale of insurance policies must be licensed. Therefore, the only DSR employees who are not covered by the regulation are those who receive only a straight salary and no compensation based in whole or in part on sales.

The Department has addressed the insurer's concerns in part by providing an exception for insurance company employees who are not acting as insurance producers, i.e., are not receiving incentive-based compensation. The Department has decided it is important for the rule to apply equally to all persons acting as licensed insurance producers.

One life insurer supports compensation disclosure, including the provisions requiring a producer to disclose: who it represents; how it will be compensated; and that compensation varies among insurers and different insurance contracts. The insurer supports general disclosure explaining the relationship between the producer and the insurer, but not detailed financial information about compensation structures. The insurer argues that the requirements relating to disclosure of compensation structures will create confusion for consumers and undermine fair competition among insurers. In addition, the insurer opposes the requirement that producers inform customers that they may obtain specific information about the producers' compensation, claiming it would misdirect the consumer's focus to the amount of compensation to be received by the producer, and away from the benefits and attributes of the product being considered, and the company standing behind it.

There is nothing in the regulation that requires insurers or producers to disclose their "compensation structures." The only requirement is that producers disclose the amount of compensation, if known, along with a general description of the factors that may lead to further compensation and a reasonable estimate of the amount of such further compensation. As previously discussed in the Regulatory Impact Statement, there is no reason for compensation to "distract" consumers from other matters. The Department envisions the required disclosure to be just one aspect of the oral and/or written sales presentation made by producers.

A trade association of health plans resubmitted comments that were made in March, 2009, and to which the Department previously responded in the Regulatory Impact Statement published on December 2, 2009.

The trade association of health plans comments that employees of health plans should not be subject to the proposal. The trade association of health plans also objects to a definition of purchaser that includes certificate holders in health plans who do not select the coverage. The trade association of health plans also criticizes the broad definition of compensation included in the proposal and points out that such definition would include even de minimus items. In response to these comments, the Department has clarified that employees of insurers who do not receive incentive-based compensation (and are therefore not licensed producers) are exempt from the proposal. The Department has also narrowed the circumstances in which certificate holders would be defined as purchasers to instances where the producer has "sales or solicitation" contact with certificate holders, and further narrowed the final version of the regulation to require disclosure only when the certificate holder pays all of the premium. Finally, the Department has excepted certain de minimus items of compensation from the proposal.

An association of independent insurance agents and brokers maintains that there is no documented need for this proposal, which will not address the types of behavior that created the perceived need – i.e., the illegal activities of a few mega-brokers that were brought to light by then - Attorney General Spitzer. The association argues that it has strongly advocated for voluntary disclosure of compensation when requested by the consumer and continues to support a voluntary approach to transparency. The association also argues that the costs of compliance with the proposal will create a burden for insurance producers, many of whom are small businesses, and that over time the additional costs to implement this proposal will be shifted back to the consumer in the form of higher premiums. The association also suggests, among other things, that the definition of "compensation" in the proposal be narrowed. Finally, the association proposes that the "exceptions" provision of the proposal be eliminated so that the requirements will equally apply to all insurance transactions and the licensed producers who conduct those transactions.

The association's complaints about the lack of need for the regulation are already addressed above. In addition, as discussed in the previously published Regulatory Impact Statement, the investigations by the New York Insurance Department and the New York Attorney General in 2004-2007 into major insurance companies documented steering misconduct by small and medium size brokers, as well as independent agents. Moreover, insurers pay commissions, contingent commissions and other incentives in order to affect producer behavior, and such incentives create potential conflicts. At the very least, insurance consumers are entitled to some level of disclosure of those potential conflicts, particularly when the insurance producer holds himself or herself out as the consumer's "trusted choice."

The Department addressed the association's concerns about the costs of compliance by moving to the two-step disclosure process – i.e., disclosure of role, followed by more specific compensation-related information upon request – that the association itself proposed. As discussed elsewhere, the "broad" definition the association is concerned about is only used in the context of compensation "based in whole or in part on the sale" throughout the regulation. Finally, the regulation applies equally to all licensed producers who are acting in a producer capacity in the transaction.

Another trade association of independent insurance agents and brokers argues, among other things, that the requirement that an agent and broker disclose whether he/she "represents the purchaser or the insurer for purposes of the sale" creates precarious legal landmines for the thousands of small businesses who sell insurance products in New York State. The association believes that the question of who a producer represents in a particular transaction is often complex, and the answer to this inquiry will always be fact-intensive and transaction-specific. The association is troubled by the fact that the proposal does not apply equally to all insurance producers, and certain categories of transactions and producers are exempted altogether from its application. The association strongly objects to the creation of this unlevel playing field and urges the Department to eliminate this disparity. The association also states that the proposal requires, in cases of "supplemental" disclosure made in response to the consumer's request, agents and brokers to disclose greater information than what is actually requested by the consumer. The association urges the Department to revise the proposal to clarify that a producer is not required to make supplemental disclosures concerning subject matter not requested by the consumer. The association also argues that requiring a producer to provide information concerning all alternative quotes "obtained" is onerous and would require producers to develop detailed insurance policy abstracts that compare and contrast the various terms of coverage. The

association urges the Department to eliminate that requirement as it relates to the mandated production of information concerning coverage. Finally, the association recommends that the Department exempt renewals from the scope of this proposal, and notes that a consumer renewing a policy will have already received disclosure statements and will retain the ability to request and obtain additional information from the producer.

As noted above, the Department is sensitive to the association's concern that requiring producers to make a statement as to who they represent may require the producer to draw a difficult legal conclusion. Therefore, the Department has changed the initial role disclosure to require producers to simply describe their role in the transaction.

The Department has considered the association's concern that the proposal requires producers to give the consumer more information than he or she has requested. Given that a consumer may make the request orally and in a number of different ways, the Department feels it is important that every consumer who expresses an interest in such information be provided with a full written disclosure prior to issuance of the insurance contract. The insurance producer is free to explain the compensation information orally and in an abbreviated form when the request is made.

The Department has already addressed the association's concern about alternative quotes "obtained" by narrowing the scope of the required disclosure to alternatives "presented."

As discussed elsewhere, the Department has addressed the association's comment concerning renewals by exempting from the final regulation renewals from the initial disclosure requirements.

A trade association of life insurers has argued, among other things, that the proposal is duplicative of existing state and federal statutes. In addition, the trade association of life insurers suggests that the proposal exclude the amount of the compensation from the disclosure requirements. The trade association of life insurers also opposes the requirement that producers disclose to consumers that they have the right to request and obtain information regarding the nature, amount and source of the producer's compensation. The trade association of life insurers would also like the proposal to be revised to acknowledge the uniqueness of life products and argued that implementation and compliance will be particularly challenging for life insurance producers.

As discussed in the previously published Regulatory Impact Statement, the Department and the trade association of life insurers disagree about the importance of the requirement that producers "prompt" consumers that they may receive more information about the producer's compensation. In the Department's view, without such a requirement, consumers will have no way of knowing that they have a right to such information. The Department has considered the uniqueness of life insurance products, as well as the potential difficulties life insurers and producers will have in complying with the regulation. However, the Department has determined that the goal of making producer compensation transparent to insurance consumers outweighs these concerns. In fact, in some respects the regulation should be less burdensome for life insurance producers who are already under legal obligations to make disclosures that in some instances are more extensive than what this regulation requires. Accordingly, no changes were made to the proposal in response to these comments.

One property and casualty insurer has commented that the proposal should exclude direct writers, including their employee sales representatives, captive agents, exclusive agents and call centers. Alternatively, the property and casualty insurer suggests that if the proposal is to be applied to those parties, disclosure should be limited to "role disclosure" when insurance options presented to a consumer do not have a materially different compensation structure associated with them. The property and casualty insurer states that its sale compensation structure is a trade secret. Finally, the property and casualty insurer suggests that, among other things, the proposal be revised to: (1) indicate that requirements are satisfied if the disclosure is provided at time of application in writing, even if policy is bound before a consumer receives or signs a paper application; (2) require that compensation be disclosed in general, rather than specific terms; (3) exclude from disclosure referral fees earned when one producer refers business to another producer who completes the sale; and (4) exclude flood insurance.

As discussed above, the Department has carefully considered the arguments of DSRs and determined that it is important for the regulation to apply equally to all insurance producers. The regulation as drafted does not require disclosure of detailed compensation structures. The Department found no compelling reason to exclude referral fees or flood insurance from the scope of the regulation. Therefore, the Department has not changed the regulation in response to the insurer's comments. However, to the extent that the insurer or any other stakeholder has questions about implementation of the regulation after its effective date, the Department is committed to working to provide sufficient guidance in response to specific inquiries.

A trade association of property and casualty insurers opines that, among other things, incentive-based compensation does not represent an inherent conflict of interest between producers and their clients, and the Department has failed to demonstrate the need for, or benefit of, the proposal. The trade association argues that the definition of compensation should exclude "employees salaries, benefits and expenses" and de minimus situations that involve total commissions or other compensation less than \$100. The trade association further argues that the proposal should exclude direct writers and their representatives and agents. The trade association also argues that the proposal should allow a producer to satisfy the disclosure requirements by issuing one disclosure in situations where the producer provides multiple quotes on different lines at the same time for the same insurer.

The Department has addressed almost all of the trade association's concerns elsewhere in this assessment and in the previously published Regulatory Impact Statement. Nothing in the regulation requires multiple disclosures for multiple lines of coverage provided at the same time. Therefore, there is no need to change the regulation in response to that comment by the trade association.

Another trade association representing the property and casualty insurance industry argues that the regulation should exclude captive or exclusive insurance agents. The Department finds that, like other insurance agents, many captive insurance agents are permitted to place consumers with other insurers when their appointed insurer does not provide the requested coverage. In addition, even in the captive or exclusive agent context, incentives may vary from insurance product to insurance product, thus creating the potential for conflicts. As noted above, the Department has determined that the regulation should apply to all licensed insurance agents and brokers. Therefore, no changes were made in response to these comments.

Another trade association of property and casualty insurers argues that, among other things, disclosure requirements will adversely impact insurers that use employees to sell insurance directly to the public and pay bonuses based on sales because employees' time spent not closing a sale will cost the insurer money. The trade association argues that if the proposal does not exempt such employees, it should exempt them from having to disclose their salary to people to whom they try to sell insurance. Further, the trade association proposes that the definition of the term "compensation" be modified to exclude an employee's salary, and not require an employee to disclose the exact amount of a bonus.

As discussed previously, throughout the regulation, disclosure is limited to compensation "based in whole or in part on the sale." Therefore, producer salaries are clearly excluded, and there is no reason to change the language of the regulation in response to these comments. Furthermore, the regulation does not require that the exact amount of an unknown bonus be disclosed. The requirement is that the factors that go into a bonus, plus a reasonable estimate of what the bonus may be (which may be stated as a range of amounts), be disclosed.

One trade association of insurance brokers repeats many of the arguments it made in previous submissions to the Department including its argument that the definition of "compensation" is too broad. The brokers association also argues that the timing of disclosure should be placed on the actual policy. The brokers association asserts that disclosure of the role of the producer in transactions does not contemplate a producer acting as agent/broker in a single transaction. The brokers association also comments that it supports a generic statement that is general in nature concerning disclosure of the amount of compensation. The broker association argues that alternative quotes may have the unintended consequence of inhibiting consumer choice and competition, and that providing to consumers a description of circumstances and reasonable estimates of value will only serve to distract consumers. Further, the brokers association argues that the record retention requirements in the regulation will be onerous on small businesses, and the penalties in the proposal should only be assessed against willful violators, i.e., those who violate the requirements with frequency as to indicate a pattern or general business practice.

The Department has addressed virtually all of the broker association's concerns throughout the informal and formal comment periods, in the previously published Regulatory Impact Statement, and in this assessment. Nevertheless, based on the broker association's (and other's) comments concerning the record-keeping requirements, the Department has modified the regulation to allow producers to enter into written agreements with insurers whereby the insurers keep the required records. Furthermore, based on those concerns about the costs of record keeping, the Department has eliminated the requirement that producers who elect to make an oral disclosure to clients retain a certification that the oral disclosure was given in addition to the follow-on written disclosure required by the regulation. The final regulation requires only that the written disclosure documents be retained.

One life insurer comments that the proposal will place an undue and expensive burden on life insurance producers because it does not take into account the unique nature of life insurance transactions. The insurer further argues that the proposal fails to recognize that New York and national requirements/limits already exist for producer compensation disclosure. Finally, the insurer argues that the proposal is vague, which will result in abuse and selective, discriminatory enforcement. As discussed above and in the previously published Regulatory Impact Statement, the Department considered compensation

disclosure requirements in other states and the standard promulgated by the NAIC and determined that such standards were inadequate to provide transparency for New York's insurance purchasers. The remaining arguments raised by the insurer also have been addressed in this assessment or elsewhere. Accordingly, no changes were made in response to these comments.

An insurance agents group argues that compliance with the disclosure and record retention requirements will impose cost and time burdens on producers. The agents group also argues that the definition of "compensation" is overly broad and should be confined to "commissions", and that the proposal should define the term "material ownership".

As discussed previously in this assessment and elsewhere, the Department has addressed the cost concerns of the agents group by modifying the regulation to remove initial renewal disclosures from the regulation, allowing producers to contract with insurers to meet record keeping requirements, and eliminating the certification retention requirement. The agents group's other comments have been addressed previously by the Department, or can be addressed through the implementation process in response to specific inquiries.

Finally, representatives of a property and casualty insurer argue that the proposal should not apply to travel insurance specifically or to captive or employee insurance agents more generally. They assert that the same conflicts of interest do not exist for agents who represent only one company and who only sell products that do not compete with one another. The Department finds that, like other insurance agents, many captive insurance agents are permitted to place consumers with other insurers when their appointed insurer does not provide the requested coverage. In addition, even in the captive or exclusive agent context, incentives may vary from insurance product to insurance product, thus creating the potential for conflicts. As noted above, the Department has determined that the regulation should apply to all licensed insurance agents and brokers. Therefore, no changes were made in response to these comments.