

The Conflict and Burden of Insurer Appointments for Brokers and the Need for Regulatory Reform

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IMPORTANCE Many states still require insurers to appoint a broker as an agent to transact insurance with the insurer. This creates a dual agency situation that results in several conflicts and burdens. We submit that the requirement of broker appointment could be removed without causing harm and would remove this conflict of interest.

OBJECTIVES

1. Describe the current requirement of a broker appointment.
2. Present the disadvantages created by this dual appointment situation.
3. Analyze the “what-if” of removing the broker appointment requirement.

SUMMARY Insurance brokers are supposed to be independent to represent the insured, rather than the insurer; yet, the law in many states still requires insurers to appoint a broker as an agent actually to transact insurance with the insurer. This dual agency creates well-known conflicts and burdens.

We contend that the requirement that insurers appoint agents in each state with the department of insurance (DOI) has outlived its usefulness and should be abolished for independent insurance brokers, at least those of a minimum size. Insurers with exclusive agents should retain the appointment requirement.

Protection of the insured against unethical brokers is not accomplished by this appointment requirement. Protection against rogue brokers is already achieved by malpractice claims and malpractice insurance. This can be further strengthened by requirements for higher malpractice insurance limits.

Removing the appointment requirement for brokers will further the goals of simplified regulatory burdens, business efficiency, and customer protection by eliminating one conflict of interest of the dual agency situation.

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ABSTRACT

Brokers are supposed to be independent to represent the insured, rather than the insurer; yet, the law in many states still requires insurers to appoint a broker as an agent actually to transact insurance with the insurer. This dual agency creates well-known conflicts and burdens. We contend that the requirement that insurers appoint agents in each state with the department of insurance (DOI) has outlived its usefulness and should be abolished for independent insurance brokers, at least those of a minimum size. Insurers with exclusive agents should retain the appointment requirement. Protection of the insured against rogue brokers is not accomplished by this appointment requirement. Protection against rogue brokers is already achieved by malpractice claims and malpractice insurance, which can be strengthened by requirements for higher malpractice insurance limits. Removing the appointment for brokers will further the goals of simplified regulatory burdens, business efficiency, and customer protection by removing one conflict of interest of the dual agency situation.

1. Introduction

The appointed agent requirement has outlived its usefulness for all but the small exclusive (also called captive) agents and should be abolished for independent insurance brokers, at least those of a minimum size. This will reduce regulatory burdens, improve business efficiency, and may enhance customer protection by removing one conflict of interest of the dual agency situation that now burdens independent agents and brokers.

Independent insurance brokers are supposed to be independent of the insurer. By definition, brokers are supposed to represent insureds. In many instances, brokers forego the commission and instead work on a flat (or negotiated) fee to avoid the apparent conflict of interest of being paid by insurers to represent the insureds. Yet, to transact insurance, many states require all producers, including brokers, to have an appointment from an insurer or at least put the business through some appointed general agent. This ancient requirement to have an appointed agent in the mix is unlikely to protect any insured or even protect the insurer. It seems unlikely that anyone would check a DOI appointment website until a lawyer is hired to file a lawsuit against the agent and the insurer. We contend that the requirement to appoint any producer as an agent, as is still required in most states, should be removed for brokers. Our proposal here only concerns the "independent agent" and broker, terms that are largely synonymous. We contend that the vital goal of protection of insureds can be

1962). Agency expansion was also necessary when mutual insurers entered the life insurance business, because the mutuals lacked the large capital of stock insurers (Athearn, 1962). In modern times, the appointment of agents to sell insurance is to expand the book of business and generate revenue.

Agents were also needed because the terms of the early insurance contracts required delivery by an agent to make them effective contracts. This was an important point in the U.S. Supreme Court case of *Paul v. Virginia* (1869), which decided that insurance was not interstate commerce because contracts were “not subjects of trade and barter offered in the market as something having an existence and value independent of the parties to them. They are not commodities to be shipped or forwarded from one State to another ...”. Instead, the U.S. Supreme Court ruled that insurance contracts “are like other personal contracts between parties ... The contracts do not take effect - are not executed contracts - until delivered by the agent in Virginia.”

The U.S. Supreme Court later reversed the decision in *U.S. v. South-Eastern Underwriters Association* (1944), ruling that insurance was interstate commerce and could be regulated by the U.S. Congress, specifically under the Sherman Antitrust Act of 1890. The U.S. Supreme Court observed that many decisions since the *Paul v. Virginia* case ruled that specific transactions constituted interstate commerce (e.g., transporting lottery tickets, a woman in a common carrier, quarts of whiskey, stolen automobiles, diseased cattle, and telegraph transmissions):

These activities having already been held to constitute interstate commerce, and persons engaged in them therefore having been held subject to federal regulation, it would indeed be difficult now to hold that no activities of any insurance company can ever constitute interstate commerce so as to make it subject to such regulation; -- activities which, as part of the conduct of a legitimate and useful commercial enterprise, may embrace integrated operations in many states and involve the transmission of great quantities of money, documents, and communications across dozens of s4 (te commi 075 Tw 101 (and comm(as

In line with the early idea that insurance was about contracts, rather than commerce,² was the need for local agents to sign and deliver the contract; this was embodied in countersignature laws:³ "Where a countersignature is required, a contract is not properly and completely executed so as to be enforceable against the company until it is countersigned as stipulated." (Plitt et al., 1995, § 14:5). Countersignature laws have in recent years been ruled by many courts as unconstitutional because they violate the privileges and immunities clause of the constitution, affecting out-of-state agents.⁴ As one court said:

The notion that an agent cannot provide assistance outside his home state is nonsense; whatever may have been said when people traveled by horseback and communicated by regular mail, today people communicate by telephone and facsimile and e-mail and overnight courier, and they travel by jet; state

3. Brokers, Agents, and State Requirements for Insurers to Appoint Agents to Transact Insurance

General agents of property-casualty insurers play an important role in helping insurers reach local retail producers and soliciting agents: “A general agent is one who has charge of the insurer’s business in a particular state and acts on broad instructions and without special limitations on his or her authority. The general rule is that an insurance agent is authorized to accept risks, to agree upon and settle terms of insurance contracts, and to carry them into effect by issuing and renewing policies” (Holmes, 1998–2009, § 44.2). However, life insurance agents do not have power to bind (Ibid.). *New Appleman on Insurance Law Library Edition* (2021, § 2.03[4]) states, “In short, a general agent has nearly unlimited authority to act on behalf of the insurer that employs him.”

Brokers are producers who represent the insured. That is the standard definition and understanding. A “broker is a licensed independent contractor who represents buyers (applicants) for insurance (typically property and liability insurance) and who deals with either insurance companies or insurance agents in obtaining the insurance coverage which the insurance buyer wants ... As a general legal rule, an insurance broker is the agent of the buyer/insured, and an insurance broker is not the insurer’s agent ...” (Holmes, 1998–2009, § 44.2). *New Appleman on Insurance Law Library Edition* (2021, § 15.02) states, “Brokers search the market on behalf of their prospective insured and may place business with any insurer that is willing to accept the risk submitted by the broker (i.e., brokers are not limited to placing business with one insurer).” Maas (2010) found that the principal benefit that brokers provide is consultative, reflecting a “customer-value approach.” Maas (2010) states, “Four key issues concerning the customers’ desired future functions of brokers were discovered. Customers expect brokers to offer professional consulting services, risk management support, international relationship networks, and innovative solutions.” This is expanded to mean “high customer orientation and customer-specific services,” empathy and sympathy, long-term relationships, continuity, trust, and being “an independent and neutral business partner.” Depending on the particular needs of the insured, a broker’s relationship might be classified into a function of transformer (being innovative), problem-solver (innovative dealing with complex situations), supplier, or partner (Maas, 2010).⁵ As a result, brokers are not merely a “market maker” to match insureds with insurers, but they provide “crucial social functions,” “specific skills and competencies” (Maas, 2010).

Brokers can be dual agents—for the insured and the insurer—and the particular facts of a situation and any contract between the broker and the insurer will determine the exact relationship (Maas, 2010; Stempel and Knutsen, 2021, § 6.02; Plitt et al., 2021, § 45.3–45.7; Richmond, 2004, p. 7–9⁶). Plitt et al. (2021, § 45:5) states, “[A]n agent licensed to sell insurance products for a variety of insurers as an independent insurance agent may still be considered an agent of an insurer if the insurer has a written agency

5. The survey was of German, Swiss, and Austrian companies. We have no reason to doubt that the same statements would apply universally in the insurance intermediary business.

6. These treatises cite numerous cases for these points. Specific case rulings are not relevant to this paper.

behaviour of the insureds is not a factor in determining whether the agent is acting as an agent or as a broker. The appointment agreement expressly authorizing the agent to transact the business on behalf of the insurer as its agent.”

Bluntly stated, an “insurance agent” represents the insurance company, whereas an “insurance broker” represents the insured, although the question of whether one is an insurance agent or broker is a question dependent on the particular facts. A person may be both an agent and a broker, and at different times act in different capacities, sometimes representing the applicant for insurance and at other times acting for the insurance company.

...

However, insurance representatives may not always escape liability when sued by a policyholder/insured by arguing that they are agents instead of brokers. Courts often blur, or disregard, the distinction between the two depending on the circumstances of a particular case.

(Holmes, 1998-2009, § 44.2)

Brokers are rarely pure brokers in the strict sense of representing only the insured. Brokers may view their role as representing the insured only, consistent with their role for

producer, broker, solicitor, or insurance counselor under this act" (Mich. Comp. Laws Serv. § 500.1243). To bind a policy, the producer must be appointed by the insurer (Mich. Comp. Laws Serv. § 500.1208a). California's statute on insurance brokers says the presumption of a broker is rebutted if the broker is also appointed as an agent (California Insurance Code § 1623⁷). New York issues separate agent or broker licenses (N.Y. Insurance Code § 2103, 2104), but the appointment statute refers to appointing a "producer" as an agent (N.Y. Insurance Code § 2112). Connecticut and Illinois issue a producer license (Conn. St. § 38-702b; Illinois St. Ch. 5/500/15-35). Georgia defines agents and agency also to include a producer without the mention of a broker (O.C.G.A. § 33-23-1⁸). Ohio defines an agent as anyone required to be licensed to sell insurance (Ohio Rev. Code Ann. § 3905.01⁹).

Calling everyone an agent creates confusion as to what the intermediary is supposed to do. The *agent* should to find customers to sell the insurer's policies and then act on the insurer's behalf to the extent of authority granted or implied. The *broker* is supposed to find insurance policies for his or her client; i.e., the applicant. Of course, there can sometimes be a dual agency, where the broker has authority from the insurer to do such things as receive premiums and notice of claims. Our contention in this paper is that requiring a notice of appointment of someone as an agent to accept an application for insurance to transact insurance tangles up brokers' roles and independence and adds to regulatory burdens, without doing anything to protect consumers and policyholders, whether they are individuals or large businesses.

4. A Non-Uniform Appointment Process

Our research and review of industry practices show that only nine states do not require a broker to be appointed by an insurer with the appointment on file with the state DOI: Alaska, Arizona, Colorado, Illinois, Indiana, Maryland, Missouri, Oregon, and Rhode Island. States have various practices after that to require appointments. Iowa's statute does not require appointments of brokers (Iowa Code § 522B.13), but the Iowa Insurance Division makes no distinction betw

appointment has been approved by the commissioner" (Ky. Rev. Stat. § 304.9-270).

NARAB (EX) Working Group still in compliance, but there were other states eligible for certification as well. By 2011, 40 states were certified for reciprocity.

In early 2015, several large states were still not reciprocal. As a result, new legislation, called the National Association of Registered Agents and Brokers Reform Act of 2015 (NARAB II), was enacted. NARAB II created an independent nonprofit corporation, known as NARAB which is governed by a 13-member board comprising eight current or former insurance commissioners and five insurance industry representatives. By October 2021, 47 jurisdictions were certified.

For a producer to join NARAB, the producer must be licensed in his/her home state, must not have a license suspension or revocation in place at the time of application, must pass a background check, and pay membership fees. Then, s/he can engage in producer activities in that jurisdiction. Membership in NARAB is completely voluntary and not required (NAIC, n.d.).

While much of the licensing and reciprocity goals have been achieved, the state appointment processes have lagged.

6. The European Approach

The U.S. is unique among developed countries in regulating insurance at the state level rather than the national level. The European Union's (EU's) practices on intermediary (producer) licensing and appointment processes are informative to our position. We present the more general rules of the EU and address Germany here as an example. We chose Germany because within the EU, it is the biggest country by inhabitants and Gross Domestic Product (GDP) (EU, n.d.) and likely the biggest market by Gross Written Premium (GWP) (European Insurance and Occupational Pensions Authority [EIOPA], 2021; Swiss Re Institute, 2021) and the number of intermediaries (EIOPA, 2018); although, this position might vary depending on the year observed and methods used.

In Europe, the Insurance Mediation Directive (IMD)¹⁶ was introduced in 2002, followed by the Insurance Distribution Directive (IDD¹⁷) in 2016, both subsequently implemented by each member state. Germany implemented the IMD in 2007 with amendments to the Insurance Contract Act (VVG),¹⁸ and subsequently the IDD in 2018 with additional legal modifications.

The regulatory requirements mostly pertain to how the intermediary interacts with the customer. The regulations do not differentiate substantially between agents and brokers. Only intermediaries who sell insurance on a very small scale and/or as an annex product can be exempted from this regulation (Art. 1 IDD).

To become an insurance intermediary, the applicant must be registered (Art. 3 IDD), which in Germany takes the form of a business license and an entry in a register maintained by the respective chamber of industry and commerce. The intermediary must be of good repute, have a clean criminal record with regard to relevant offenses (police certificate of good conduct), have an orderly financial situation, have professional indemnity insurance (what we call errors and omissions insurance), and have the

16. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32002L0092&from=EN>.

17. <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32016L0097&from=en>.

18. https://www.gesetze-im-internet.de/vvg_2008/vvg.pdf.

The point is to appear as if Marsh is providing a service to the insurance market rather than the reality which is that Marsh is receiving major income for directing business to preferred providers/insurance markets.

(Fishman, 2004)

Spitzer accused Marsh McLennan of cheating customers by rigging prices and steering business to selected insurers in exchange for contingent or “back end” commissions (Treater, 2004). Spitzer’s lawsuit also named American International Group Inc. (AIG) and three other insurers: The Hartford, Ace, and Munich Reinsurance America.

The investigation revealed that Marsh charged a commission up front to give the illusion that it was representing the buyer. In reality Marsh was steering business to preferred insurers and rigging the bidding process. Then, after the fact, the involved insurers would pay Marsh a “contingent commission,” which was not disclosed to the insurance buyers. The broker was receiving compensation from the buyer and the insurer, again resulting in a conflict of interest. Thereafter, the New York State Department of Financial Services (NYDFS) issued Regulation 194 (11 NYCRR part 30) that required brokers to disclose the source of their compensation (later upheld in *Sullivan Fin. Grp. Inc. v. Wrynn* [2012] 94 A.D.3d 90 [App. Div.]). Contingent commissions have been around for a century, known to state insurance regulators and decided and enforced by courts.¹⁹ That of course does not mean they should be hidden, nor that they are still appropriate; the debate on whether they create a real or apparent conflict of interest (New Appleman on Insurance Law Library Edition, 2021, § 2.05[b]) is beyond the scope of this paper. The question of contingent commissions to brokers is relevant, or at least informative, to the question we address here as to the conflict that appointment requirements impose on brokers who try to avoid the conflict by asserting that they do not represent the insurer, only to be undermined by legal requirements that they in fact be appointed by the very insurer they contend they are not an agent for. The removal of the appointment for brokers removes one part of the conflict. Individual business practices must solve the rest.

8. A Modern Approach to Insurance Broker Licensing and

agent (MGA), as a matter of workflow and agency management convenience. Whether a general agent needs an appointment on file with the DOI is, we believe, debatable; although, we need not resolve that here. One author notes that the modern tendency has been for general agencies to diminish and disappear, particularly in property and liability insurance lines (Harnett, 2021, § 2.02 [2b]).

In furtherance of producer licensing uniformity and efficiency, as well as the removal of an obvious and unnecessary conflict of interest, we contend with brokers and their kin that independent agents should be outside the appointment process. The related practice in many states that every transaction with an insurer must be through a licensed agent, *having an appointment on file with the DOI*, rather than only a licensed producer, is an extra step and commission sharing, which seems unnecessary and unduly burdensome to achieve the necessary goal of establishing responsibility for insurance contracts. The persistence of this practice requiring an appointed agent in the middle, long after the development of toll-free telephone lines and the internet, has the effect of requiring that insurers appoint at least some of the individual brokers in the brokerage as agents. It is a transaction cost that lacks any substantive benefit for liability and accountability for brokers. We can think of no other brokerage business that requires someone serving as a broker to be *appointed* by the company it transacts for or sells goods or services, or even contracts, for (e.g., stockbrokers, commodities brokers, shipping brokers, mortgage and loan brokers, real estate brokers); most are of course licensed and highly regulated. All these brokers facilitate a contract of some sort between the ultimate parties.

Insurers should and will continue to select whom they want to do business with and on what terms. That should remain as it is; i.e., a contractual issue. Brokerages have contracts with insurers because the business requires that there be agreements on how transactions are done: application information; the submission process; the complexity of the business and fitting the insurance coverage to that; the handling of premiums, especially when done through agent billing, etc. Also, the contract is necessary when the insurer pays a commission to the brokerage for placing the insurance contract,²⁰ unless the broker foregoes the commission and charges the insured a fee instead, if agreed to, as permitted in many states (e.g., Cal. Code Regs. Titl. 10 § 2189.3; N.Y. Ins. Law § 2119 and NYSDFS OCG Op. No. 03-01-20).

Where disputes arise between the insureds, the brokers, and the insurers as to imputed knowledge to the insurer and authority of the agent, these are handled by interpreting the contracts and the acts, not by appointments on file. As Harnett (2021) writes, "The principal conclusion to be drawn from generalized definitions of 'agent' and 'broker' is that they may be valueless in solving specific legal problems ... A broker can be an agent, but an agent is not necessarily a broker. A broker represents the insured, but the broker is paid by the insurer ... In the final analysis, the determination of legal responsibility must depend in some material part on an examination of the activities in each case on its individual merits. Designation of status often provides no more than a departing point for the necessary analysis."

20. "A broker typically has contracts with a number of insurers and is compensated by way of commissions paid by the insurers with which he places coverage. Brokers are sometimes described or referred to as 'independent agents'" (New Appleman on Insurance Law Library Edition, 2021, § 2.03[5]).

Today the characterization of an operative as an agent or broker does not rest solely on whether he is called a "broker," "agent," or "general agent." These are merely identifying terms for general economic function and for recognition in the industry's system of sales. The important facets are the actual relationship; what the parties say and do; their relative access to information; the reasonableness of reliance; and the reasonable expectations which flow from their connection. Moreover, statutes may prescribe rules.

(Harnett, 2021)

If the agency appointment on file with the DOI has little to no bearing on deciding producer liability, then it seems to be a regulatory burden and transaction cost that provides little to no benefit to the consumer or policyholder. Stempel and Knutsen (2021, § 6.02.) state, "Determining who works for whom and the exact status of an intermediary can become particularly difficult when modern practices blur traditional lines of agency loyalty." Modern practices need modern solutions. Protections can be achieved with less regulatory burden on all parties by enforcing the liability for malpractice and misdeeds, not the paperwork. Customer protection can be enhanced with requirements for higher errors and omissions insurance, perhaps based on some percentage of the revenue of the brokerage to some maximum required amount or higher bond limits for brokerages²¹ and requirements for stronger producer training beyond the initial 40 hours for the license, plus annual minimal CE requirements. Although, quality brokerages and dedicated producers provide extensive training to create highly skilled professionals. Capable and conscientious producers already put in the time to really know their clients' needs, the details of insurance coverages and gaps to fill, and the insurer practices to properly serve their clients, with many attaining specialized insurance qualifications.

9. Conclusion

Insurer appointments of brokers with DOIs have outlived their relevance since insurers ceased to require a local agent to sign a contract to make it effective as a contract.²² The dividing line between independent agents and brokers is blurry, if not meaningless. Agency appointments remain valuable for exclusive agents and general agents. Agency appointments for brokers serve only to set in place a conflict between the broker and insurer as to the broker's role to serve the insured. Relations between brokers and insurers are sufficiently served by the contracts between them. Disputes as to broker and insurer liability are based on the acts, not filed appointments. Regulatory reform seems in order.

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