



COMMONWEALTH OF KENTUCKY
DEPARTMENT OF INSURANCE
Frankfort, Kentucky

ADVISORY OPINION
2012-01

The following Advisory Opinion is to advise the reader of the current position of the Kentucky Department of Insurance (the “Department”) on the specified issue. The Advisory Opinion is not legally binding on either the Department or the reader.

TO: All insurers transacting insurance business in the State of Kentucky
All producers transacting insurance business in the State of Kentucky

FROM: Sharon P. Clark, Commissioner

RE: Insurer Collection of Commission Payments

DATE: January 10, 2012

The Department has been made aware of an emerging practice related to the collection and payment of producer compensation. This Advisory Opinion provides an overview of Kentucky law related to the subject matter, an outline of the emerging practice as it has been made known to the Department, and a statement of the Department’s position related to the practice.

Kentucky Revised Statute 304.14-030 defines “premium,” in pertinent part, as follows:

“Premium” is the consideration for insurance, by whatever name called. Any “assessment,” or any “membership,” “policy,” “survey,” “inspection,” “service” or similar fee or other charge in consideration for an insurance contract is deemed part of the premium.

Further, KRS 304.12-190(2) provides, “No person shall willfully collect as premium or charge for insurance any sum in excess of the amount actually expended or in due course to be expended for insurance applicable to the subject on account of which the premium was collected or charged.” Based on the definition of premium and the prohibition against collecting charges

above and beyond the premium charged, the Department's long-standing position has been that fees, commissions, and compensation (collectively referred to herein as "commissions") to be paid by the insurer to an agent are considered a part of the premium and must be included in and filed as part of an insurer's rate filing. Absent the inclusion of commissions in a rate filing, insurers would be in violation of KRS 304.12-190 should commissions be added to the cost of the insured's premium.

The Department has become aware of an emerging practice, particularly with respect to health insurance. The practice entails insurers excluding commissions from the premium charged to the insured, encouraging agents/producers to negotiate a commission with the insured directly, collecting the commission from the insured separate from the premium, and forwarding the commission to the agent. It has been acknowledged to the Department that this practice is being implemented by insurers as an effort to avoid paying rebates under the Medical Loss Ratio requirements of the federal Patient Protection and Affordable Care Act. The Department is concerned with this practice and has determined that the practice is not permitted in the State of Kentucky.

An agent is defined by KRS 304.9-020 as a "person who sells, solicits, or negotiates insurance or annuity contracts." An "agent" is an agent of an appointing insurer and, in accordance with KRS 304.9-035, an insurer is liable for the acts of its appointed agents. On the other hand, a "consultant" is defined at KRS 304.9-040 as follows:

A "consultant" is a person, who as an independent contractor in relation to a client, for fee or compensation *other than* from an insurer, in any manner advises or purports to advise, any person actually or prospectively insured...under, an insurance contract...existing or proposed, relative to coverage, advisability, rights, or interests under such contract, or relative to the retention, exchange, surrender, or exercise of rights thereunder. (Emphasis added).

It is the Department's position that the changes that insurers are contemplating with respect to commission payments, if implemented, will change the role of the insurance producer from that of agent to that of consultant. That being the case, an insurance producer will be required to have a consultant's license with the proper line of authority in order to engage in the practice of negotiating and receiving commissions directly from the client/insured¹ rather than receiving compensation from the insurer for business produced.

Not only will additional licensure requirements be imposed with respect to an insurance producer who collects commissions directly from the insured but, it is imperative that an insurance producer acting as a consultant understand their fiduciary responsibilities to their client. KRS 304.9-360 sets forth the obligations of a consultant. The statute provides as follows:

¹ KRS 304.9-350(2)(a) provides, "If the licensee has received or is to receive any fee, commission, or compensation from the insured or proposed insured, or from any other person other than the insurer, directly or indirectly, with respect to any insurance transaction or proposed insurance transaction, or with respect to any insurance or annuity contract existing or proposed, it shall conclusively be presumed that the licensee was acting as a consultant with respect to such transaction or contract."

A consultant is obligated, under his license, to serve with objectivity and complete loyalty the interest of his client alone; and to render his client such information, counsel and service, as within the knowledge, understanding and opinion in good faith of the licensee, as will best serve the client's insurance or annuity needs and interests.

KRS 304.9-360 clearly specifies that the consultant must serve the client/insured's interests rather than the interests of the insurer. Further, KRS 304.9-360(7) prohibits a person dually licensed as a consultant and an agent to act as both a consultant and an agent with regards to any risk which is the subject of a consultant contract required by KRS 304.9-360(4). As a result, a person dually licensed as a consultant and an agent is prohibited from selling, soliciting, and negotiating insurance as an agent while also collecting commissions from an insured as a consultant.

In addition to the above, the Department also has concerns with respect to an insurer collecting the commission on behalf of the agent/consultant from the insured and subsequently paying the commission to the agent/consultant. The act of collecting the commission separate from the premium does not necessarily transform the payment of the commission into something other than premium. The definition of premium in KRS 304.14-030 broadly includes any fee or charge by whatever name called. Consequently, it is the Department's position that the insurer cannot avoid the implications of the federal Medical Loss Ratio requirements simply by requiring the insured to remit the commission check separate from the premium check. Also, the ramifications of an insurer acting as a collection entity for the agent/consultant remain unclear. In particular, it is unclear what the effect of non-payment of the commission payment would be on the insured. Further, KRS 304.12-190 prohibits the insurer from collecting any fee in excess of the premium charged for insurance.

Based on the above, the Department opines that the practices as outlined in this Advisory Opinion are contrary to Kentucky law and public policy as stated herein. Consequently, such practices are prohibited in the State of Kentucky. Any plans to implement such practices should be terminated. Any insurers that have already implemented such practices should cease and desist in order to avoid any further administrative action. If you have any questions regarding this Advisory Opinion, please contact the Department's Health and Life Division at (502) 564-6088.

/s/ Sharon P. Clark
Sharon P. Clark, Commissioner
Kentucky Department of Insurance