



DIVISION OF INSURANCE

Frank H. Murkowski, Governor

BULLETIN B 04-14

TO: ALL PROPERTY AND CASUALTY INSURANCE PRODUCERS LICENSED IN THE STATE OF ALASKA AND OTHER INTERESTED PARTIES

RE: BROKER'S FEES AND THE APPOINTMENT OF INSURANCE PRODUCERS AS BROKERS

This bulletin provides a discussion of the sections of the Alaska Insurance Code that deal with the appointment of insurance producers as brokers for a client and the fees that may be charged regarding the related insurance transactions, along with a discussion of the distinctions between premium, policy fees, and broker fees.

AS 21.27.560 outlines the three permitted methods of broker's fee compensation and describes the elements necessary to establish a broker relationship when an insurance producer is appointed as broker to represent a client in accessing insurance markets.

Under AS 21.27.560(a), a written contract must be signed by a consumer before a producer can charge the consumer a broker's fee. This allows for disclosure to the consumer and an opportunity to negotiate the fee. A broker's fee agreement must

- 1) contain an appointment by the client naming the insurance producer as their broker;
- 2) set out the duties, functions, powers, and authority of the insurance producer as broker;
- 3) disclose the amount of the broker's fee charged to the client, including amounts charged by surplus lines wholesalers to access their markets; and
- 4) be kept in the insurance producer's permanent records and made available for the director's inspection.

Three Permissible Methods of Compensation Under a Broker's Agreement

AS 21.27.560(c) states: *An insurance producer appointed as a client's broker may only receive compensation if the compensation is a*

(1) fee that requires the insurance producer to offset or reimburse the client for the full amount of a commission earned by the insurance producer;

For example, a broker agrees to place a policy for a \$2,500.00 fee **alone**, but ends up placing a policy that pays a \$1,000.00 commission. The broker must refund \$1,000.00 of the fee back to the client. The compensation arrangement must be clearly communicated in a broker's fee agreement. The commission offset or reimbursement is applied to the broker's fee, not the insurance premium. If the policy commission exceeds the agreed upon fee, the insurance code allows the broker to request a commission rate reduction from the insurance company.

(2) combination of a fee paid by a client and a commission paid by an insurer with which coverage is placed that may offset or reimburse a client for all or part of a commission earned by the insurance producer if the amount of the commission is disclosed to the client; or

For example, a broker may initially know what market will be used and thus know the policy commission rate. Knowing this, the broker may require additional compensation as a broker's fee for the amount of work required to place the policy. This arrangement is permitted if the commission rate and the fee are clearly disclosed in a broker's fee agreement. The policy premium is not usually known when the agreement is signed; thus the need to disclose the commission rate. If the commission amount is known, it should be disclosed to the client.

(3) commission paid by an insurer with which coverage has been placed.

A client has designated the insurance producer as their exclusive broker. The client depends exclusively on the broker to place coverage, and the broker is compensated by the policy commission alone.

AS 21.27.560 provides flexibility in compensation arrangements while protecting the consumer by requiring full and clear disclosure of compensation agreements involving broker fees.

Sharing of Fees and Commissions

Compensation may be shared between appropriately licensed persons under the provision of AS 21.27.370, including fees under AS 21.27.560. An insurance producer appointed as broker may share a fee or commission with another properly licensed producer, provided all necessary disclosures are made.

Distinctions Between Premium, Policy Fees, and Broker Fees

It is important to understand the difference between what is defined in statute as a policy fee and its distinction from what is defined as a broker fee. As you will note below, a policy fee in statute may not be the same thing that is often referred to as a policy fee in various industry nomenclature. The following should help to clarify those distinctions.

1. **Premium:** All funds going to or fees **initiated** by the insurer, including those allocated to commission or insurance company **policy fees**, independent of their name, are **premium** as defined in AS 21.90.900(33) and **are** subject to premium tax.
2. **Other fees:** Other fees considered premium are membership, survey, inspection and service or similar fees **made in consideration** for an insurance contract and **are** subject to premium tax.
3. **Policy fee:** A fee charged by an insurance company in addition to the risk premium to cover the cost of issuing the policy (i.e. an underwriting cost or contract preparation) is considered a policy fee. There is an important distinction between this type of **policy fee** charged by the insurer and the wholesaler policy or access fee described in paragraph 5 below and discussed under Special Circumstances. Insurance company policy fees **are** subject to premium tax.
4. **Broker's Fees:** All funds, regardless of their name, collected and **retained solely** by the broker either to defray costs or just for profit are **broker's fees** under AS 21.27.560. Since these fees **are not** required as payment for the insurance contract, they **are not** subject to premium tax.
5. **Wholesaler Policy or Access Fee:** A fee charged by a wholesaler to access their markets and **retained solely** by them, either to defray costs or just for profit, **should not be** confused with **insurance company policy fees** described in paragraph 3 above. Wholesaler policy or access fees **are not** subject to premium tax.

Special Circumstances (Broker's Fee Agreements Used in Surplus Lines Transactions)

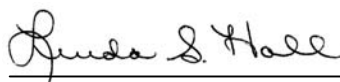
In surplus lines transactions, a wholesaler often will charge what are referred to as policy fees for access to their markets. This policy or access fee should not be confused with **policy fees** charged by an insurance company. Such wholesaler fees **are not** considered premium and **are not** subject to premium tax or fees.

When a licensed producer is appointed as a broker and coverage is sought in the non-admitted market, the broker fee agreement must disclose any anticipated fee. The division understands the difficulty that occurs when the broker may not know in advance which market will be used. The producer must first seek coverage in the admitted market. If the risk is not accepted, the producer may then seek coverage in the surplus lines market as long as the procedures outlined in the Alaska insurance laws and regulations are followed. Initially, the cost to access these markets will be unknown to the broker.

In situations where a broker anticipates the possibility of a wholesaler policy or access fee and a broker's fee agreement is established in accordance with AS 21.27.560(c)(1) or (2), the agreement should include notice to the client that such fees **may be incurred** and will be disclosed when the cost is known. **If the broker's fee agreement does not make disclosure of the possible fees, the producing broker must absorb any wholesaler policy fee incurred.**

If you have questions regarding the information in this bulletin, please contact the Division of Insurance; P.O. Box 110805; Juneau, AK 99811-0805, or Ted Lehrbach at (907) 465-2577; fax (907) 465-3422; or via electronic mail at insurance@commerce.state.ak.us.

Dated this 15th day of September, 2004.



Linda S. Hall
Director