

THE PAYMENT OF REFERRAL FEES TO UNLICENSED PERSONS IN NEW YORK

Frederick J. Pomerantz, Esq.
(212) 490-3000, ext. 2109

Introduction

In recognition of the Gramm-Leach-Bliley Financial Services Modernization Law of 1999,¹ on September 8, 2000, Governor Pataki signed into law Senate Bill 8090, Ch. 418, Laws of 2000. The bill amended New York State Banking Law Sections 14-g and 14-h by allowing financial institutions to sell insurance and annuity products in New York as agents and brokers. These amendments to the Banking Law were accompanied by a series of amendments to the New York Insurance Law. One of those amendments permits insurance producers to pay to unlicensed service providers fees for business referred to insurance producers through the internet and other means. Sections 2114-2116 of the New York Insurance Law, which define situations where insurers can lawfully pay fees for referred business, were amended to redefine “referral” in such a manner as to permit referrals by non-licensees to New York State licensed insurance agents or brokers. Under the new sections, certain referrals are permitted as long as the non-licensees do not discuss with customers specific policy terms and conditions and compensation for the referrals is not based upon the purchase of insurance by such customer. Specifically, Section 2114 (a) (4), which was added by Section 4 of Chapter 418 of the Laws of 2000, reads as follows:

(a)(1) No insurer ... doing business in this state shall pay any commission or other compensation to any person, firm or corporation, for any services in obtaining in this state any new contract of life insurance or any new annuity contract, except to a licensed life insurance agent of such insurer ... or to an insurance broker licensed under subparagraph (A) of paragraph one of subsection (b) of section two thousand one hundred four of this article, and except to a person described in paragraph two or three of subsection (a) of section two thousand one hundred one of this article.

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(4) Services of the kind specified in this subsection shall not include the referral of a person to a licensed insurance agent or broker that does not include a discussion of specific insurance policy terms and conditions and where the compensation for *referral is not based upon the purchase of insurance by such person.* (emphasis added)

Section 2114 applies to life and accident and health insurance agents. Section 2115, as also amended, applies to property/casualty agents. Section 2116, as also amended, refers to insurance brokers. All three sections contain identical provisions. It is the language “referral...not based upon the purchase of insurance by such person” which is most subject to conflicting interpretations: does it prohibit payment of referral fees measured by a percentage of the premium volume attributed to the sale of insurance by the agent or broker following the referral? Such an interpretation would appear consistent with Section 305 of the Gramm-Leach-Bliley Act, 12 USCS §1831 x (d)(2)(B) (“GLBA”), providing, in relevant part, that:

Any person accepting deposits from the public in an area where such transactions are routinely conducted in a depository institution, *who refers a customer seeking to purchase any insurance product to a qualified person who sells such product, may not receive more than a one-time nominal fee of a fixed dollar amount for each referral that does not depend on whether the referral results in a transaction.* (emphasis added)

The intent of Section 2114 (a) (4) becomes even more obscure by virtue of Office of General Counsel (“OGC”) opinions and New York Insurance Department (“NYID”) Circular Letters issued subsequent to the amendment of the laws. For example, it came as no surprise that shortly following amendment of the state law that the NYID restated its position on advertisements, referrals and solicitations on the internet.² This Circular Letter was intended to clarify prior Department pronouncements which providers of insurance and other financial services over the internet understood to be clear signals that the NYID wanted to remove obstacles to the use of website providers as a source for referred business.³ The challenges of e-commerce to insurance providers (insurance companies and producers) are, after all, the same challenges as are presented by insurance transactions in other media. If an activity

is illegal when it is regulated as a paper insurance transaction (i.e., illegal solicitation or marketing of insurance), then it is still illegal if it is transacted over the internet. Generally speaking, there appear to be no meaningful differences.⁴ However, a distinction was drawn in Circular Letter 5 between passive websites and active websites and made it clear that the Insurance Department does not consider the mere maintenance of a passive website accessible to New York residents containing information about insurance products or services to constitute solicitation under the Insurance Law. Further Circular Letter 5 stated:

If advertisements or websites contain, or if an advertisement is framed by, recommendations, endorsements or promotions from a non-licensee concerning the advertised products or services, this would constitute a referral, subject to the discussion below. Referrals by non-licensees to New York State licensed insurance agents or brokers are permitted under a recent New York State statutory enactment contained in Chapter 418 of the Laws of 2000. Under that statute, a non-licensee may make a referral to a licensed insurance agent or broker provided there is no discussion of specific insurance policy terms and conditions and the compensation to the non-licensee for the referral is not based upon the purchase of insurance by the referred person.

Referrals may not direct New York residents to the products or services of unlicensed agents or brokers. Such a referral to an unlicensed agent or broker would constitute solicitation as outlined in prior Department opinions. In addition, compensation may not be paid for such referrals.

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However, it should be noted that the New York Insurance Law *does not prohibit licensees from purchasing lists of customer names and related information from non-licensees for the purpose of soliciting insureds. The compensation payable to non-licensees for such lists may be contingent upon the successful placement by the licensee of the insurance and may be a percentage of the insurance commission the licensee earned from placing the business.* (emphasis added)

Interpretations of Sections 2114-2116, As Amended

The amended statutes permitting the payment of referral fees by insurers and insurance producers have been subsequently interpreted in a series of OGC Opinions, some of which appear to expand the limits of the amended statutes. As the amended sections of the Insurance Law have been interpreted, licensees are clearly permitted to purchase customer lists from non-licensees and to pay a “flat fee” based upon successful placement by the licensee of the coverage. Thus, a licensed life insurance agent may pay a referral fee to a non-licensed certified public accountant for referring his client who is interested in purchasing a life insurance policy and the referral fee may be equal to the amount of the advisory fee the accountant would normally charge while working on an estate plan.⁵ Contingent fees based on a percentage of business produced may be another story, however.

However, in OGC Opinion 2001-46 dated March 21, 2001, the Department approved a proposed referral arrangement where a list of the unlicensed person’s customers would be provided to the licensee in exchange for a fee based on the successful placement of insurance by the licensee and constituting a percentage of the commission earned by the licensee for placing the business. OGC Opinion 2001-46 appears inconsistent with the amended statutes since they specifically condition the exemption from licensing on “referrals ... not based upon the purchase of insurance.” However, OGC Opinion 2001-46 has been followed by OGC Opinion 2001-114.11, dated June 19, 2001, which prohibited an arrangement whereby a licensed insurance agency would lease space from a bank, with the intention of paying to the bank rent measured by a percentage of the sales realized by the agency from bank-directed referrals, and not simply the overall number of referrals. This latter result appears to be consistent with the language if not the intent of the amended statutes⁶ and also appears to be consistent with Section 305 of GLBA.⁷

In the particular instance in which a teller does nothing more than direct a customer to an insurance agent after the customer inquires about insurance, under this section of GLBA the teller would not be required to be licensed as an insurance agent unless the teller or its employer is compensated based upon the actual sale of insurance.⁸

Typically, referral fees are paid to those persons who “aid” in the licensed insurance agent’s business by referring potential customers to the agent. Because these types of activities no longer require licensure as an agent or broker,

the Department no longer prohibits the payment of referral fees to unlicensed individuals, as long as they comply with the parameters set forth in the amended laws. Thus, the Insurance Department's prior opinions permitting limited marketing of insurance products by associations to their members in exchange for a "flat" administrative fee equal to the actual cost of the administrative services rendered⁹ have now been specifically incorporated into the New York Insurance Law by the amendments to Sections 2114-2116. The payment of a fixed amount to a website operator is more easily defended against regulatory scrutiny than the payment of a fee measured by a percentage of premium or commissions.

It is likely that the insurer would not be viewed as sharing commissions illegally if an advertising fee is paid to a website operator.¹⁰ If, further, the prospective purchaser of products or services on an internet marketplace is obliged to insure his purchase and is directed by the website operator to the website link of an unlicensed insurer, it is more likely that the marketplace operator will be viewed as participating in the illegal sale of insurance, or "aiding and abetting" the illegal transaction of insurance by the insurer.¹¹ In such a case, illegal commission sharing and illegal tie-in sales may be implicated.¹²

The NYID has, in the past two years, taken fairly lenient views toward the use of banner ads and referral fees. In a recent OGC Opinion, the NYID has taken the position that an insurance agent may enter into a mutual internet advertising arrangement whereby it places its advertisement on the website of one of its clients, a real estate agent, in exchange for the client being allowed to place an advertisement on the insurance agent's website. Such an arrangement would not be viewed as rebating or as an improper inducement under New York Insurance Law §§ 2324 or 4224 (g) provided there is no other *quid pro quo* involved in the arrangement and as long as the mutual advertising arrangement does not alter the amount of premium paid by the real estate agent/client for its policy of insurance. Further, the OGC stated that the real estate agent would not be acting as an insurance agent, subject to licensing requirements, as long as the insurance agent's advertisement on the real estate agent's website does not rise to the level of soliciting insurance business, such as by recommending products or coverage.¹³ Circular Letter Number 5 (2001) allows banner ads to be compensated on a percentage of premium basis. Thus, both methods of compensation, "flat fees" and "percentage fees," appear to be permissible for website advertising in New York at this time, if not necessarily for referrals by website operators.¹⁴

The NYID has also opined¹⁵ that a licensed real estate broker may provide names and addresses of prospective insureds to an insurance broker in exchange for a flat fee for each such lead. There it was contemplated that the real estate broker's website home page would include a link connecting the user to an insurance broker's web page on the real estate broker's website. That web page, featuring an insurance questionnaire to be completed by the user, but making no mention of the insurance broker, would simply ask for contact information and whether the user is interested in obtaining insurance services, thereby facilitating qualified lead generation. Compensation would not be based upon the successful placement of insurance by the insurance licensee. In this case, unlicensed persons under amended Sections 2114-2116 may receive fees for referrals to licensed insurance brokers, as long as there is no discussion of specific policy terms, and as long as compensation would not be based on whether insurance is purchased.

Further, the New York Insurance Law does not prohibit a licensee seeking to solicit insureds from purchasing customer lists from a non-licensee. In this case, compensation payable to the non-licensee for the lists may be contingent upon the successful placement of insurance and may be a percentage of commissions earned by the licensee in placing the business.

However, the owner of a non-insurance website may not solicit users for information about their insurance needs and then sell the information to specific insurance brokers and insurers without a license.¹⁶ In this situation, the website operator would gather information from potential insurance purchasers and sell the information to specific brokers and insurers who would subsequently contact the individuals directly with offers to sell insurance. The brokers or the insurers would either pay the website operator: (1) a fixed monthly fee based upon the number of questionnaires submitted; (2) per lead for each questionnaire submitted; or (3) a percentage of the proceeds from any resulting sale of a policy. Instead of merely referring potential insureds to a licensed agent or broker or merely selling customer lists to a licensee for the licensee to solicit the potential insured, as the amended laws now permits, the website operators would be actively soliciting insurance by gathering information for specific insurance providers or producers. As such, the website operator would become their agent. When acting in regard to brokers, the statute precludes an unlicensed person from acting or aiding in any manner in soliciting, negotiating, or

procuring insurance. In this scenario, the website operator would be acting as a middleman by affirmatively suggesting that insurance be obtained from an insurer or producer with whom the operator has an existing relationship, and by collecting information from users to enable the insurer or producer to sell insurance.

In another OGC Opinion, the NYID has stated that participation by an unlicensed marketing consultant in presentations and promotions at trade shows and organizational meetings is prohibited by the amended statutes where the non-licensee is involved in discussions of the policy and other forms of solicitation. However, distributing promotional literature providing information about how to purchase insurance through the licensee's office, which does not include a discussion of specific policy terms and conditions, in exchange for a flat referral fee, would be permissible.¹⁷

Conclusion

As amended, Sections 2114-2116 of the New York Insurance Law go a long way in achieving the goal of the Superintendent of the State of New York and the Governor of the State of New York to keep New York the number one financial services marketplace in the country. However, there is still no unambiguous test to determine when and under what circumstances referral fees would be deemed to be similar to commissions based on actual premiums written, thereby triggering producer licensing requirements. By the express language of the amended statutes, the closer the compensation appears to be a *quid pro quo* for actual premiums written, the more likely the practice would be viewed as violating amended sections 2114-2116.

Referrals may not direct New York residents to the products or services of unlicensed agents or brokers. In addition, compensation may not be paid for such referrals. However, if licensees simply purchase customer lists and related information from non-licensees for the purpose of soliciting insureds, the compensation payable to such non-licensees may, according to N.Y. Circular Letter 2001-5, be contingent upon the successful placement by the licensee of the insurance and equal a percentage of the commissions earned.

It is likely that the trend toward uniform licensing of insurance companies and producers, and initiatives both undertaken voluntarily and as mandated by Gramm-Leach-Bliley will encourage the increased use of links to insurance producers and companies by website providers of financial services. For now, the prudent course would be for any insurance producer or insurer, particularly those doing business over the internet, to keep an eye on the shifting state regulatory environment, to keep on top of what their agents and other producers are doing, and to maintain an ongoing periodic internal legal audit of all internet activities.

Endnotes

1. Pub. Law 106-102, Nov. 12, 1999, 113 Stat. 1381.
2. Circular Letter No. 5 dated February 1, 2001.
3. NYID Circular Letter No. 33 (1999) and Circular Letter No. 31 (1998) and Insurance Department OGC Opinion dated March 6, 2000.
4. The definition of doing or "transacting" insurance business in Section 1101 of the New York Insurance Law is purposely broad and includes all kinds of activities by insurers, both property/casualty and life/health, without distinction, including underwriting, collection of premiums, issuance of delivery of policies of insurance, confirmation of insurance premium, the issuance of coverage, confirmation letters, and the forwarding of offshore policies and other documents. *See also*, Office of General Counsel Opinion dated March 6, 2000.
5. NYID Office of General Counsel Opinion 2001-51 dated March 29, 2001.
6. The Department has not opined on the level of compensation that would be appropriate in such a rental situation.
7. *But see* OGC Opinion 84-14 permitting a bank leasing space for the purpose of selling insurance products to base the rental fee on the volume of business generated.

8. Insurance Department Office of General Counsel Opinion 2000-142.
9. The most recent of these is Office of General Counsel Opinion 98-64.1 dated September 11, 1998.
10. OGC Opinion 99-86 dated July 12, 1999.
11. New York Insurance Law § 2117.
12. The Office of General Counsel of the NYID has issued an informal opinion dated July 14, 2000, representing the position of the New York State Insurance Department on internet solicitation and agent licensing.
13. In a NYID OGC Opinion dated April 25, 2000. OGC pointed out, however, that depending upon how interactive the internet advertisement of the insurance agent is, and how it is framed (or not) within the real estate agent's website, the Department's response could differ.
14. In NYID Office of General Counsel Opinion dated March 13, 2000, the OGC opined that dividends and refunds might be distributed via the internet if the policyholder agrees and the distribution is otherwise in accordance with New York law. However, the amount of the dividend or refund may be greater if distributed over the internet only if such a difference would be allowable under the applicable provisions of the law on rating classifications. The amount of the distribution may not be greater if the only basis for the difference is that the policyholder makes purchases from on-line merchant. Rebates of any kind are prohibited.
15. OGC Opinion No. 2001-122. 01 dated June 26, 2001.
16. OGC Opinion No. 2001-25 dated February 12, 2001.
17. OGC Opinion No. 2001-35 dated March 1, 2001.