

WHOLESALE DISTRIBUTION IN WISCONSIN: A MINEFIELD FOR THE UNWARY

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It is common practice in most states for insurance intermediaries to refer business to each other in order to efficiently and cost-effectively place business with specialty insurers. The intermediaries facilitating such transactions are referred to by a variety of terms, including general agents and wholesalers. By specialty insurers, we are referring to those admitted insurers who specialize in niche markets for difficult-to-place business.¹ This distribution system has a long distinguished history and benefits insureds, intermediaries and both specialty and non-specialty insurers. Insureds benefit by having greater availability and affordability for their hard-to-place coverages. Intermediaries benefit by being able to provide their customers with access to insurers who are better positioned to underwrite and service their unique businesses. Specialty insurers benefit in that it would be impractical, if not impossible, for specialty insurers to individually contract with and appoint intermediaries who only infrequently have a piece of business that would require placement with a specialty insurer. Finally, even non-specialty insurers benefit from this distribution system as they may be under less pressure from their established distribution networks to write business that may not fit within their existing underwriting guidelines.

While there are many positive attributes associated with this distribution system, it is critical for intermediaries and insurers operating in Wisconsin to be familiar with some specific and substantial restrictions Wisconsin has placed on intermediaries exchanging business in this manner. These restrictions are occasionally overlooked by intermediaries and insurers, resulting in regulatory criticism and penalties.

§ Ins 6.66, Wis. Admin. Code²

Of particular importance is a thorough understanding of the Wisconsin regulation governing the proper exchange of business between agent intermediaries. This regulation, § Ins 6.66, Wis. Admin. Code, defines the proper exchange of business to mean:

. . . the forwarding of insurance business from one agent who cannot, after due consideration, place the business with any of the insurers for which the agent is listed because of capacity problems, the refusal of the company to accept the risk or the onerous conditions it imposes on the insured, to another agent licensed for those lines of insurance whose insurers are able to accommodate the risk under conditions more favorable to the insured. The agent forwarding the business is entitled to split the commission involved. Proper exchange of business is not the regular course of business and such forwarding of business is thereby distinguished from brokerage by its occasional and exceptional nature.³

There is no specific guidance under the regulation as to what constitutes proof that the agent cannot place the business with any of the insurers for which he/she is listed because of “capacity problems, the refusal of the company to accept the risk or the onerous conditions it imposes on the insured.” However, agents have a clear understanding of the underwriting appetite for their appointed insurers and should not be expected to obtain perfunctory declinations from the insurers, as often occurs in the surplus lines context.

Section Ins 6.66, Wis. Admin. Code, prohibits an agent from exchanging business with another agent, “. . . unless: (a) the agent forwarding the business to a listed agent is licensed for the lines of business that are being exchanged; (b) the agent who receives the business and agrees to place it is licensed in the line or lines of insurance involved in the exchange; and (c) both the agent forwarding the business and the agent who places the business with the insurer sign the insurance application, or if no application is completed, the names of the agents involved in the transaction appear on the policy issued.”⁴ The requirement that each of the agents involved in the exchange of business have the required licenses is rarely a problem, but the requirement that both agents sign the application sometimes requires a change in the submission process utilized by certain intermediaries and insurers.

Section Ins 6.66, Wis. Admin. Code, also limits the number of times that intermediary-agents may exchange business without the referring intermediary-agent being appointed by the insurer. As the exchange of business is not intended to be part of the referring intermediary-agent’s regular course of business, “[i]n the absence of evidence to

the contrary, an intermediary-agent shall be presumed to have exceeded the occasional exchange of business if he or she places more than 5 insurance risks per calendar year with any single insurer with which he or she is *not listed* as an intermediary-agent, or exchanges in total more than 25 insurance risks per calendar year.”⁵ While exceeding the “5/25 Rule” may not be of concern to some intermediaries, the necessity of tracking this information for compliance purposes can create an administrative burden for all of the parties involved.

The Broker Defense

Some intermediaries attempt to avoid the restrictions associated with § Ins 6.66, Wis. Admin. Code, by claiming that the referring intermediary is acting as a *broker* and, therefore, § Ins 6.66 doesn’t apply to their actions because the regulation is limited to the proper exchange of business between *agent-intermediaries*.⁶ Intermediaries rely upon a number of statutory and regulatory provisions to support their position.

They point to § Ins 6.66(2), Wis. Admin. Code, and its acknowledgment that the “. . . [p]roper exchange of business is not the regular course of business and such forwarding of business is thereby *distinguished from brokerage* by its occasional and exceptional nature. . .”⁷ Further, the statute under which § Ins 6.66, Wis. Admin. Code, was promulgated, sec. 628.61, Wis. Stats., explicitly permits the exchange of business between agent and broker intermediaries that are lawfully licensed in Wisconsin.⁸ The advantage to intermediaries of characterizing their activities as those of a broker is that they are able to avoid appointment by, and execute a contract with, the insurer.⁹

This characterization often accurately reflects the nature of the relationship between the referring intermediary and the insurer. The insurer usually would have no direct contact with the referring intermediary and views the intermediary as the representative of the insured. The properly appointed general agent/wholesaler is solely responsible for the interaction with the referring intermediary.

While these are valid defenses and useful in distinguishing a given intermediary’s actions, intermediaries and insurers wishing to take this position need to consider the regulatory history of § Ins 6.66, Wis. Admin. Code, and Wisconsin’s restrictive definition as to what constitutes a “broker.”

Wisconsin defines an “insurance broker” as an intermediary that “. . . acts in the procuring of insurance on behalf of an applicant for insurance of an insured, and does not act on behalf of the insurer except by *collecting premiums* or performing other *ministerial acts*.”¹⁰ An “insurance agent” is simply defined as an intermediary other than a broker.¹¹ Another confounding factor is that the Wisconsin Office of the Commissioner of Insurance (“OCI”) only issues intermediary-agent licenses despite the fact that Wisconsin’s statutes and regulations recognize the existence of brokers.

The significant limitations applicable to the activities of brokers in Wisconsin may make it difficult for insurers and intermediaries to efficiently operate in a manner where the referring producer may only collect premiums and perform ministerial acts. The OCI has traditionally taken a narrow view as to what constitutes “ministerial acts.” Insurers and intermediaries wishing to characterize their relationship as one of brokerage need to carefully structure their relationship so that the role played by the referring producer is solely ministerial in nature.

It is also important for those intermediaries and insurers interested in avoiding the application of § Ins 6.66, Wis. Admin. Code, to be familiar with its regulatory history. Prior to 1988, § Ins 6.66 contained subsection (6) which stated: “[t]he forwarding of business from an intermediary-agent to an intermediary-broker shall be deemed an exchange of business within this section. *This section shall not limit in any way the amount of business that an intermediary-broker may place or forward to any intermediary-agent.*”¹²

Subsection Ins 6.66(6), Wis. Admin. Code, was repealed in 1988. The Notice of Hearing applicable to this change in the rule indicated that the “. . . purpose of this rule is to remove references to intermediary-brokers in Ins 6.66. A handful of agents occasionally use the distinction made in Ins 6.66 between agents and brokers to proclaim themselves brokers. They then claim that they are not subject to any statute or rule governing agents. Since these laws are meant to protect Wisconsin’s insurance consumers, this practice should be discouraged. Eliminating the distinction made between agents and brokers in Ins 6.66 will discourage the practice of agents proclaiming themselves to be brokers.”¹³

While the Notice of Hearing indicates that the change in the rule is only to “discourage,” as opposed to “eliminate,” the described practice, it clearly expresses the OCI’s intent to strictly enforce the requirements of § Ins 6.66, Wis. Admin. Code.¹⁴

Ramifications

The ramifications of § Ins 6.66, Wis. Admin. Code, are more than academic.¹⁵ Insurers working with intermediaries who have exceeded the “5/25 Rule” and that are unable, or unwilling, to structure their relationships so as to be exempt from the requirements of § Ins 6.66, Wis. Admin. Code, will be required to appoint the referring intermediaries as their agents. The appointing of an agent in Wisconsin brings with it more than just the time and expense associated with making such appointments.

Under sec. 628.40, Wis. Stats., “[e]very insurer is bound by any act of its agent performed in this state that is within the scope of the agent’s apparent authority, while the agency contract remains in force and after that time until the insurer has made reasonable efforts to recover from the agent its policy forms and other indicia of agency.”¹⁶ This statute can significantly impact an insurer’s ability to deny a claim where the insured alleges that the referring agent committed an error or omission relevant to the disposition of the claim.

Conclusion

Permitting the exchange of business between intermediaries is sound public policy. This distribution methodology benefits insureds, intermediaries and insurers by efficiently bringing together insureds with unique insurance issues and insurers positioned to meet those needs. However, it is important for intermediaries and insurers operating in Wisconsin to be familiar with the limitations placed on their activities by § Ins 6.66, Wis. Admin. Code, and other applicable Wisconsin law.¹⁷

Endnotes

1. This article does not address business placed through surplus lines intermediaries in accordance with Wis. Stat. § 618.41 (2001-02). However, those insurers and intermediaries operating on a surplus lines basis should be familiar with Wis. Admin. Code § Ins 6.66(5)(b) which states: “The burden of showing that specialty lines, non-standard and professional liability business placed through surplus lines intermediaries in accordance with s. 618.41, Stats., or written on an excess rate or other individually rated risk basis beyond the limits prescribed for other exchanges of business in par. (a) is occasional and otherwise in compliance with this rule, shall be upon the intermediary-agent soliciting and forwarding such business.”
2. Wis. Admin. Code § Ins 6.66 (current through Wis. Admin. Reg. No. 565, Jan. 2003).
3. Wis. Admin. Code § Ins 6.66(2).
4. Wis. Admin. Code § Ins 6.66(3) (emphasis added).
5. Wis. Admin. Code § Ins 6.66(5) (emphasis added). There is no specific guidance in the applicable regulations on what constitutes “evidence to the contrary” justifying the exchange of business between intermediaries in excess of the “5/25 Rule.”
6. Wis. Admin. Code § Ins 6.66(1).
7. Wis. Admin. Code § Ins 6.66(2) (emphasis added).
8. Wis. Stat. § 628.61(2)(b).
9. Wis. Admin. Code § Ins 6.57(6).
10. Wis. Stat. § 628.02(3) (emphasis added).

11. Wis. Stat. § 628.02(4).
12. Wis. Admin. Code § Ins 6.66(6) (emphasis added).
13. Wis. Admin. Reg. No. 387, March 1988.
14. *Id.*
15. Wis. Admin. Code § Ins 6.66.
16. Wis. Stat. § 628.40.
17. Wis. Admin. Code § Ins 6.66.