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**MARKETING IN TEXAS: NEW DEVELOPMENTS**

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This article addresses recent legislative developments impacting the marketing of property and casualty insurance in Texas arising from the 75th Regular Session of the Texas Legislature, which adjourned June 2, 1997. The repeal of one statute and the amendment of two others could lead to major changes in how and by whom marketing will be done in Texas, particularly by direct writers and by non-residents, but that answer will not be known until the Texas Department of Insurance ("Department") issues its interpretations of the new legislation. The new legislation authorizes banks to sell insurance, although within strict limitations, and rental car agencies to sell limited lines of insurance. This article does not apply to the sale of life or health insurance. The agents selling those lines are licensed under separate provisions of the Texas Insurance Code.

*Direct Writers, Independent Agent System, or Both?*

The Department has long held the position that a property and casualty insurance company doing business in the state must write either on a direct basis (using company employees) or through licensed local recording agents, but not both.<sup>1</sup> The Department had relied on two provisions in the just-repealed article 21.09 of the Texas Insurance Code. The first provision required the use of resident local recording agents to issue, countersign and deliver all property and casualty insurance policies, while the second provision excepted any insurance company whose general plan of operation did not contemplate the use of local recording agents.<sup>2</sup> Staff members of the Department have cited these two provisions as authority for prohibiting a plan of operation which incorporated the use of both local recording agents and direct writing. Effective July 1, 1997, article 21.09 was repealed and with it went the previously cited justification for requiring only one method of marketing.<sup>3</sup>

Because the authority found in article 21.09 has been repealed, one might expect that more than one method of marketing would now be permissible. We are not aware of any other statutory authority which would support the prohibition of more than one marketing method. The Licensing Group-Deputy Commissioner of the Department has indicated that companies will be allowed to write on a direct basis and through local recording agents, and that clarifying bulletin or proposed rules will be issued soon.<sup>4</sup>

*Registration of Direct Writer Employees*

Prior to the most recent session of the Texas Legislature, section 20(a) of article 21.14 of the Texas Insurance Code exempted direct writer employees from the licensing requirements imposed on local recording agents.<sup>5</sup> The exemption was available to any "actual full-time home office salaried employee" of an insurance carrier.<sup>6</sup> The person was required to be an employee, and not an independent contractor, of the company and on the payroll of the "home office." "Home office" was not defined in the statute or the regulations, but was presumably the principal office of the insurance company in Texas. The Department did not require that the employee be physically located in the company's home office, but did require that the employee be on the payroll of that office.

While the exemption for any "actual full-time home office salaried employee" was retained, the new legislation imposes major limitations on the use of the exemption by requiring that any home office salaried employee who solicits or receives an

major limitations on the use of the exemption by requiring that any home office salaried employee who solicits or receives an application for the sale of insurance through an oral, written, or electronic communication register with the Commissioner of Insurance of Texas ("Commissioner").<sup>7</sup> Previously, all home office salaried employees were exempt, and were not required to register with the Commissioner. There had previously been no distinction between home office salaried employees that solicited or received an application for insurance and those that did not, and there had been no specific law which stated that all types of communication, particularly electronic communication, were to be regulated.

Effective September 1, 1997, any direct writer employing an actual full-time home office salaried employee to solicit or receive an application for insurance must certify to the Commissioner that such employee receives at least fifteen hours per year of continuing education on the principles of insurance, licensing and regulatory laws, insurance policy provisions, and the duties of an insurer to an insured, including training in ethical considerations.<sup>8</sup> If the registrant (1) willfully violates any Texas statute or regulation, (2) is guilty of fraudulent or dishonest acts, (3) materially misrepresents the terms and conditions of any insurance policy or contract, (4) issues or causes to be issued any statement misrepresenting, or making incomplete comparisons of, insurance contracts to induce a forfeiture, surrender or expiration of another contract to replace it with another, (5) is guilty of rebating any insurance premium or discrimination between insureds, (6) or is convicted of a felony involving fraud or breach of fiduciary duty, the registrant's registration may be suspended and the employer insurance carrier may be disciplined.<sup>9</sup> The registrant must disclose its registration to each insurance applicant when making an oral, written or electronic communication to solicit or receive an application for the sale of insurance in Texas. The Commissioner is authorized to publish rules regulating full-time home office salaried employees, but has not proposed or issued any rules to date.

The significance of this legislation is that direct writer employees who solicit or receive an application must register with the Commissioner and be subject to discipline by the Department, and the direct writer companies must provide continuing education to their registered employees and be subject to disciplinary action if their employees are found guilty of certain prohibited acts. Solicitation by direct writers via electronic communication is now specifically regulated.

#### ***Residency of Direct Writer Employees***

Prior to the adoption of the new legislation, it had been the long-held position of the Department that only residents of Texas could solicit in Texas. This limitation was applied to direct writer employees entitled to the home office salaried employee exemption as well as to local recording agents. In support of its position, the Department relied on article 21.09 of the Texas Insurance Code, which prohibited a company from authorizing a non-resident to issue, countersign, or deliver policies of insurance except through regularly licensed local recording agents, and article 21.11 of the Texas Insurance Code, which prohibited solicitation by licensed non-resident agents. The Department read these two articles together and determined that only Texas residents could solicit in Texas, either as a local recording agent or as an home office employee.

Because the new legislation repealed article 21.09, and amended articles 21.11 and 21.14, the Department is now reconsidering its position. Non-resident agents licensed under article 21.09 are by definition residents and are prohibited from soliciting in Texas. Local recording agents licensed under 21.14 are required to be residents of Texas and residency is expected to be a requirement for home office salaried employees as well. The Deputy Commissioner-Licensing Group of the Department has indicated that "home office" will be defined as a principal office located in Texas and that the employees must be salaried out of that office. He has indicated that Texas will not permit direct writer employees working in out-of-state service centers to solicit in Texas. It is not known whether residency will be a requirement. The Department is expected to issue clarifying rules on this issue.

#### ***Salaried Employees of Independent Agents***

In addition to changing the exemption for home office salaried employees, the legislation which amended article 21.14 of the Texas Insurance Code added one major clarification to the statute. Salaried employees of a local recording agent who are not involved in either the solicitation or negotiation of insurance and who are devoted full time to clerical and administrative services are now exempt from the licensing requirements imposed on local recording agents.<sup>10</sup> These employees may take "incidental" information from customers and receive premiums in the office of the local recording agent, but may not receive any commissions or compensation based on the volume of premiums received.<sup>11</sup> By implication, any employee of a local recording agent who receives commission income or who receives premiums outside of the office of the local recording agent, or who is involved in solicitation or negotiation of insurance other than by the incidental taking of information, will not qualify for the exemption and therefore must be licensed as a local recording agent (or as a solicitor employed by the

not qualify for the exemption and therefore must be licensed as a local recording agent (or as a solicitor employed by the local recording agent). This new exemption is effective September 1, 1997.

### ***Non-Resident Agents and Countersignature Requirements***

Non-resident agents were substantially impacted by the passage of House Bill 3391, which repealed one statute and substantially amended another. Effective July 1, 1997, Texas no longer mandates countersignatures of policies by Texas resident local recording agents for policies originated by licensed, non-resident agents unless the new retaliatory provision is triggered. This change was accomplished by the repeal of article 21.09.<sup>12</sup> Countersignature by a Texas resident local recording agent is only required if (1) a licensed, non-resident agent seeks to place insurance in Texas through a Texas local recording agent, and (2) the non-resident's state of residence imposes countersignature requirements on Texas resident agents seeking to place insurance in the non-resident's state.<sup>13</sup>

The statute dealing with non-resident agents, article 21.11 of the Texas Insurance Code, was substantially rewritten, although most of the prior limitations placed on non-residents were retained. Non-resident agents licensed under article 21.11 are prohibited from maintaining an office in Texas, soliciting insurance in Texas by any method (whether by oral, written or electronic communication), or employing solicitors or others to directly or indirectly solicit insurance.<sup>14</sup> Prior law did not specify the types of communication which were regulated.

One unknown aspect of the new law involves what authority a licensed, non-resident agent will have in Texas. The prior law stated that the non-resident agent could originate insurance, but not solicit in Texas, inspect and service business in Texas, but not office in Texas, and share commissions with a Texas resident local recording agent who solicits the insurance in Texas. The new law has eliminated the "safe harbor" provisions of the old law which were clear in defining what the non-resident agent was authorized to do.<sup>15</sup> The absence of these "safe harbor" provisions, together with the law's prohibition against transacting insurance as a local recording agent by subterfuge and against employing solicitors or others to directly or indirectly solicit insurance in this state, draw into question what activities, if any, a non-resident agent may perform in Texas. Section 2(a) of the amended article 21.11 of the Texas Insurance Code states that the non-resident license grants the holder all of the rights and privileges of a local recording agent. It is arguable then that the non-resident agent can perform any of the acts permitted of a local recording agent, except for the three stated prohibitions of maintaining an office in Texas, soliciting insurance in Texas, and employing others to solicit for the non-resident.

The Texas Deputy Commissioner-Licensing Group has confirmed that licensed, non-resident agents may service insurance in Texas, but cannot solicit new accounts. In his opinion, a licensed, non-resident agent can handle the "add-on" of new properties as part of its servicing responsibility and can handle renewals of existing business. This opinion is unofficial and is expected to be clarified in the future either by the issuance of a bulletin or in proposed rules.

Because the new legislation contains a retaliatory provision, requirements or restrictions imposed by law on Texas residents seeking to do business in the state of the non-resident will be imposed on the non-resident in Texas. For example, a non-resident from a state which requires that a minimum commission be paid to a resident agent will be subject to the same requirement as respects business written in Texas originating from the non-resident agent.

The new law also appears to codify the Department's previous interpretation of the law which limited non-resident agent licenses to natural persons only. Although the new law does not clearly prohibit licenses for corporations or partnerships, it authorizes only "persons" to become so licensed.<sup>16</sup> The term "persons" is not defined in the statute. The Department has not changed its interpretation, and therefore non-resident agent licenses will continue to be limited to natural persons. Even under the old article 21.11, which authorized corporations to be licensed as non-resident agents, the Department refused to license non-resident corporations, forcing natural persons only to be licensed for their non-resident corporate employees. The result was, and will continue to be, retaliation against Texas licensed corporations by those states which enforce retaliation.

The new legislation retains the prohibitions of the previous law which bar a person or firm licensed solely as a broker in the state of residence from receiving a non-resident agent's license in Texas.<sup>17</sup> Texas recognizes brokerage in only a limited manner for Texas agents.<sup>18</sup>

### ***Licensing of Banks as Agents***

In March 1996, the United States Supreme Court unanimously held that a federal law preempted state statutes which prohibit banks from selling insurance.<sup>19</sup> Texas adopted interim procedures to permit banks to engage in the sale of insurance as an agent, but imposed significant safeguards to subject banks to many of the same licensing and operating requirements as other insurance agents.<sup>20</sup>

These procedures were incorporated into new legislation effective July 1, 1997.<sup>21</sup> The new legislation limits the authority of banks to sell insurance to those located or doing business in a place with a population of 5,000 or less. A bank may have additional offices from which the business of insurance is conducted, but only in "places" with populations of 5,000 or less. At least one officer of the bank, and each individual performing the acts of an agent, must be individually licensed as agents. Books and records relating to the agency activity of a bank must be maintained separate from the banking transaction records. Banks are specifically prohibited from engaging in certain activities defined as "unfair methods of competition and unfair practices," including tying transactions (directly or indirectly conditioning the terms of credit on the acquisition of insurance from the bank). The bank is required to disclose to each applicant the bank's affiliation, as well as a description of risks inherent in insurance. The person involved in the insurance transaction may not be involved in the loan transaction. Customer privacy prohibits non-public information from being used for the solicitation of insurance. The physical location of the insurance activities must be conspicuously shown in order to distinguish the insurance agency activities from the banking activities.

### *Limited Licensing of Rental Car Agencies*

Texas has joined a number of states in authorizing limited licensing of rental car agents and their franchisees.<sup>22</sup> Rental car companies or their franchisees may apply for limited licenses to sell excess liability, accident and health, and personal effects insurance for policies to be issued, delivered, or renewed on or after September 1, 1997. Each licensee is required to file a written application along with a certificate from an insurer that the licensee is trustworthy and competent to act as an insurance agent for the limited purpose of the license.

The rental car agency must have brochures or other written materials readily available that disclose that the policies may provide duplication of coverage, that the purchase of insurance is not required for the car rental, and such other information as the Commissioner may prescribe. The rental car agency must conduct a training program for its employees providing basic instruction about insurance, including its obligation to acknowledge to the customer that insurance is not required and that the insurance may constitute a duplication of coverage.

### *Interim Study of Agents and Agents' License Statutes*

The Commissioner is mandated to review and evaluate the regulation of agents and agents' licenses and report to the Legislature by no later than January 1, 1999.<sup>23</sup> The Commissioner must determine whether any changes are needed to: (1) address new methods of marketing insurance, including use of the Internet and telemarketing; (2) reduce the number and types of agents' licenses; (3) determine which provisions should consistently apply to all licenses; and (4) address other problems with agents' licensing requirements. The Commissioner is to appoint an advisory committee to include agents, insurers, consumers, banks and others.

### *Summary*

Under new legislation recently passed in Texas, direct writers must register home office salaried employees, provide them with continuing education, and be subject to discipline for their prohibited acts. It appears that the change in the law will be interpreted broadly to permit more than one method of marketing by an insurance company permitting the use of both employees and independent agents. Administrative personnel of independent agents are exempt from licensing requirements so long as they do not solicit or negotiate and do not receive commissions or other similar compensation based on volume of premium. Countersignature requirements are eliminated except to the extent required by retaliatory provisions. Non-resident agents are restricted from soliciting in Texas by any method, whether through oral, written or electronic communication. Banks may act as insurance agents in Texas, but must comply with many of the requirements imposed on other licensed agents and are limited to doing insurance business out of locations with population of 5,000 or less. Rental car agencies may obtain limited licenses to sell excess liability, accident and health, and personal effects insurance. Finally, the Commissioner will study agents' licensing issues and make a report to the Legislature by January 1, 1999.

The State of Texas has often been considered unique in its approach to the regulation of insurance. That perception will likely continue as a result of the recent legislation which addresses the licensing and authority of non-resident agents, direct writer employees, banks as insurance agents, and rental car agencies selling insurance. This new legislation will result in significant changes in how property and casualty insurance companies will do business in Texas.

### *Endnotes*

1. Local recording agents are licensed under Tex. Ins. Code art. 21.14 and are the primary vehicle through which property and casualty insurance is written in Texas other than by direct writers. Local recording agents must be natural persons and residents of Texas. Local recording agents are usually independent and thus are free to write for more than one insurance company; hence, local recording agents are usually considered a part of the "independent agent system." There are instances, however, where a direct writer insurance company may use captive agents who are independent contractors, licensed as local recording agents, but who do not write for other insurers. Even though these captive agents may be contractually prohibited from writing for other insurers, their licenses permit them to write for other companies from whom they may obtain appointments. These captive agents are likely to be considered part of the "independent agent system" because they are not company employees and they hold local recording agent licenses.

2. Tex. Ins. Code art. 21.09 *repealed by* Act of May 23, 1997, 75th Leg., R.S., H.B. 3391, 24, eff. July 1, 1997.

3. *Id.* Notwithstanding the Department's position, a number of companies may have utilized both methods in marketing their products in Texas.

4. Because of its impending nature, the bulletin or the proposed rules may have been issued prior to the time that this article was published. Any interested reader may contact the authors for an update on the status or the content of the bulletin or rules.

5. Tex. Ins. Code art. 21.14, 20(a), *amended by* Act of May 31, 1997, 75th Leg., R.S., S.B. 206, eff. Sept. 1, 1997.

6. *Id.*

7. Act of May 31, 1997, 75th Leg., R.S., S.B. 206, eff. Sept. 1, 1997.

8. *Id.*

9. *Id.*

10. *Id.*

11. *Id.*

12. Act of May 23, 1997, 75th Leg. R.S., H.B. 3391, 24, eff. July 1, 1997.

13. *Id.* at 23.

14. *Id.* at 23.

15. *Id.* at 23.

16. *Id.* at 23.

17. *Id.* at 23.

18. *See* 28 Tex. Admin. Code 19.905 which authorizes licensed agents to refer business to licensed and appointed agents and to perform limited acts with the insured.

19. *Barnett Bank v. Nelson*, 116 S.Ct. 1103 (1996).

20. TDI Commissioner's Bulletin No. B-0043-96.

21. Act of May 23, 1997, 75th Leg. R.S., H.B. 3391 1-22, eff. Sept. 1, 1997.

22. Act of May 23, 1997, 75th Leg. R.S., H.B. 3563, eff. Sept. 1, 1997.

23. Act of May 31, 1997, 75th Leg. R.S., S.B. 206, 5, eff. Sept. 1, 1997.