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State Regulators Target Value Added Services Provided By Benefit Brokers

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The insurance industry has faced increased scrutiny in recent years. Insurance regulators in several states issued guidance recently with respect to the application of state anti-rebating statutes (collectively, the "Anti-Rebating Statutes") to "value added" services provided by producers in connection with employee benefit plans. Generally speaking, rebating is the act of offering anything of value as an inducement to purchase insurance that is not included in the terms of the insurance policy. In other words, rebates are incentives, in the form of gifts or other consideration, given to induce customers to purchase insurance coverage from a particular insurer or producer.

This article provides an overview of the Anti-Rebating Statutes, including the intended purpose and constitutional challenges against these laws aimed at consumer protection. It then summarizes recent guidance with respect to the Anti-Rebating Statutes and "value added" services provided to clients by employee benefit producers and concludes that the National Association of Insurance Commissioners ("NAIC") and state legislators should consider reforms to these arcane laws that, when strictly interpreted and enforced, arguably result in higher costs to consumers and a less efficient market.

I. BACKGROUND

A. Anti-Rebating Statutes

Forty-eight states and the District of Columbia prohibit insurers and producers from giving an insured or prospective insured anything of value not specified in the policy as an inducement to the purchase of insurance.¹ Each of these jurisdictions has enacted Anti-Rebating Statutes substantially similar to the NAIC Model Unfair Trade Practices Act (the "Act").² Section 3 of the Act prohibits engaging in any trade practice which is defined as an unfair method of competition or an unfair or deceptive act or practice in the business of insurance.³ Section 4 of the Act provides in pertinent part:

The following are hereby defined as unfair methods of competition and unfair or deceptive acts or practices in the business of insurance:

...

H. Rebates. (1) Except as otherwise expressly provided by law, knowingly permitting or offering to make or making any contract of life insurance, life annuity or accident and health insurance, or agreement as to such contract other than as plainly expressed in the insurance contract issued thereon, or *paying or allowing, or giving or offering to pay, allow, or give, directly or indirectly, as inducement to such insurance or annuity, any rebate of premiums payable on the contract, or any special favor or advantage in the dividends or other benefits thereon, or any valuable consideration or inducement whatever not specified in the*

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contract; or giving, or selling, or purchasing or offering to give, sell, or purchase as inducement to such insurance contract or annuity or in connection therewith, any stocks, bonds, or other securities of any insurance company or other corporation, association, or partnership, or any dividends or profits accrued thereon, or anything of value whatsoever not specified in the contract.⁴

The most obvious rebate is a cash return of part of the premium to the policyholder, or the acceptance of an amount less than the full premium payable, ordinarily through a reduction in the producer's commission. State insurance regulators have found that other less obvious benefits tied to the sale of insurance violate Anti-Rebating Statutes, including but not limited to the following:

- providing goods or services at no cost or at a discount;
- renting office space at excessive rates from companies purchasing a substantial amount of insurance from a producer or insurer;
- joining the insurance transaction with a sale of stocks or bonds at a price lowered by the amount of the proposed rebate;
- retaining and compensating the policyholder or a representative of the policyholder for acting in a fictitious "advisor" role;
- selling shares to policyholders in proportion to the premium volume of business placed and declaring dividends⁵; and
- giving the insured a favorable interest rate on a loan used to pay the premium.⁶

It should be noted that although: (i) the Act prohibits rebating in connection with life, health, and accident insurance and annuities, many states have enacted laws extending the prohibitions against rebating to property and casualty insurance; and (ii) the prohibitions are directed at insurers and producers, many states also prohibit an insured from knowingly accepting a rebate.⁷ Violations of Anti-Rebating Statutes are generally punishable by civil and criminal sanctions, including cease and desist orders, license suspension or revocation and fines.

B. Intended Purpose of Anti-Rebating Statutes

It is often difficult to explain to clients why such a seemingly pro-consumer practice is prohibited in most states. The Anti-Rebating Statutes were enacted in the late 1800s and early 1900s to protect consumers from widespread abuses in the insurance industry occurring at that time, particularly in the sale of life insurance, by preventing discrimination in the rates payable by similarly-situated policyholders and assuring insurer solvency.⁸

Like most insurance laws and regulations, the Anti-Rebating Statutes are aimed at consumer protection by ensuring that consumers are treated fairly and that insurers possess adequate reserves to meet their obligations to policyholders. Prior to the enactment of the Anti-Rebating Statutes, insurers and agents would in some cases discriminate between similarly situated insureds by offering some insureds preferential rates, often by agreeing to return a portion of the premium received by the insurer or commission received by the agent. This would in effect allow insurers to offer coverage at less than the rates filed with and approved by the state insurance departments based on established actuarial assumptions. This practice also raised concerns regarding insurer solvency, as insurers in some cases were receiving total premiums that were less than the approved rate.

C. Constitutionality of the Anti-Rebating Statutes

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The Anti-Rebating Statutes in several states have been subject to constitutional challenges on the grounds that they have no relation to public safety or welfare and deprive consumers and insurers of property rights. In fact, in 1986, the Florida Supreme Court found that Florida's anti-rebating statutes were unconstitutional. ⁹ In *Dep't of Ins. v. Dade County Consumer Advocate's Office*,¹⁰ the Consumer Advocate's Office (the "Consumer Advocate") filed a complaint against the Florida Office of Insurance Regulation ("FOIR") alleging that Florida's anti-rebating statutes deprived consumers of their property rights because such statutes prohibited policyholder negotiations of insurance agent commissions, thereby increasing the amount policyholders paid for insurance. The FOIR argued that Florida's anti-rebating statutes guaranteed insurer solvency and prevented discrimination against policyholders in the same actuarial class. The Florida Supreme Court held that Florida's anti-rebating statutes were unconstitutional because there was "no identifiable relationship between the anti-rebate statutes and a legitimate state purpose in safeguarding the public health, safety or general welfare," and such laws "interfered with property rights by unnecessarily limiting the bargaining power of the consuming public."¹¹

In a later case, the Florida Supreme Court affirmed its decision in Dade County stating that "[t]he anti-rebate statutes...simply deprive the consuming public of a choice in the price of products or services, the choice of which is the cornerstone of a competitive, free-market economy."¹² In other states, however, courts have found that Anti-Rebating Statutes are constitutional because they bear a rational relation to public safety and general welfare, and do not deprive insurers or policyholders of property or equal protection rights.¹³

II. RECENT GUIDANCE REGARDING VALUE ADDED SERVICES

Although the practice of rebating is expressly prohibited in most U.S. jurisdictions, state regulators and attorneys general have not been very active over the years in the enforcement of violations of the Anti-Rebating Statutes. This is likely due in large part to the fact that consumers receiving rebates are receiving a benefit and, therefore, have no reason to complain to state regulators. In our experience, most complaints against producers alleging violations of Anti-Rebating Statutes are brought by competing producers that have lost business to a producer providing something of value to an insured as an inducement to the purchase of insurance.

In response to such complaints, state regulators have issued written guidance on the parameters of the Anti-Rebating Statutes. Insurance regulators have become increasingly focused on "value added" services commonly offered by employee benefit brokers to defray the total cost of the insurance product and provide a wider range of services to their clients to gain a competitive advantage in the market. Many large and medium-sized brokers are even willing to provide certain services not directly related to the insurance policy at no additional cost to clients in connection with the purchase of health and welfare plans, including payroll services, compliance services related to the federal Consolidated Omnibus Budget Reconciliation Act ("COBRA") and Health Insurance Portability and Accountability Act ("HIPAA") and flexible spending account administration.¹⁴ To level the playing field, smaller brokers without the resources to provide such value added services will often complain to state insurance regulators that their larger competitors are acting in violation of Anti-Rebating Statutes.

Many would argue that providing these services free of charge or at a discount provides a benefit to the employer purchasing coverage and that the cost savings can ultimately be passed on to individual employees because the employer's overall health and welfare benefit costs are reduced. Unfortunately, the Anti-Rebating Statutes are broadly written and do not exempt benefits that can otherwise be provided in a non-discriminatory manner and without any impact on insurer solvency. In interpreting their Anti-Rebating Statutes, state regulators have consistently determined producers and insurers are prohibited from providing free or discounted value added services unrelated to the sale of the insurance, unless it is set forth in the insurance policy.¹⁵

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The New York Insurance Department ("NYID") has been by far the most active state insurance department in terms of issuing guidance with respect to the scope and application of its Anti-Rebating Statutes and has offered more than 170 Office of General Counsel Opinion Letters on the topic. Most recently, the NYID issued Circular Letter 9 which clarifies its position with respect to insurance agents and brokers offering value added services.¹⁶

Circular Letter 9 states that insurance producers may provide services to clients that are not specified in the insurance policy if the following conditions are met:

- (1) The service *directly relates* to the sale and servicing of the policy or provides general information about insurance risk reduction; and
- (2) The insurer or producer provides the service *in a fair and nondiscriminatory manner* to like insureds or potential insureds.

According to Circular Letter 9, "services that fall within the scope of services that an insurance producer may lawfully provide in connection with insurance sold by the producer if provided incidental to the insurance and in a fair and nondiscriminatory manner" include the following:

- risk assessment related services;
- insurance consulting services or other insurance-related advice;
- insurance-related regulatory and legislative updates;
- certain claims assistance services;
- tax preparation on behalf of an employer reporting information regarding insurance contract coverage, fees, and commissions, investment and annuity contracts, and welfare benefit contracts;
- information to group policy holders and members, as well as forms needed for plan administration, enrollment in a plan, insurer website links, and answers to frequently asked questions related to the insurance;
- Certain services performed pursuant to COBRA, such as billing former employees, collecting the insurance premiums, and forwarding the aggregate premiums to the employer policy or contract holder or to the insurer, when offered in connection with the provision of accident and health insurance;¹⁷ and
- Certain services provided in accordance with HIPAA, such as those pertaining to health care access, portability, and renewability, when offered in connection with the provision of accident and health insurance.

Producers may provide services that directly relate to the insurance purchased for free or at a discount without violating the New York Anti-Rebating Statutes if the services are provided in a fair and non-discriminatory manner.¹⁸

Circular Letter 9 also states that some services are too attenuated to the provision of insurance and, therefore, producers providing such services for free or at a reduced cost may be violating the Anti-Rebating Statutes if the services are not specified in the policy. Such services include, but are not limited to:

- flexible spending administration services;
- legal services;
- payroll services;
- referrals to third-party service providers through which policyholders may receive a discounted rate;
- advice regarding compliance with laws concerning human resource issues not relating to insurance purchased;

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- management of employee benefit programs not relating to insurance purchased;
- preparation of employee benefit statements listing benefits provided to employees not relating to insurance purchased;
- development of employee handbooks and training not relating to insurance purchased; and
- services related to employee compensation, discipline, job descriptions, leaves of absence, organizational development, business policies and practices, safety, staffing, and recruiting not relating to insurance purchased.

Under New York law, a broker may charge for these types of services pursuant to an agreement satisfying the requirements of § 2119 of the New York Insurance law, but an agent representing the insurance company may not.

In attempting to provide additional services to policyholders without running afoul of the Anti-Rebating Statutes, insurers have attempted to include certain ancillary services within the terms of policy forms filed with state regulators. The insurance departments in New York and Iowa have responded by declaring that the goods or services in the insurance policy must "have a legitimate nexus to the insurance coverage provided under the policy" and be "necessarily or properly incidental to the insurer's insurance business."¹⁹ If it is determined that the goods and services in the policy do not have a "legitimate nexus," then the departments will not approve such policies, regardless of whether such goods and services are available to all persons of the same class. While Circular Letter 9 attempts to delineate between permissible and impermissible services, by finding linkage to the insurance policies sold, the reality is that health and welfare benefits are inextricably entwined with the human resource services provided by most employers, and it creates great inefficiencies to impose regulations attempting to separate the permissible from impermissible activities when they are all part of an employer's overall human resource plan.

III. APPLICATION OF THE ANTI-REBATING STATUTES TO THE MODERN INSURANCE INDUSTRY

As previously stated, the Anti-Rebating Statutes are broadly written and subject to little or no interpretation by state regulators. Application of the Anti-Rebating Statutes to modern insurance products, particularly employer sponsored health and welfare plans, may produce bizarre results that are harmful to consumers. Employee benefit producers often earn large commissions on the placement of employer sponsored health plans, particularly with the steep rise in rates on health insurance products and the resulting commissions payable to producers. Due to the economic crisis and high cost of health insurance, many employers have been forced to reduce or even eliminate certain employee benefits. To gain a competitive advantage and better service their clients, producers are willing to provide a broader range of services at no cost or at a discount and even to pay third-party service providers to provide certain services to clients.

The Anti-Rebating Statutes were originally intended to protect consumers by preventing discrimination between like insureds and the risk of insurer insolvency through the rebate of premiums and payment of other valuable consideration. These same concerns do not apply to producers providing value added services to clients in connection with employee benefit plans. In cases where producers are providing services directly to clients and/or are paying for them out of commissions earned, there is no risk to insurer solvency.

Moreover, the sale of employer sponsored health and welfare plans are not subject to the same issues with respect to discrimination between like insureds as personal lines policies. In most cases, employee benefit plans involve negotiations between commercial parties, with most large employers being represented by a broker and/or an experienced risk manager. These sophisticated purchasers of insurance should be free to negotiate the best terms possible and to receive the broadest range of services for the premiums paid. Instead, the Anti-Rebating Statutes are being used as a mechanism to level the playing field between large and small brokers, which ultimately increases the expenses of employers and their employees.²⁰

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In this age of rising health insurance costs, the NAIC and state legislators and regulators should seriously consider reforms to the Anti-Rebating Statutes. One possible approach that some have suggested would be to provide some type of commercial exemption to the Anti-Rebating Statutes to allow sophisticated commercial purchasers of insurance, who do not require the same level of consumer protection as individual consumers, to negotiate the best deal possible and for producers to provide the broadest menu of services to their clients. This will lower health and welfare benefit costs and make employers more efficient in providing human resource services to their clients.

Endnotes

1. Some states have exceptions to the Anti-Rebating Statutes, such as, provision of nominal promotional and advertising materials. *See, e.g.*, Me. Rev. Stat. Ann. tit. 24-A § 2163-A (1997); Mich. Comp. Laws § 500.2024a (1989); S.D. Codified Laws § 58-33-74 (2001); Connecticut Insurance Department Bulletin S-12 (12/24/08).
2. III Nat'l Assoc. of Ins. Comm'rs, Model Laws Regulations And Guidelines, 900-1 to 900-17 (1989).
3. *Id.* at 900-2
4. *Id.* at 900-2, 900-4 (emphasis added).
5. Kimball & Jackson, *The Regulation of Insurance Marketing*, 61 Colum. L. Rev. 141, 147 (1961).
6. *See Western Union Life Ins. Co. v. Musgrave*, 25 Ariz. 219, 215 P. 536 (1923); *Johnson v. American Nat'l Ins. Co.*, 126 Ariz. 219, 613 P.2d 1275 (Ct. App. 1980) (alleged contract that insurer would make loan to insured if insured bought policy is illegal and unenforceable); *Jones v. Crawford*, 21 Ga. App. 29, 93 S.E. 515 (Ct. App. 1917); *Morris v. Ft. Worth Life Ins. Co.*, 200 S.W. 1114 (Tex. Civ. App. 1918).
7. Many states also prohibit the payment of rebates in connection with title insurance; however, such prohibitions are generally restricted to title insurance and are separate from the Anti-Rebating Statutes applicable to life and health and property and casualty insurance.
8. *Statutory Prohibitions On The Negotiation Of Insurance Agent Commissions: Substantive Due Process Review Under State Constitutions*, 51 Ohio St. L.J. 773, 777 (1990).
9. In addition, California's anti-rebating statutes were repealed by Proposition 103, an insurance reform initiative enacted by voters in 1988.
10. 492 So.2d 1032 (Fla. 1986).
11. *Id.* at 1035.
12. *Chicago Title Ins. Co. v. Butler*, 770 So. 2d 1210 (Fla. 2000).
13. *See, e.g., Katt v. Insurance Bureau*, 200 Mich App 648, 505 N.W.2d 37 (1993) (holding that Michigan anti-rebating statutes are constitutional because such statutes are reasonably related to achieving proper legislative purposes of nondiscrimination and solvency of insurance companies); *Quetnick v McConnell*, 154 Cal. App. 2d 112, 315 P.2d 718 (1957, 1st Dist) (holding that California anti-rebating statutes were constitutional and did not violate equal protection rights); *People v. Commercial Life Ins. Co.*, 247 Ill. 92, 93

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N.E. 90, error dismissed 227 U.S. 681, 33 S. Ct. 327 (1910) (holding that Illinois anti-rebating statutes are constitutional and that such statutes do not deprive insurers of property without due process of law); *Equitable Life Assur. Soc. v Commonwealth*, 113 Ky. 126, 67 S.W. 388 (1902) (holding that the Kentucky anti-rebating statute do not unconstitutionally restrain trade or prevent competition and that such statutes have a rational basis in protecting consumers); *People v. Formosa*, 131 N.Y. 478, 30 N.E. 492 (1892) (holding that New York anti-rebating statute is constitutional because such statutes bear a relation to the public's general welfare).

14. Pub. L. No. 99-272, 100 Stat. 222 (Apr. 7, 1986), codified at 26 U.S.C. § 4980(b), 29 U.S.C. §§ 1161 et seq., 42 U.S.C. §§ 300bb-1 et seq; Pub. L. No. 104-191, 110 Stat. 1936 (1996), codified at 42 U.S.C. § 201 et seq. (42 U.S.C. 1320d-2).

15. *See, e.g.*, Connecticut Insurance Department Bulletin S-12 (12/24/08); Iowa Insurance Division Bulletin 08-15, 08-16; New York Insurance Department Circular Letter 9 (3/3/09); Texas Department of Insurance Bulletin B-0004-08 (1/31/08). *See also*, N.H. Rev. Stat. Ann. § 402:41 (2008) (New Hampshire legislature amended New Hampshire's anti-rebating statutes in 2008 to prohibit insurers and producers from offering value added services unrelated to the sale of insurance unless included in the insurance policy).

16. New York Insurance Department Circular Letter 9 (3/3/09).

17. With respect to COBRA administration services, the NYID has indicated that services not related to the insurance policy may not be provided to the insured by a producer at no cost or at a discount. *See e.g.*, New York Insurance Department Office of General Counsel Opinion 98-54.

18. Similarly, New Hampshire law expressly recognizes that a producer may provide certain value added services directly related to the insurance policy, including risk assessments, risk control tools, claims assistance, legislative updates, and administrative consulting. N.H. Rev. Stat. Ann. § 402:41 (2008).

19. *See* New York Insurance Department Circular Letter 9 (3/3/09); Iowa Insurance Division Bulletin 08-15, 08-16.

20. *See, e.g.*, Connecticut Insurance Department Bulletin S-12 (12/24/08)(Conn. Gen. Stat. § 38a-825 prevents the creation of competitive disadvantages among insurers and producers by creating a level playing field for all insurance professionals); New Hampshire Insurance Department Website-For Producers and Adjusters, *Rebating and Anti-Rebating Laws and Q&A*, available at <http://www.nh.gov/insurance/producers/index.htm> ("Rebates can result in unfair market advantage for those insurers or insurance producers that can afford to or are willing to offer the most generous or desirable rebates.").