WHITE PAPER

Producer Commission Sharing and Payment of Referral Fees

Understanding the groundrules for working with referral sources

BACKGROUND

In an effort to expand their customer base, insurance producers and agencies will often look for new referral sources. The types of referral sources vary and may include other individual producers and insurance agencies, as well as businesses outside of the insurance industry. Compensation models for the referral arrangements commonly involve sharing the producer's commissions with the referral source and/or paying a referral fee. When compensating non-licensed individuals and entities for referrals, it is important to consider the services to be provided by the non-licensed referrer as certain referral activities may trigger producer license requirements.[1]

ACTIVITIES REQUIRING A LICENSE

Section 13(D) of the NAIC Producer Licensing Model Act (the "PLMA") and the state insurance laws prohibit any person or company from selling, soliciting or negotiating insurance, unless that person or company is licensed as a producer for that line of authority. The PLMA defines the terms "sell," "solicit" and "negotiate" as follows:

> **"Sell"** means to exchange a contract of insurance by any means, for money or its equivalent, on behalf of an insurance company.

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> **"Solicit"** means attempting to sell insurance or asking or urging a person to apply for a particular kind of insurance from a particular company.
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> **"Negotiate"** means the act of conferring directly with or offering advice directly to a purchaser or prospective purchaser of a particular contract of insurance concerning any of the substantive benefits, terms or conditions of the contract, provided that the person engaged in that act either sells insurance or obtains insurance from insurers for purchasers.

These definitions are deliberately broad and subject to interpretation by state regulators. It can be difficult to determine whether a person or a company is engaged in one or more of these activities, particularly with respect to referral activities considered the "solicitation" of insurance. As mentioned above, producers sometimes turn to non-insurance businesses for referrals by entering into joint marketing/referral agreements. Whether a business making a referral is engaging in solicitation of insurance depends on the activities of the referral source. Consider the following examples:

> **EXAMPLE 1:** A start-up insurance agency contracts with an IT company to develop a custom agency management system. Like many start-up businesses, the agency does not possess capital to pay for these services upfront. Instead, the agency offers to share its commissions with the IT company to compensate the IT Group for its services. The IT group is clearly not engaged in soliciting insurance as it has no communication with any potential client of the agency regarding the insurance offered by the agency, and the compensation is for activities not requiring a producer license.
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> **EXAMPLE 2:** A dental practice provides its uninsured patients with advertising materials for an insurance agency that sells dental insurance. In turn, the insurance agency pays the practice a fee for each referral it receives. A state regulator may determine that this type of arrangement constitutes solicitation of insurance since the practice is communicating to potential customers about procuring insurance through the agency. If such activities were considered a solicitation, the dental practice and the employees making the referral are required to hold a producer license.

COMPENSATION PAID TO UNLICENSED REFERRAL SOURCES

Commission Sharing

The PLMA prohibits licensed producers from compensating an unlicensed person for selling, soliciting or negotiating insurance (i.e., activities requiring a producer license). Section 13 (D) of the PLMA generally allows a licensed producer to share commissions with, or pay other types of compensation to, an unlicensed person or entity as long as such person/agency is NOT engaged in the sale, solicitation or negotiation of insurance.

The producer licensing laws in over half of the states have adopted Section 13(D) of the PLMA or similar language. In these states, a producer can enter into a marketing/referral agreement and share his/her commissions with, for example, a car dealership that provides information about dealership customers who may be interested in purchasing an auto insurance policy, so long as car dealer employees do not "solicit" such customers for car insurance. The producer may choose to share commissions with the car dealership based on each referral or only the referrals resulting in a sale.

The producer licensing laws in the remaining states do not, however, follow the PLMA with respect to commission sharing and generally prohibit sharing of "commissions" with an unlicensed person, regardless of whether or not the unlicensed person is otherwise engaging in the sale, solicitation or negotiation of insurance. It is possible to structure payment arrangements in these states for services that do not require a license, and those arrangements should be reviewed by regulatory counsel to avoid unwittingly violating the commission sharing laws.

Referral Fees

Certain states permit licensed producers to pay a "referral fee" to an unlicensed referral source even though "commission sharing" with an unlicensed person may be prohibited under state law. In these states, however, a licensed producer may pay a referral fee to an unlicensed referral source only if:

- The unlicensed person does not discuss specific insurance policy terms with the prospective buyer (i.e., no selling, soliciting or negotiating),
- The referral fee is de minimis (generally less than $50), and
- The compensation is not based on the sale of insurance (i.e., based on referrals regardless of whether the referral results in a sale).

CONCLUSION

As you can see, states vary considerably in their approach to regulating commission sharing and payment of referral fees by a licensed producer to an unlicensed referral source. ACCEL Law Group has considerable experience with producer compensation regulations and can assist producers to navigate the various state requirements and provide strategic solutions.

NOTES

1 Similar rules apply to producers who are not licensed in the line of authority of the policy being sold and making cross-referrals to a licensed producer (e.g., a referring producer who is licensed to sell life insurance products refers his/her client to another producer who is licensed in the property and casualty line of authority).

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