

Does your Insurance Agency Need to Be Foreign Qualified?

Background

If you own an insurance agency that intends to engage in sales activity outside of your resident state, you may be required to register or “qualify” with the Secretary of State in that foreign state. Failure to qualify can lead to fines and/or a loss of your producer license so keep reading to learn where and when you need to be foreign qualified. For purposes of this article, we refer to “resident state” as the state where the principal business is located and you hold a resident producer’s license, and “state of formation” as the state where your agency was formed by filing formation documents with the Secretary of State.

Agency Formation

To form an insurance agency, you must first form a “legal entity” (e.g., a corporation or limited liability company). Upon formation with the Secretary of State, the entity can apply to become a licensed resident producer with the Department of Insurance in the state of formation, or another state if the principal office will be located in a state other than the state of formation (e.g., many businesses choose to form their entity in Delaware and maintain their business operations in a different state). It is important to note that forming an entity with the Secretary of State is different from obtaining an insurance producer license with the Department of Insurance. The Secretary of State and Department of Insurance are two separate state agencies - the former deals with legal entities while the latter regulates insurance producers.

The Secretary of State of the insurance agency’s state of formation typically requires the entity to (a) submit an annual report to the state, (b) pay taxes to the state, and (c) submit to the state’s regulations regarding domestic entities.

Agency Foreign Qualification

Most insurance agencies sell insurance outside of their resident state and must therefore obtain insurance licenses from the Departments of Insurance in the states where they are selling insurance. Some of these states (a/k/a “foreign” states) require the insurance agency to be qualified with the Secretary of State to hold an insurance license. In some states, providing evidence of a foreign qualification is a prerequisite to obtaining a nonresident agency producer’s license, and in others, the Department of Insurance directs the nonresident

licensee to obtain a foreign qualification after issuing the license. To become foreign qualified in a foreign state, the agency must register with the Secretary of State by completing and filing a “Certificate of Authority” application or “Registration Statement.” This registration allows the agency to transact business in the foreign state.

Similar to the requirements in the state of formation, once an agency is “foreign qualified”, that foreign state may require the agency to (a) file an annual report, (b) pay taxes, and (c) submit to the state’s regulations for foreign entities. Because of these regulatory burdens, many insurance agencies simply avoid becoming foreign qualified unless the foreign state’s Department of Insurance requires qualification or their activities in that state clearly indicate they are “transacting business in the state” and require qualification (e.g., the entity has an office or employees in the state). It is advisable to seek guidance from your legal counsel or accountants to determine if foreign qualification is required, as failure to qualify can subject the agency to enforcement actions, including significant fines and penalties.

Foreign Qualification Factors

The most conservative approach to avoid fines and penalties is for the insurance agency to become foreign qualified in every state where the agency has an insurance license. However, not every state requires a foreign licensed insurance agency to be foreign qualified, and the determination as to whether the foreign qualification is required involves a facts and circumstances analysis. Foreign qualification subjects the agency to annual filing fees and state department of revenue filings, so it is advisable to conduct an analysis of your business and the transacting business rules of each state, rather than blindly filing in every state where the agency is licensed.

There are numerous factors to consider when deciding whether an entity, which has an insurance producer license in a state but no employees or offices in that state, should be foreign qualified:

- Most states have adopted an “interstate commerce” exemption to foreign qualification requirements. If an insurance agency is solely engaging in interstate commerce in a state with the exemption, then it may not be required to obtain a foreign qualification from the Secretary of State, unless there is some other factor requiring qualification (e.g., the Department of Insurance requires qualification or the activities of the agency fall within the type of activities that the state determines to be transacting business).
- Some states have a “look back” provision in their foreign qualification application. If an agency subsequently decides to become foreign qualified in a state (e.g., the agency is being sold and the buyer requires the agency to become foreign qualified), the state’s foreign qualification

application asks when the agency first started doing business in that state, and will fine the agency for the period of time when the agency should have been qualified but was not. To complicate matters, whether a state's foreign qualification application includes a "look back" provision sometimes depends on whether the agency is organized as a corporation or a limited liability company. The failure to timely file for foreign qualification in some look-back states can result in fines in excess of \$10,000!

- As discussed above, the Departments of Insurance in some states will not issue an insurance producer license to an entity until that entity is foreign qualified with the Secretary of State. In other states, the Departments of Insurance will issue an insurance producer license but subsequently require the licensed entity to become foreign qualified. Failure to do so can result in the agency's insurance producer license being revoked, or the Department of Insurance will refuse to process any filings (e.g., amendments to a license) without proof of a foreign qualification.

To summarize, there is little uniformity among the states on when foreign qualification is required, and a failure to qualify when required can result in fine or even an insurance license suspension or revocation. ACCEL Law Group has experience with foreign qualification filing issues in all U.S. states and territories and can guide you through the process as you seek to expand your business.

If you would like to learn more, please contact Dan Kalosieh at ACCEL at (860) 726-4208 or your regular ACCEL contact.

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ACCEL Law Group specializes in advising insurance agents and brokers on complex mergers, acquisitions and regulatory matters. Learn more at ACCELLawGroup.com.