



Things to Consider When Charging Broker Fees

A broker fee is a fee in addition to premium and commission that is charged by retail and wholesale insurance brokers and that ultimately is paid by the insurance buyer. Such fees are subject to two overriding rules: (1) they must be fully disclosed to the insurance buyer and (2) they must be reasonable.



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In addition, broker fees may be subject to specific state insurance regulatory restrictions. For example, Florida caps retail broker fees at \$35, whether admitted or non-admitted. In the surplus lines market, some states like

Minnesota treat broker fees as surplus lines premium and subject those fees to surplus lines premium tax.

(The authors assume that the retailer has a “broker fee agreement” with the insurance buyer making full disclosure of all charges for all services, along the lines of “broker fee agreements” discussed in two previous Insurance Journal articles that address rebating.)

Retailers

Retail producers are busy people. A retail firm can get itself in trouble if no experienced broker is tasked with reviewing the firm’s existing broker fee agreements at least annually.

Not only do regulatory requirements change over time, it is surprising how many inconsistencies, poor wording, and other glitches one will find that can give rise to consumer complaints, market conduct exams, other regulatory action or litigation because no one was

really paying attention.

Disclosure

Retailers bear the main burden of disclosure of fees and any other charges because they directly interface with the insurance buyer.

Disclosure means full disclosure. Any retailer that tries to hide the ball by lumping commissions, broker fees, inspection fees or other charges together for the insurance buyer is setting itself up for regulatory scrutiny, as well as detailed audits, substantial refunds, fines and penalties.

As a retail producer knowledgeable in the insurance business, what would you expect for broker fees and other fee disclosures if you were the insurance buyer? Do unto others what you would want them to do for you and you are probably home free.

Consumer complaints to insurance regulators about failure to fully disclose

fees are serious and costly business. They also affect the brand and reputation of the producer. In addition to complaints lodged by the insurance buyer, such complaints can also be made by or stimulated by competitors. These complaints can tarnish a retailer's otherwise sterling reputation in the marketplace, so the retailer almost certainly will require services of outside counsel. Not fun.

Reasonableness of the Fee

As an example, regarding inspection fees associated with inspections of the subject property, if the insurer requires an inspection, the retailer can charge a reasonable markup over the actual cost of the inspection. Charging the insurance buyer \$1,000 for an inspection that cost \$125 would be way off the mark. As a broker one should charge an amount you would consider to be reasonable if you were paying it.

Some states may claim that there is a going "market rate" for inspections. That is not always true, but a reasonable "markup" should be in order. That markup may be somewhat higher if we are talking about cat-prone risks or other risks requiring a greater degree of underwriting. Applying common sense to such charges goes a long way.

If the retailer pushes the envelope on charging unreasonably excessive fees, that eventually will come to the attention of insurance regulators.

Remediation of a compliance issue will cost a lot more to fix than the value of the inspection or similar fees, plus the retailer will also have to refund those amounts.

The retailer typically is not directly placing complex risks. Instead, retailers turn to wholesale brokers for market access and underwriting expertise.

Wholesaler Fees

Where retailers are not equipped to vet a specialty risk, they turn to wholesale brokers. The wholesaler is a specialist that knows how to package a risk so that it is suitable for insurance underwriters.

Generally, the wholesaler does the bulk of the work to ensure that underwriters are provided with the appropriate information. And wholesalers are entitled to charge a wholesale broker fee for their underwriting efforts as well as access to insurance markets likely to entertain the risk.

The retailer is primarily responsible for disclosure to the insurance buyer of wholesaler fees and charges. But, if the retailer fails to properly disclose, the wholesaler may be at risk for the retailer's failure to disclose. In practice, most states are satisfied if the wholesaler fully discloses its fees and charges to the retailer. *See, e.g., California Insurance Code Section 1623.*

There are few constraints on wholesale broker fees so long as they are not outrageous. But if the wholesaler charges exorbitant fees, it likely will lose retailer clients to the competition.

In conclusion, lest you not be misled, states have varying regulations concerning broker and related fees. They also

vary on whether these fees are subject to premium tax. States also have differing regulations regarding stamping office fees and whether these also are subject to premium tax. **■**

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U.S. Specialty Insurance Company
13403 Northwest Freeway
Houston, TX 77040

The above company has made application to the Division of Insurance to amend their Foreign Company License to transact Property and Casualty Insurance in the Commonwealth of Massachusetts.

Any person having any information regarding the company which relates to its suitability for the license or authority the applicant has requested is asked to notify the Division by personal letter to the Commissioner of Insurance, 1000 Washington Street, Suite 810, Boston, MA 02118-6200, Attn: Financial Surveillance and Company Licensing within 14 days of the date of this notice.

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