



Premium Financing Compensation Disclosures: Are You in Compliance?

Failing to disclose could lead to lawsuits

By Mark B. Robinson

Many insurance brokers and agents who perform services for premium finance companies may unwittingly violate certain disclosure requirements under the *California Insurance Code* because they are unaware that the obligations exist. In an era of movement towards transparency of compensation received from insurers and customers by brokers and agents, it is imperative for brokers and agents not to forget to disclose compensation received from premium finance companies. Currently, only about 5 percent of brokers provide this disclosure to their customers.

Under the *California Insurance Code §778.2*, brokers and agents are required to disclose to their customers any compensation to be received from a premium finance company for arranging, directing or performing services in connection with the premium finance agreement.

Although often overlooked, the compliance requirements under California law should not be ignored by insurance professionals whose livelihood in part depends on remaining current with the ever-changing laws. Failure to comply with *§778.2* may result in serious consequences for brokers and agents. In addition to potentially losing a valuable customer, the state may issue regulatory sanctions, and brokers and agents could face significant civil liability.

Recently, a class action lawsuit was filed in California against a broker and national premium finance company for violating this very premium financing compensation disclosure requirement. The potential civil exposure includes restitution of all compensation received from premium finance companies, attorney's fees and costs.

Insurance Premium Financing

Insurance premium financing is the advancement of money to an insurer, broker or agent at the request of an insured pursuant to the terms of a premium finance company. In most instances, the insured has assigned the unearned premiums, accrued dividends or loss payments to the premium finance company as security for the

advancement of the premium. In the event of a cancellation, the unearned premiums are paid directly to the premium finance company to pay off the loan balance with the insured.

Insurance premium financing is an important tool available to brokers and agents to assist their customers with paying substantial insurance premiums. The premium finance industry is competitive, and many premium finance companies offer significant monetary incentives to brokers and agents to place financed business with them. The compensation received by brokers and agents may be based on a number of factors, such as the amount the broker or agent can charge his or her customer above the minimum annual percentage rate charged by the premium finance company, the volume of business placed and the default rates of the customers.

The compensation received from premium finance companies may reach hundreds of thousands of dollars on an annual basis. Accordingly, it is imperative that brokers and agents disclose the compensation they will receive to avoid certain liability.

Disclosure Requirements

While the disclosure requirements may seem simple on the surface, broker-agents must remain consistent with the practice of disclosing the compensation received from the premium finance company.

Under *California Insurance Code §778.2*, any broker or agent who participates in the arrangement of a premium finance agreement shall, if he or she accepts compensation for arranging, directly or performing services in connection with the premium finance agreement, disclose to the customer the amount of compensation to be received from the premium finance company.

The California Department of Insurance has created a list of disclosure requirements. Specifically, brokers and agents must disclose the following:

1. name of the insured;
2. list of financed policies and amounts of premium financed on each policy;
3. the name and address of the premium finance company;
4. the gross finance charges for financing the premiums; and
5. the total compensation to be received by the broker or agent from the premium finance company for arranging the premium financing.

The code also requires that the broker and agent maintain for a period of three years a list of customer accounts where the broker or agent accepted compensation, and the amounts of such compensation. The disclosure must be made every time a broker or agent receives

compensation from a premium finance company for arranging insurance financing.

The disclosure of the compensation by brokers and agents to the customer must be made prior to the execution of the premium finance agreement, either on a form adopted by the California Insurance Commissioner or within the premium finance agreement or other document, so long as it contains all of the information required by the Insurance Commissioner. (See *California Code of Regulations* Title 10, §2185.) Many premium finance companies have the ability to provide the required disclosure on the premium finance agreement.

Compliance with Section 778 is required by state law and should not be overlooked by the insurance professional.

Mark B. Robinson is founding partner at Michelman & Robinson LLP, where he focuses on insurance regulatory and corporate transactions. E-mail: mrobinson@mrlip.com.