FLORIDA'S ANTI-REBATING LAW

BACKGROUND & DEVELOPMENT

Early History

Insurance rebates, often referred to as "side deals", "kickbacks" or "back-end payoffs"; are thought by many to be unethical and, except in the instances enumerated herein, are illegal inducements to purchase an insurance policy specifically prohibited by most state statutes.

In general, rebating occurs when an insurance producer (agent), acting on behalf of an insurer, gives part of the commission, or some other thing of value, to an applicant in exchange for the purchase of insurance; or, when an insurer makes a deduction from the stipulated, state approved premium to induce such purchase. Typically, rebating involves an agent discounting the initial premium via a back-end return of a portion of the sales payment which was already contemplated in the approval of the premium for the insurance policy by the state regulatory authority.

Rebating was widely practiced in the late 19th and early 20th century. In those early days it was not uncommon for rebates to be in the amount of 50 percent or more of the first year premium, while other buyers received no discount when purchasing the same product. With life insurance, cash values often locked-in the future payments to the original producer. In other lines, restrictive and often anti-competitive side contracts could be drafted to require renewals with the same agent for a number of years going forward. Enforcement was left to civil courts.

It's recognized that the expansive growth of life insurance was attributed in part to high pressure sales, deceptive policies, and very high agent commissions--all created by the overutilization of rebating. As time passed, many of the same practices began to infiltrate the property and casualty field, which held its own unique opportunities for abuse and which preceded life insurance in the American colonies by many decades.

Eventually, policyholders who did not receive a rebate realized that if an agent could afford to rebate so much, then the policy was not worth as much as they paid. Setting aside the obvious regulatory problems inherent in policies with rates that are "prior approved", some policyholders concluded the obvious: their premiums were subsidizing the rebates bestowed to others. This meant, in essence, rebates were unfairly discriminatory from an actuarial standpoint. And, thus the practice was acknowledged as an evil that threatened the integrity of the insurance business generally.

Consequently, insurance regulators, acting in the public interest, independently began to prohibit the practice on a state-by-state basis.

The nearly universal means of prohibiting rebating is by use of state statutes enforced by each individual states regulatory agency. In Florida this is the Office of Insurance Regulation (OIR)

which regulates insurance carriers and approves their policy forms and premiums, and/or; the Department of Financial Services (DFS) which has specific authority over the activities of insurance agents.

It's important to note that such laws were often enacted during a time when antitrust laws were emerging. These laws, like rebating laws, were designed to protect smaller companies and agencies from insolvency and predatory practices of larger entities; prevent unfair discrimination between applicants; protect consumers from exorbitant rates; prohibit misrepresentation and unfair sales practices; and avoid a concentration of business in the hands of a few.

In a 1996 legal opinion from the Attorney General of Alaska, it was opined that anti-rebating statutes, particularly those based on the NAIC model (like Florida's), were constitutional in part because they provided basic consumer and commerce protections. In addition to stating that... ***rebating can result in unanticipated negative consequences to the general public, including, at a minimum, a torrent of sharp business practices by producers...***the AG's opinion also provides an enumeration of specific problems rebating creates for the sale of insurance products:

1. The desire for rebates may lead consumers to buy new or replacement policies year after year, resulting in an adverse impact to the solvency of insurance companies
2. Rebates may result in consumers going to other states to make large insurance purchases, resulting in regulatory oversight and enforcement problems
3. Unrestricted rebating keeps prices hidden and unavailable to government monitoring for discrimination
4. Rebating will jeopardize the livelihood of a small town producer, opening the door to concentration of business by the big players and monopolistic practices.
5. Rebating will result in a de-emphasis on producer advice and service, to the detriment of consumers
6. Insurers will experience adverse selection and increased costs, when unhealthy insured's cannot switch companies to get rebates
7. Rebates will result in an increased number of policy lapses with attendant increased costs for everyone
8. Rebates will result in increased unfair discrimination among policyholders, particularly those with little or no economic leverage
9. Rebates will render ineffective some cost disclosure requirement which are considered a fundamental protection device
10. With respect to cash value policies, rebates will diminish investment capital because consumers will replace policies to obtain rebates rather than allow them to stay on the books to accumulate cash value
11. Rebates will result in policies being cancelled short rate or with penalties, in order to obtain a rebate that may be net, only slightly better. This churning of business mid-term is costly and disruptive to consumers in the long term
12. Rebates will result in undue emphasis on price over coverage and protection.

It should be noted that regulation of the insurance industry is strictly the responsibility of the states. In 1945, Congress formally recognized the long-standing existence of state regulation as opposed to the federal government through a broad delegation of regulatory authority via the McCarran-Ferguson Act.

However, as stated above, anti-rebating laws have been around for over a century, with the first such laws being enacted in Massachusetts in 1887. Three years later, ten states had adopted similar laws. Florida passed its prohibition in 1915 and by 1945, when the McCarran-Ferguson Act was passed, all then existing states had a prohibition against rebating. In most instances, as in Florida, the laws enacted prior to 1945 were amended to mirror the model act established by the National Association of Insurance Commissioners (NAIC).

Florida's Law

Today, with the exception of Florida and California, all states continue to prohibit rebating. In 1988 California's law was repealed by a voter initiative (Prop 103) which rolled back auto insurance premiums and which also repealed the bank-insurance prohibition among other things.

In 1984 the Dade County Court of Appeals struck down Florida's anti-rebating statute stating it violated the due process clause of the Florida constitution. In 1977 a licensed Florida insurance agent named Joseph Blumenthal, had sued the Florida Department of Insurance (DOI/OIR), arguing the statute prevented him from competing.

The lower court held against Blumenthal who died during the appeal. In May of 1983, Walter Dartland, Director of the Dade County Consumer Advocates Office, picked up the case, losing on summary judgment in the lower court but prevailing when the First District Court of Appeals overturned the decision.

However, the 1st DCA had not ruled that rebating was not worthy of regulation, only that the existing statute, prohibiting the practice across the board, was unconstitutional. In fact, Florida lawmakers had revisited the issue during the 1982 sunset of the insurance code and affirmatively re-enacted the existing prohibition. Consequently, during the 1990 session lawmakers again acted to severely restrict the practice by codifying what constituted "legal" rebating, as follows:

1. Rebating; when allowed (§626.572)

No agent shall rebate any portion of his/her commission except as follows:

A. the rebate shall be available to all insureds in the same actuarial class;
B. the rebate shall be in accordance with a rebating schedule filed by the agent with the insurer issuing the policy to which the rebate applies;
C. the rebate schedule shall be uniformly applied in that all insureds who purchase the same policy through the agent for the same amount of insurance receive the same percentage rebate;

D. rebates shall not be given to an insured with respect to a policy purchased from an insurer that prohibits its agents from rebating commissions;
E. the rebate schedule is prominently displayed in public view in the agent's place of business and a copy is available to insureds on request at no charge;
F. the age, sex, place of residence, race, nationality, ethnic origin, marital status, or occupation of the insured or location of the risk is not utilized in determining the percentage of the rebate or whether a rebate is available.

The agent shall maintain a copy of all rebate schedules and their effective dates for the most recent five years. No rebate shall be withheld or limited in amount based on factors which are unfairly discriminatory. No rebate shall be given which is not reflected on the rebate schedule. No rebate shall be refused or granted based upon the purchase or failure of the insured or applicant to purchase collateral business.

Conclusion

Due to the detailed statutory requirements and the inherent system-wide problems with the practice, most Florida carriers (including state residual markets) do not allow rebating and, with the exception of flood insurance sold under the National Flood Insurance Program (NFIP), very little rebating occurs.

There is no approved approach or set of specific guidelines for rebating. Except for a clarification that the "actuarial class" as described in item "A." above is best determined by the carrier, regulatory inquiries for guidance on rebating having consistently proved fruitless.

Financial models regarding the practice are not available at the agency or carrier levels either; and, the implications of eliminating rebating once it has been undertaken are unknown; assuming such can be done. Agents considering the practice of rebating are cautioned to move carefully, seek the advice of an attorney qualified in such matters and to consider both the implications to the business of insurance and the future fiscal well being of their agency.

THE FLORIDA ASSOCIATION OF INSURANCE AGENTS