STATE OF TENNESSEE
DEPARTMENT OF COMMERCE AND INSURANCE
Insurance Division
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Nashville, Tennessee 37243
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August 22, 2005

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RE: Interpretive Opinion No. 03-05
Monthly Premium Audit Services

Dear Mr. Ledyard,

Please allow this letter to respond to your letter to Michael Shinnick dated November 29, 2004. Your letter is being treated as a request for an interpretive opinion from the Insurance Division of the Tennessee Department of Commerce and Insurance ("Division") pursuant to Tenn. Comp. R. & Regs. Tit. Dept of Commerce and Ins., ch. 0780-1-77-.01(1).

The facts as understood by the Division are as follows:

Your client, The Sheffield Group, Inc. ("Sheffield Group"), performs services as a general agent for certain insurance companies issuing workers' compensation coverage to employers in this state ("Companies"). As part of the general agency agreement with the Companies, Sheffield Group agrees to be the general agent for the purposes of "producing, underwriting, and servicing on behalf of workers' compensation and employers liability insurance." Included in Sheffield Group's responsibilities under the agency contract is the auditing of workers' compensation insurance policies. This function is typically performed at the end of the policy year by Sheffield Group for the Companies.

Sheffield Group wishes to enter into an Employer Participation Agreement ("Participation Agreement") with employers that purchase workers' compensation insurance. The Participation Agreement would give the employer the option of either paying a lump sum estimated annual premium or allow for the employer to

be audited under the policy on a monthly basis to determine the amount of premium due. If the employer chooses the monthly audit program, the employer must pay an additional fee of ten dollars ($10) per month to Sheffield Group. The additional fee is paid directly to Sheffield Group and does not go to any of the Companies.

The fees collected by Sheffield Group from its audit program are not included in the rate filings made by the Companies.

You opine on behalf of your client that the above actions do not require the Companies to include the ten dollar ($10) fee in their rate filings because Sheffield Group is entering into these Participation Agreements as an agent of the employer and not of the Companies.

RESPONSE:

Tenn. Code Ann. § 56-5-306 requires commercial risk insurers to file "all rates, supplementary rate information, policy forms and endorsements not later than fifteen (15) days after the effective date." Tenn. Code Ann. § 56-5-302(10) defines "supplementary rate information" as "any manual or plan of rates, classification, rating schedule, minimum premium, policy fee, rating rule, and any similar other information needed to determine the applicable rate." It is the opinion of the Insurance Division that the charges collected by Sheffield Group in connection with the audit program are policy fees that fall within the definition of "supplementary rate information," and, therefore, should be filed with the Division.

In applying the above statutes to the facts presented, the Department's Bulletin dated January 8, 1998 ("Bulletin") provides relevant guidance. The Department, through the Bulletin, sets forth its opinion that Tenn. Code Ann. §§ 56-5-301, *et seq.*, requires that all charges and costs incurred by the insured in connection with the purchase of a policy of insurance to be included in the insurer's rate filing. Additionally through the Bulletin, the Department also sets forth three (3) factors to use in determining whether a fee is charged in connection with the sale, solicitation, or negotiation of a policy of insurance, and thus, must be included in the insurer's rate filing.

The first factor enumerated in the Bulletin is "[w]hether the services performed by the agent are associated with the sale, underwriting, issuance, or servicing of a policy of insurance." It cannot reasonably be disputed that the audit services performed by Sheffield Group are being performed as a part of the servicing of the workers' compensation policies sold through Sheffield Group. Sheffield Group is obligated to determine the employer's premium based on the Companies' underwriting guidelines, and the Companies' willingness to accept the audit results of Sheffield Group solely relate to Sheffield Group's capacity as general agent of the Companies. Sheffield Group's performance of this audit function on a monthly basis does not affect the conclusion that audit services are related to the servicing of a policy of insurance, and, therefore, satisfies the first factor.

The second factor is "[w]hether compensation is dependent upon the purchase of a policy of insurance." Again, the ability of the employer to enter into the Participation Agreement is dependent solely on the employer's decision to purchase a workers' compensation policy from one of the Companies. Absent the purchase from one of the Companies, Sheffield Group's willingness to audit the insurance policy is without any value as no other company would likely be willing to accept the audit findings of Sheffield Group. Therefore, the second factor exists in the facts you have presented.

The third factor is "[t]he date of payment of the fee in relation to the date a policy of insurance was issued." The Participation Agreement requires an employer to pay an advance premium and thereafter pay when invoiced by Sheffield Group around the first day of each month. Although, the audit fee is not being paid by the employer on the date the policy is issued, the audit fee is being paid on an installment basis. The audit fee is tied to determination of the amount of premium that the employer must pay each installment to continue their workers' compensation coverage. This factor is less relevant as the services being provided are related to the continuous servicing of the insurance policy, as opposed to the initial sale.

Analyzing the Participation Agreement through the Department's historic interpretation of Tenn. Code Ann. §§ 56-5-301, *et seq.*, and the three (3) factors enumerated in the Bulletin, it becomes clear that the monthly audit services proposed by Sheffield Group are services that generate a fee connected with the sale, solicitation, or negotiation of a policy of insurance, and falls within the definition of "supplementary rate information" in Tenn. Code Ann. § 56-5-302(10).

In support of your contrary conclusion, you make several points which the Division shall address. One contention you have advanced is that the monthly audit fee is not a rate because it is not being charged by the Companies. You further state that Sheffield Group is charging this fee as an agent for the policyholder and not the Companies. You cite *Ebbtide Corporation v. The Travelers Insurance Company, et al.*, 2001 Tenn. App. Lexis 5582001 (July 31, 2001), in support of your argument that Tennessee law would recognize Sheffield Group as a broker of the insurance company as opposed to an agent of the Companies. The facts presented, however, are easily distinguishable with *Ebbtide*. In *Ebbtide*, Willis Coroon had no contractual agency relationship with the Travelers. In the facts presented, Sheffield Group is a general agent of the Companies and has agency agreements with the Companies. Unlike in *Ebbtide*, should the Companies send information to Sheffield Group, the law would not view that as the equivalent of sending it to the employers that receive their workers' compensation coverage through the Companies.

You also point out that the Companies do not direct Sheffield Group to provide the monthly audit service to its policyholders, nor are the Companies a party to the Participation Agreement. It is worth noting that the Bulletin does not discuss as a factor the existence of any action on the part of the agent's insurance company or even knowledge of the company of the fee being charged. This is because the law would treat the actions of the company's agent as the

actions of the company itself. The Division does not believe that the insurance company must have actual awareness of the fee in order to have the fee considered as part of the insurance company's rates. Insurance companies are responsible for the actions of their agents and if their agent, such as Sheffield Group, charge a fee which meets the definition of a rate in this State, then the insurance company is responsible for including that fee in its rate filings and to also pay all appropriate taxes on it. Again, while the Companies are not parties to the Participation Agreement, the Companies are parties to the agent contracts with Sheffield Group, and Sheffield Group in performing audits on the Companies' policyholder is an agent of the Companies. In addition, the Companies show their tacit approval of the Participation Agreement by allowing those employers that agree to the monthly audit to pay their premiums on a monthly basis.

Although Sheffield Group states that the Companies are not a party to the Agreement and does not direct Sheffield Group to perform these audit services, the fact remains that the Companies receive a benefit when an employer chooses the audit program over the lump sum payment. Sheffield Group is performing a service beneficial to the Companies, even though the Companies are not receiving any portion of the additional fee paid by the employer for the audit program. The Companies, through Sheffield Group, are able to more closely monitor the activities of the employer and more frequently adjust the premiums due from the employer. This enables the Companies to avoid the hassles of attempting to collect a large amount of additional premium after the yearly audit has been performed.

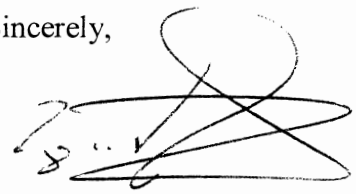
In many ways, the monthly audit service is analogous to providing policyholders the ability to have their premiums taken through electronic fund transfers. The Division has long held that such was appropriate, but if the insurance company wanted to charge a fee for doing so, the company had to file the fee in its rate filing and pay taxes on it. While there may be benefits of convenience to the policyholder to be able to pay their premium in this way, the insurance company also receives some obvious benefit of ensuring prompt payment of the premium. If the fee was not being charged by the insurer, itself, but instead by an agent for the insurer, the Division would still consider the charge or fee to be a rate and need to be accounted as such under Tennessee law.

Also of note is the fact that Sheffield Group can only offer its monthly audit services to employers that purchase coverage from carriers with which Sheffield Group has a general agent agreement. Additionally, should an employer choose not to have its premium audited monthly, Sheffield Group will perform the audit on a yearly basis. Such facts are counter to the argument that the monthly audit services are done as the agent of the employer as opposed to the carriers.

In conclusion, it is the opinion of the Insurance Division that the audit fees charged by Sheffield Group should be included in the rate filing made by the Companies. The Companies should also ensure that they are paying premium taxes on these fees.

This response by the Insurance Division to a specific fact situation relating to the interpretation of the Tennessee Insurance Law should not be construed as a legal position or opinion of the Commissioner of Commerce and Insurance or any other official in the Department of Commerce and Insurance. As each inquiry is reviewed on the specific facts presented, this response is based only on such facts and may not be used as precedent. Any variation in the facts presented to the Insurance Division could result in a different conclusion as asserted herein.

Sincerely,



Larry C. Knight, Jr.
Assistant Commissioner for Insurance

LCK/jfm
cc: Paula A. Flowers, Commissioner
John F. Morris, Chief Counsel for Insurance
Coit C. Holbrook, Director, Actuarial Services Section