DIFS
DEPARTMENT OF INSURANCE AND FINANCIAL SERVICES

Market Conduct Agency Audit News

Office of Insurance Licensing and Market Conduct

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Introduction

This Market Conduct Agency Audit News is written to provide useful information on common questions and issues that have been noted throughout the year. This newsletter contains the following topics:

- Reasonable Accounting and Segregation of Duties
- One Tip for Handling Premium Refunds
- Discussion About Fee Requirements
- Reminders for Surplus Lines Producers
- Valuable DIFS Information Links

Reasonable Accounting and Segregation of Duties

Insurance agencies are considered trustees with fiduciary responsibilities when receiving and disbursing insurance premiums on behalf of their clients. The Michigan Insurance Code (the Code), Section 1207(2) requires licensees to “use reasonable accounting methods to record funds received in his or her fiduciary capacity including the receipt and distribution of all premiums due each of his or her insurers.” Many insurance agencies transact high volumes of agency-billed premium, especially property and casualty agencies. While billing practices are moving to direct-bill, the need for good accounting practices remains paramount for all agencies.

A good accounting system improves agency operations and accountability. When agencies have insurance premiums, commissions, and operating funds flow through the bank on a daily basis, a reasonable level of segregation of duties contributes to the effective handling of insurance premiums and helps business owners ensure operating funds are properly safeguarded. The common denominator among agencies where employee embezzlement has occurred is the lack of segregation of duties. For example, one employee handles premiums from the beginning to the end, including taking customer payments, making deposits, recording transactions, writing checks to carriers and other vendors.

Segregation of duties is a preventive and detective accounting control. The division of responsibilities among several employees increases the chance of detection of accounting errors and it is a form of risk management that can help guard agents and agencies against risks due to fraud.

Small businesses may lack resources to segregate critical accounting functions, however, they can follow a few simple rules for separating duties to help reduce the exposure to fraud and errors:

- One key aspect of an internal control system is setting the right tone at the top in terms of compliance and fraud prevention.
- Independent verification and management oversight becomes even more critical for small agencies. This alone can serve as deterrence.
- The person who maintains and reconciles the accounting records should not obtain custody of premium funds.
- The person who prepares a listing of premiums received does not make the deposit and does not maintain the accounts receivable accounting records.

One Tip for Handling Premium Refunds

A common audit finding in the past year pertains to premium refunds. Our audits discovered some agencies failed to refund unearned premiums in a timely manner or failed to refund them at all. From the auditor's perspective, this noncompliant activity is partially attributable to an agency's lack of sufficient accounting procedures and controls to address the return premium handling process.

Policy cancellations or final audits usually generate unearned premiums to be refunded to the policyholder. When an insurance agency gets involved in the reimbursement process, it is typically responsible for two transactions: 1) receiving net unearned premiums from carriers or general agencies, and 2) refunding gross unearned premium to the insured and/or the finance company after adding the unearned commission to the amount to be refunded. Due to the complexity of these transactions, it is imperative for an agency to maintain accounting records that will ensure the fiduciary funds are properly and effectively accounted for.

One quick tip to improve the refund process is periodic review of client account balances. Many agencies use an agency management system which has the capability to track client transactions and generate an accounts receivable report or a customer transaction report. Regular review of the account balances on these reports will help an agency detect outstanding refunds owed to clients. This practice also works for small agencies that rely heavily on manual recordings without a sophisticated system in place. Notably, a system is not the key control to make the premium refund process effective. The bottom line is the need for licensee awareness of their fiduciary duty to properly handle unearned premiums and to ensure adequate controls are in place.

Discussion About Fee Requirements

In accordance with Chapter 19 of the Code, only surplus lines agencies/agents may charge insureds a $50 fee, for selling, soliciting, and negotiating surplus lines insurance. The fee cap is adjusted annually with the consumer price index and published in DIFS annual surplus lines bulletin. The current surplus lines fee cap is $62 as provided in the bulletin via the link: https://www.michigan.gov/-/media/Project/Websites/difs/Bulletins/2019/Bulletin_2019-08-INS.pdf.

During the year we received many inquiries regarding fees. The audits conducted also discovered a few scenarios where an agency charged excessive fees. The following Q&As address common issues with regards to agency fees.

Q1: May an insurance producer charge a fee to the insured for policies placed in the admitted market?

A: No. Insurance producers in Michigan get compensated by their carriers with commission payments. No additional fees can be charged to the insureds for providing administrative services. For example, a producer is not allowed to charge a processing fee for collecting premiums via credit card.

Q2: If multiple surplus lines producers are involved in a surplus lines transaction, can each producer assess a fee not exceeding the statutory limit?

A: No. The fee threshold (currently $61) applies to the whole transaction. The total fee charged by all involved surplus lines producers cannot exceed the fee allowed by statute.

Q3: Can a surplus lines producer charge a fee to the insured when a third-party inspection company charges an inspection fee?

A: Yes, if the additional fee complies with the statutory requirement. For example, if the inspection company bills the producer $100 for conducting an inspection, the producer can pass on the inspection fee by billing the policyholder for the $100 inspection fee plus the $61 threshold fee. At the same time, the producer must list the $100 as "inspection fee" and the $61 fee as separate line items on the invoice. The producer can keep the $61 fee and forward the $100 fee to the inspection company.

Reminders for Surplus Lines Producers

Reminder 1: Except for policyholder filings, all surplus lines tax filings and payments are required to go through the NAIC OPTins system. Occasionally, we encountered cases where a licensee accidently makes a duplicate or incorrect payment in OPTins. When you make an entry error, you must contact the OPTins team prior to 4:00 pm Eastern Time on the same day so they can issue a stop payment on the erroneous transaction. The OPTins Help Desk can be reached at (816) 842-3600.

Reminder 2: We will continue to issue reminder and past due notices to our licensees two weeks before and six weeks after each semiannual filing deadline, respectively. See the schedule below for upcoming filing dates.

Semiannual Filing Period	Filing Due Date	Reminder Notice	Past Due Notice
2018-1st	8/15/2018	7/31/2018	9/28/2018
2018-2nd	2/15/2019	1/31/2019	3/29/2019
2019-1st	8/15/2019	7/31/2019	9/30/2019
2019-2nd	2/15/2020	1/31/2020	3/31/2020

A DRLP (Designated Responsible Licensed Producer) is responsible for an insurance agency's compliance with state insurance laws, rules and regulations according to MCL 500.1205(2)(b) of the Code. When you are a DRLP, you will get the same reminder and past due notices issued to the agency.

Valuable DIFS Information Links

To check an agency's DRLP, simply use the Insurance Agency Locator via the following link: https://difs.state.mi.us/locators?searchtype=InsAgency. You can locate the DRLP information by expanding the "Individual Associations" section.

To view bulletins issued by DIFS, use the following link:
https://www.michigan.gov/difs/Legal/bulletins

To sign up to receive bulletins, Director's orders, or other updates from DIFS, use the following link and enter your email address:
https://public.govdelivery.com/accounts/MIDIFS/subscriber/new

A DRLP or agency owner can make electronic changes to an agency's record, such as address, email address, affiliations, and DRLP changes, on the Insurance Licensing Online System (ILOS) by using the following link:
https://www.michigan.gov/ilos

Questions regarding the content of this newsletter, or suggested topics for future newsletters may be directed to the DIFS Market Conduct Section, Agency Audit Unit at (877) 999-6442 or DIFS-MarketConduct@michigan.gov.