



Insurance Department

TODD E. KISER
Insurance Commissioner

State of Utah
GARY R. HERBERT
Governor

SPENCER J. COX
Lieutenant Governor

November 20, 2014

Thomas J. Welsh
Orrick, Herrington & Sutcliffe LLP
400 Capitol Mall Ste. #3000
Sacramento, CA 95814-4497

ALSO SENT BY EMAIL

EMAIL: tomwelsh@orrick.com

RE: Investigation #63777: Zenefits FTW Insurance Services
Response due: **December 4, 2014**

Dear Mr. Welsh:

This letter is to inform you that the Utah Insurance Department has completed its investigation of Zenefits FTW Insurance Services (Zenefits). Based upon the investigation, the Department has found that the following Utah insurance laws apply:

31A-1-301. Definitions.

(145)(a) "Rebate" means a licensee paying, allowing, giving, or offering to pay, allow, or give, directly or indirectly:

(ii) a refund of commission or portion of commission.

(iv) providing services or other benefits not specified in an insurance or annuity contract.

31A-23a-402.5. Inducements.

(1)(a) Except as provided in Subsection (2), a producer, consultant, or other licensee under this title, or an officer or employee of a licensee, may not induce a person to enter into, continue, or terminate an insurance contract by offering a benefit that is not:

(i) specified in the insurance contract; or

(ii) directly related to the insurance contract.

(b) engaging in one or more of the following unless a fee is paid in accordance with Subsection (8):

(v) providing job descriptions, postings, and applications for a

person;...(vi) providing payroll services;...(vii) providing performance reviews or

performance review training;...(ix) providing accounting services;...(x) providing data analysis information technology programs, except as provided in Subsection (4)(h)(ii);...(xi) providing administration of health reimbursement accounts or health savings accounts

(5) An inducement prohibited under Subsection (1) includes a producer, consultant, or other licensee, or an officer or employee of a licensee: (a)(i) providing a rebate;

(8) If as provided under Subsection (5)(b) a producer, consultant, or other licensee is paid a fee to provide an item listed in Subsection (5)(b), the licensee shall comply with Subsection 31A-23a-501(2) in charging the fee, except that the fee paid for the item shall equal or exceed the fair market value of the item.

(9) For purposes of this section, "fair market value" is determined on the basis of what an individual insured or policyholder would pay on the open market for that item.

R590-154-11. Electronic Platform and Application Systems

Producers or agencies may provide electronic platforms that provide directly related services of the insurance products to the employer. Fair market value must be charged for items such as human resources and legal services whether electronic or paper.

31A-23a-402. Unfair marketing practices -- Communication -- Unfair discrimination -- Coercion or intimidation -- Restriction on choice.

(1)(a)(i) Any of the following may not make or cause to be made any communication that contains false or misleading information, relating to an insurance product or contract, any insurer, or any licensee under this title, including information that is false or misleading because it is incomplete: (A) a person who is or should be licensed under this title

Based on its investigation, the Department has determined that Zenefits has violated the above referenced Utah insurance laws as follows:

1. Zenefits' offering of up-front, free-to-all, HR benefits violates Utah's insurance inducement and indirect rebating laws. By providing a few up-front and free-to-all HR services for customers who create a free account on its electronic platform, Zenefits, in effect, offer violating inducements and indirect rebates for customers to subsequently either purchase an insurance contract, renew an insurance contract, or terminate an insurance contract through Zenefits. The up-front and free-to-all HR services are neither part of the insurance contract nor directly related to the insurance contract. Also, even if free-to-all, the up-front HR services offered to those account customers who eventually purchase, renew or terminate and transfer insurance contracts through Zenefits, are still violating inducements and indirect rebates as to those insurance customers.

2. Zenefits' providing free software use of its electronic platform and dashboard violates Utah's inducement and indirect rebate insurance laws. By Zenefits offering clients the free use of its electronic platform and dashboard, by which employers can control and coordinate payroll functions and manage tax-related elections; generate tax forms; access FSA, HSA, and HRA accounts; and administer 401k retirement savings plans and stock options; Zenefits has created a significant free inducement for clients to purchase insurance products through Zenefits. This software use is neither part of the insurance contract nor directly related to the insurance contract. Also, Zenefits connecting of the various HR benefits and insurance together creates advantages for customers to have a single internet access site to manage all HR and insurance needs; however, again, because Zenefits does all of this for free, it creates an violating inducement and indirect rebate for clients to purchase insurance through Zenefits.

3. Zenefits' up-front free importing, storing and subsequent use of the electronic employee data violates Utah's inducement and indirect rebating insurance laws. As part of setting up the free initial Zenefits account, Zenefits requires that account customers allow Zenefits to import the customers' electronic employee data. That up-front, required and free importing and storing of the customers electronic employee data is then subsequently used by Zenefits as an additional inducement for customers to buy insurance products, renew insurance products or terminate and transfer insurance products through Zenefits. This is because of the ease of using Zenefits already imported, stored and free electronic employee data in setting up the customer's employee insurance. Zenefits' up-front, free-to-all, HR services; its free software use, through its electronic platform and dashboard; its free imported, stored and subsequently used electronic employee data use; and other HR services and benefits, which are not part of, nor directly related to, the insurance contract are violating inducements and indirect rebates related to purchasing, renewing and terminating insurance through Zenefits.

4. Zenefits' advertising violates Utah insurance advertising laws. At the time the Department's investigation began, Zenefits advertised on their website, "Our technology allows us to operate profitably on insurance commissions alone, which allows us to keep Zenefits free." Zenefits now claims that the company operates profitably on the revenue share paid by the service providers in its system, allowing Zenefits to remain free to a customer. If this is indeed true, Zenefits has violated U.C.A. §31A-23a-402(1)(a) by making or causing to be made any communication that contains false or misleading information.

The following are additional considerations that support the Department's enforcement action taken in this matter:

1. The Department finds that selling health and other insurance products is Zenefits' major revenue component and therefore the most important part of the company's purpose. Also, the Department finds that Zenefits' business model is mainly driven by insurance commissions, not by the terms, conditions or benefits found in any insurance policy itself. For these reasons, as a licensed insurance broker, Zenefits solicits account clients to purchase insurance products and, in the end, uses insurance commissions to pay for and cover the costs of (a) up-front, free-to-all, HR services; (b) free electronic platform software use; (c) free importing, storing and use of electronic employee data; and (d) other free HR services and benefits. Also, not only do these insurance business practices violate Utah insurance laws, but they also do not meet the financial solidity purpose of the insurance market where unearned commissions are, in the end, used to pay for these violating inducements and indirect rebates.

2. Concerning Utah's insurance public policy and State interest, the Utah Insurance Department has the important responsibility to maintain a fair, competitive insurance business environment for all licensees. Some of the main purposes of the Utah Insurance Code are to ensure not only that insurance consumers are protected and treated fairly, but that licensees are also treated fairly within a financially healthy and adequate insurance market that is not only characterized by innovation, but also by fair conditions of competition for all insurance licensees. See Utah Code Sec. 31A-1-102. For these reasons, Utah's specific unfair inducement and rebating laws are strongly enforced.

3. Utah's intent of prohibiting insurance inducements and rebating is to have all insurance business conducted free and independent of any other matter of any kind so that a person being solicited for insurance may enter into an insurance contract entirely upon the merits of the specific insurance contract presented. In support of this intent, Insurance Department Bulletin 2010-7 emphasizes that a licensee that provides a benefit that is not specified in an insurance contract offered to an insured or potential insured is a violation of state law. This includes offering benefits not specified in the insurance contract at no cost or at a cost below fair market value. Also explained is the fact that providing other value added services not specified in an insurance contract are also insurance violations.

4. Concerning its insurance underwriting and application services, the Department finds that Zenefits does not operate like other insurance producers. Unlike other insurance producers, Zenefits generates necessary underwriting and application employee information from Zenefits' already imported and stored electronic employee data, which was accessed and imported by Zenefits from the customer during the initial Zenefits account creation. This process effectively functions as a significant violating inducement for insurance customers to purchase insurance, renew insurance, or drop existing insurance and transfer to Zenefits.

If Zenefits has any additional facts or information that it feels has not been presented or fully considered by the Department in its investigation of this matter, please feel free to immediately provide it.

Based on the above points, it is the Market Conduct's determination that Zenefits FTW Insurance Services has violated the above referenced inducement and rebating laws, committed 10 violations and that, based on the number of violations committed, the penalty could be as high as \$5,000 per violation and twice the profit gained from those violations. We have identified that as of October 31, 2014, Zenefits has received commission profits in the amount of \$23,588.69 in the State of Utah.

Even though the assessed penalty could be \$97,000, in order to resolve this enforcement matter in a timely and cost efficient manner for all involved parties, the following settlement offer is extended:

1. Zenefits will be assessed a forfeiture in the amount of \$50,000.00 and 24 months of probation for violating the above referenced statutes.
2. A 24 month probationary period must be completed. The Department is willing to suspend the monetary penalty of twice the profit gained from the inducement and rebating violations if the following conditions are met:

- a. Zenefits must refrain from committing additional violations of Utah insurance laws.
 - b. Zenefits must submit a compliance plan to the Department, outlining the steps it will take to comply with Utah insurance statutes and rules. The compliance plan must include the fees it intends to charge clients in Utah and justify the fees under fair market value requirements.
 - c. Zenefits must submit a quarterly report to the Department detailing the number of Utah clients enrolled in Zenefits services and utilizing Zenefits as the Agent of Record.
3. Unless a fair market value fee is charged in accordance with §31A-23a-402.5(9), Zenefits will immediately discontinue providing or offering to provide a refund of all or a portion of commission in the form of free services or access to software that provides access to services that are prohibited under 31A-23a-402.5 or not directly related to the insurance contract.
 4. Zenefits will immediately discontinue advertising that its electronic platform is free and that insurance commissions cover the cost of the “free services.” Advertising includes, but is not limited, to all printed materials and all verbal discussions and presentations with customers and potential customers in the State of Utah. In all of its Utah advertisements, Zenefits must make it clear that the services are not free in the State of Utah.

The Department provides the option of the following two administrative processes for concluding this matter:

Stipulation and Order. The Department’s investigation and stipulated penalty is sent to the assigned Assistant Attorney General (“AAG”) representing the Department. The AAG prepares a stipulation, which includes the agreement to the findings and the imposition of the stipulated penalty amount. After both the AAG and you have signed the stipulation, it is submitted for review and signing by the Administrative Law Judge (“ALJ”). The order will be final and any right to an administrative hearing, review or appeal is waived. This administrative action in the form of a stipulation and order is reportable to other states and regulatory bodies.

Complaint and Hearing. The investigation and statutory supported penalty are sent to the AAG who initiates a formal adjudicative proceeding by issuing a formal complaint. The complaint alleges the violations outlined above and will seek the statutory supported penalty. You will be required to file a response to the complaint and appear at a pre-hearing. At that time, any necessary discovery will be scheduled and a date for the formal hearing will be set. A formal hearing will be held which will allow both parties to present their respective cases to the ALJ. After the formal hearing, the ALJ will prepare and issue an order based on the findings of fact and conclusions of law, based on the evidence received. The order will contain the penalty, if ordered, and will explain any appeal process. The final order is reportable to other states and regulatory bodies.

If you prefer to enter into a stipulation and order with the Department, or you have additional questions about these administrative procedure options, please respond by **December 4, 2014**. If no response is received by **December 4, 2014**, the Department will assume you do not wish to settle by stipulation and will request that the AAG initiate a formal adjudicative proceeding by filing a complaint as explained above.

If you have any questions about the options or the process please feel free to contact me at 801.538.3172 or by email at jchristian@utah.gov.

Sincerely,

TODD E. KISER
UTAH INSURANCE COMMISSIONER

A handwritten signature in cursive script that reads "Jen Christian".

By: Jen Christian, MCM, PIR
Market Conduct Examiner