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INSURANCE REGULATIONS AND ETHICS COURSE

1

PRINCIPLES AND PRACTICES

INTRODUCTION

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In the past the insurance industry as a whole has enjoyed unparalleled trust in our society. Many consumers had come to rely on their life insurance and health coverages as a basic foundation for their economic security. Many business owners would praise their whole life policies as "sinking fund" policies that came in handy during times of business slowdowns. Individuals would not feel fully protected without health insurance with low deductibles also. Protection from numerous perils with property damage insurance has given individuals a sense of peace about their property insurance. Finally, casualty insurance has provided needed protection against possible lawsuits. Yes, insurance and its huge industry enjoyed a stellar reputation.

Then, things began to change during the mid 1970's. Low

paying interest whole life was attacked and gaps in the health insurance programs became scrutinized. Health maintenance organizations and universal life products appeared on the

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horizon. For the first time, the insurance industry was been questioned on their business acumen. It did not become too difficult to predict that the industry's agents would next become the focal point of evaluation.

The person who provides the valuable protection of both life & health and property & casualty insurance becomes a trusted advisor. The insurance professional becomes the individual who is suppose to evaluate the clients needs and thus, match those needs with the various products available in the marketplace. Of course, the ultimate goal is to be sure the clients objectives are met.

Millions of clients rely on the professionalism of such agents. Successful execution by the insurance professional also aides society. Society benefits as families receive funds to cover the basic needs of survival. Also, society as a whole benefits as funds are received to cover more than basic needs. Needs such as educational funds or the preservation of a business are also imperative in today's world.

Obviously, the recognition of such benefits has permitted the insurance industry to prosper. However, because of such growth, increased demands for professionalism by those who engage in the sale of insurance has risen tremendously.

Throughout this course we will examine five major areas:

1. Understanding the meaning of ethics.
2. Ethical responsibility agents have to the insurance industry.

3. The responsibility an agent has to himself/herself and to the insurance profession.
4. Ethical responsibility that agents have to policy-owners.

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5. Ethical responsibility that agents have to the public.

UNDERSTANDING ETHICS

Probably one of the first rules most of us are taught is "do unto others as you would have them do unto you." This *golden rule*, whether taught by a parent, teacher or religious leader, is a cornerstone for many as it serves as a practical guide to everyday life.

As insurance professionals deal with the public, the golden rule takes on more than a philosophical meaning. The *practical* level of such a statement applies to the basic code of ethics that agents must use not only in their personal lives, but also, in their daily responsibilities in their business dealings.

Many believe that social behavior that favors the group over the individual should be emphasized. But there are four basic obstacles that must be dealt within order to act ethically.

One. The primary obstacle has to do with concern for self versus others. This obstacle could prevent the individual from looking out for the "common good" of society, as opposed to making a decision purely on the individual's own happiness and welfare. From an insurance standpoint, this means that *agents should put the interests of their clients ahead of their own good.*

Two. The second obstacle relates to the intuition versus

rationalism obstacle. While some philosophers believe that humans intuitively know what is right, others tell us we must use pure reason to uncover what is right. The problem in the insurance industry is "does one have a ready excuse for improper behavior because he/she did not know the rules"? In order to apply *reason* in the insurance profession, we must know the rules! One realizes the importance of proper training when this precept is used. However, realistically

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speaking, even without proper training, if something doesn't "feel right," it probably is not right, and the action should be avoided.

Three. The third obstacle pits absolutism against relativism. One school of thought believes that certain actions, in and of themselves, are always right. This is called **absolutism**. Another school believes that whether an action is good or right depends upon the particular circumstances of a situation. This is **relativism**. As insurance professionals market their services, they are obligated to follow the rules that have been instituted to spell out what is considered to be right or wrong. This would be an example of **absolutism**. However, when dealing with the multitude of clients needs, the insurance professional must offer different solutions for different clients, thus **relativism** is being practiced.

Four. The fourth obstacle deals with the possible conflict between religious teaching and individual authority. Most religions delineate right from wrong according to a strict code of authority. Some philosophers reject such a notion and stress that each individual creates their own set of values. Religions vary widely as to practices and beliefs as do individual values. However, most of the religions and individual value systems agree on one basic rule: **The golden rule**, overall, ethics can be narrowed down to one general definition, which Albert Schweitzer left for the ages. "*Ethics is the name we give to our concern for good behavior. We feel*

*an obligation to consider not only our own personal well being but also that of others and of human society as a whole." To summarize such a definition, only three words are needed: **Regard for others.***

THE ORIGINS OF ETHICS

Moral codes controlling human behavior have existed for thousands of years. These standards have evolved, not only

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in moral codes, but also in conjunction with religious beliefs.

In ancient Egypt, precepts were established by secular leaders. Their precepts were combined with a strict religion that affected the behavior of all Egyptians.

In Israel, moral behavior was guided by the Judaic religion.

Greek thinkers were the first to speculate about the question of right or wrong. Names such as Socrates, Aristotle and Plato appear as the great philosophers in this period of history.

Early Christian belief focused upon the role of God in achieving good. The early Christians believed that with God's help it was possible to achieve good. Will and intelligence alone were insufficient.

Probably the biggest influence in the business community came from a modern philosopher Charles Darwin. Darwin believed that only the fittest would survive. Thus, many business believed that only the fittest will survive in a free enterprise system. Each person in business must look after his/her own interests, period! Although this philosophy might have appeared as a logical business belief, it has provoked much distrust in the public sector. When this occurs, usually

what follows is a clamor for strict regulation in order to be sure that the public's best interests are being served.

Adam Smith in [**The Wealth of Nations**] offered the business community a set of guidelines to follow. Mr. Smith believed in ethics. He believed that business is based on mutual agreements of what constitutes fair exchange. In other words, business could not operate efficiently without its participants paying their debts and living up to their agreed upon contracts. This philosophy, which had been embraced by the business community, stimulated capitalism and its popularity in the United States. Basically, business became a cooperative enterprise and was to be enjoyed by all

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individuals. In reality, business became a set of ethics.

ETHICS AND THE INSURANCE PROFESSIONAL

Unfortunately, our society is not always critical of wrongdoing. Society values wealth accumulation and ignores the means by which wealth has been gained.

One can see this emphasis on personal financial gain in the insurance industry as financial gain is often held out as the primary measure of success. We are not saying that achieving financial success is evil, it is not. The manner in which one gains financial success is much more important than the financial gains themselves.

Unfortunately, the insurance industry, with its heavy emphasis on production has a tendency to spotlight financial achievement while ignoring the professionalism and integrity of its sales force. Financial incentives such as "APP a Day Clubs" and "Top Producer of The Month" contests may often lead to bogus business and questionable sales practices.

Certainly, agents should expect to be fairly compensated for success, and production figures are vital to the well being of any agency or insurance company. However, just as important is meeting the needs of clients and the public in an ethical and professional manner.

Ethics does not need to be incompatible with capitalism.
Profit is not a dirty word!

If one perceives the insurance professional as a good person then doing business will be that much easier. In the long run, good ethics is good business. Fair competition cannot help but benefit the public. Selling insurance is an aggressive profession, which leads to heightened competition. It is this

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competition that has led to better products, and services for the general public.

Ethics is personal in nature. Since we have no control over others, we must control our own actions in a professional, ethical manner.

THE IMPORTANCE OF ETHICS TO THE INSURANCE PROFESSIONAL

For many years, the study of ethics was left to the philosophers. Business people did not see the need and thus practiced "business as usual." There are three reasons why the insurance professional should study ethics:

- Penalties for unethical behavior.
- Ethics for an understanding of business.

- Price of a tarnished reputation.

PENALTIES FOR UNETHICAL BEHAVIOR

First and foremost, any unethical behavior that is discovered will probably cost far more than any potential gain.

Ethical breaches end careers much more than any other reason.

In the past few years, newspaper headlines have screamed of business malpractice in the insurance industry. Not many of these individuals, if any at all, still work in the industry. On an agency level, those agents who made it a practice to "fudge" and made material misstatements on applications, in order to make a commission, are probably no longer in the industry. These are severe penalties for such

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behavior; however such actions are not only unethical, but also illegal.

ETHICS FOR UNDERSTANDING BUSINESS

Successful insurance professionals understand that their personal ethics are transformed into a successful insurance career. They realize that although business and personal responsibilities can be separated physically, they never will be able to separate their code of ethics. There is no door which automatically admits them into reality at the end of a business day. The ethical code of behavior is part of them and transformed into daily activities, whether it is business or personal pursuits. Thus, it becomes obvious, that the study of ethics by the insurance professional is indeed important.

Since we are called upon to make value judgments every day, how we act, both in our business and personal lives, becomes paramount. A study of ethics enables us to become aware of our thought process and helps us to make sound and ethical decisions.

PRICE OF A TARNISHED REPUTATION

Not every ethical breach is subject to the public spotlight. In many cases, the individual involved keeps his/her job. What does occur is that a reputation is established which is a tarnished one at best! We all have known individuals who established stellar reputations in the business community. Unfortunately, we all know individuals that have questionable reputations and no matter what is ever said to diminish these tarnished reputations, a lingering doubt remains. Interestingly, the individual may not even realize that their behavior has been detected. However, career paths and promotions become blocked and mediocrity sets in.

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In summary, unethical behavior is a prescription for business disaster.

INSURANCE PROFESSIONALS ETHICAL RESPONSIBILITIES

As we conclude this chapter, the insurance professional must be aware that he/she has five areas in which to act ethically. They are:

- Act ethically for himself/herself.
- Act ethically toward the insurer.

- Act ethically toward the policy-owner.
- Act ethically toward the general public.
- Act ethically toward the state.

ETHICAL RESPONSIBILITIES TO HIMSELF/HERSELF

As noted earlier, the agent must act ethically in order to conduct business. As we shall see later, this responsibility will entail proper training and education. Experience alone will *not* be enough to meet this extremely important responsibility.

ETHICAL RESPONSIBILITIES TO THE INSURER

The duties of an insurance professional to his/her insurer are established by the concept of "**Agency**." This concept is represented by the agent contract, which both parties agree to and sign. In carrying out his/her duties, the insurance professional is the direct representative of the insurer. The

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professional must keep this in mind. His/her day to day activities will be a direct reflection on the insurer within the community.

ETHICAL RESPONSIBILITIES TO POLICY-OWNERS

By filling needs and providing quality service, the insurance professional can meet his/her ethical responsibilities to policy-owners. Service is of utmost importance since proper service will often lead to future sales and referrals.

In addition, to quality service, the agent owes the policy-owner loyalty. The agent must also meet ethical responsibilities to policy owners by timely submission of all applications, prompt policy delivery and confidentiality.

ETHICAL RESPONSIBILITIES TO THE PUBLIC

Fortunately, the insurance professional has much more control over shaping the public's attitude toward insurance than do the other army of sales representatives for other consumer products. The nature of the way insurance is sold creates this advantage. The insurance professional initiates contact with a prospect, then determines if and what the insurance needs are. Upon completing these tasks, the agent recommends certain products. During the course of making these recommendations the agents provides a professional sales presentation and attempts to develop a long-term relationship with quality service after the sale.

Since this unique situation requires a great deal of contact between the consumer and the agent, public perception of the industry itself is based on this relationship.

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Such perceptions of the industry hinge on the behavior of the agent. One can now understand the importance of ethical behavior in a business setting.

The professional agent has two ethical responsibilities to the public:

1. To strive for the highest level of professionalism in any and all public contact in order to maintain the strongest positive image of the industry as possible; and

2. To keep the public informed about the insurance with the highest level of professional integrity.

ETHICAL RESPONSIBILITIES TO THE STATE

Although the responsibility to regulate the insurance industry is shared by both the federal and state governments, the states carry the burden of regulating insurance affairs, including the ethical conduct of licensed insurance agents.

In some states, the regulation of ethical conduct falls under **marketing practices** while other states refer to it as **unfair trade practices**. Regardless of its moniker, all states have established a code of ethical standards for insurance agents by defining through laws the proper behavior expected from an agent. Though these laws differ from state to state, there are enough similarities to discuss them in general terms. As we study the legal framework, one must remember these laws provide the industry with a set of absolutes. There are situations which are legal but not ethical. On the other hand, there are a few situations, which are illegal, but ethical.

Knowledge of such laws is important because they provide the insurance professional with guidelines, pointing the

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way to stay out of trouble. Staying out of trouble is very important due to the heavy penalties that can be meted out for various violations of the law. Penalties can include suspension or revocation of any insurance license. Penalties can also include the payment of monetary damages and could quite possibly end a promising career.

SUMMARY

Professional insurance agents must pay close attention to their motivations for the actions they take, the advice they provide and the quality of service they perform.

It is unlikely that this course will instill personal ethical standards in anyone who does not already possess them. This course can provide the professional sales agent with a set of personal guidelines or questions to ask when faced with making ethical decisions within the context of an insurance career. For example, when selling a certain type of insurance plan, is the agent looking out for the best interests of the client, or their pocket book instead?

It is important for the student to understand that performing good ethics is absolutely good business. An insurance career can provide an individual with both financial gain and personal growth. A individual who practices an ethical profession will enjoy the fruits of both. Clients recognize those individuals who are acting in their best interest and will reward them with repeated new sales and referrals.

Insurance carriers also respect those professional sales agents who provide ethical services to both clients and themselves. Society also benefits as a whole and the insurance professionals reputation is enhanced. People in their community will simply want to do business with someone they trust and admire. Don't we all?

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CHAPTER 1 - PRACTICE QUESTIONS

1. **In the past consumers have relied on their life and health coverages as a _____ for their economic security.**
 - A. Supplement.

- B. Foundation.
 - C. Both A and B.
 - D. Neither A or B.
- 2. In the past many business owners used their life Insurance policies as:**
- A. Primary protection.
 - B. Sinking funds for emergencies.
 - C. Supplemental policies.
 - 4. None of the above.
- 3. What development during the 1970's caused consumers to cash in their whole life policies?**
- A. Low interest rates.
 - B. Reduced benefit amounts.
 - C. No need for life insurance.
 - D. Insurance companies went out of business.

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- 4. What innovative health programs were created during the 1970's?**
- A. CPA's

- B. IPO's
 - C. Trust funds.
 - D. HMO's
5. **In most instances, the person who provides valuable advice on health insurance is considered a _____ by most consumers?**
- A. Commissioned salesperson.
 - B. Trusted advisor.
 - C. Estate planner.
 - D. Consultant.

Unit 1 – Answers

- 1. B
- 2. B
- 3. A
- 4. D
- 5. B

ETHICAL RESPONSIBILITIES TO THE INSURER

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INTRODUCTION

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Insurance professionals are subject to state administrative rules and regulations and also to the legal concept of **agency**. We will discuss the ethical responsibilities an insurance professional has to the public in chapter 5. We will cover the role of agency, with its associated topics of **power** and **authority** in this chapter. Remember that an authorized agent has the power and authority to act on behalf of another.

The concept of agency is important to the relationship between an insurance professional and his/her carrier. Questions of agency also arise regarding the relationship between the insurance professional and his/her client. Finally, the relationship between the client and the insurance professional acting as a broker is unique and will also be covered in this chapter.

ROLE DISTINCTION

Insurance professionals act in three primary capacities for purposes of the law of agency. They may be captive **agents**, **brokers**, or **consultants**.

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Captive agents solicit business on behalf of their particular insurance company. Insurance broker's act on behalf of

individual clients in order to secure needed insurance coverage. Consultants provide advice as to the type of coverage needed to be obtained by a client. For this service they are paid a fee and do not depend on commissions. Throughout this course, we will focus on the captive agent and the broker.

INSURANCE AGENT

The general definition of an agent is one who is appointed by an insurer to solicit applications for a policy of insurance or to negotiate a policy of insurance on the **insurer's behalf**. An agent could also be a partnership or corporation. The entity is appointed by the insurer, and receives a written and signed contract from the insurance company. As part of this process, the insurance agent will be licensed in the state where such contracts are to be solicited.

AGENCY BASICS

A valid agency relationship between an insurance professional and an insurance carrier rests on two fundamental principals. These principals are the concepts of **power** and **authority**.

The agent receives **power** to sell insurance on behalf of a carrier through his/her agency agreement. Through this agency agreement the insurance professional is given the **power** to contractually bind the insurance carrier. This principal of power is extremely broad.

An agent also derives his/her **authority** from the **agency contract**. The agency contract usually authorizes the agent to:

- Solicit insurance applications

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- Describe the various coverages offered by the insurance carrier.
- Provide service to the company's policy-owner.
- Collect needed premiums to initiate the insurance coverage.

One must remember that the power and authority granted by the agency agreement **is not the same** as obtaining a state license.

TYPES OF AGENT AUTHORITY

The agency contract will spell out clearly the **express authority**, which is granted to an insurance professional by the insurance company. The agency relationship, which binds the insurance company, can also be created by using **implied authority, apparent authority and ratification**.

EXPRESS AUTHORITY

This type of authority is the simplest to understand because it is specifically spelled out under the agency contract and granted to the insurance agent. An example would be giving the insurance agent authority to describe appropriate coverages.

Not many legal questions arise in regard to express authority. This type of authority is easily identified from the terms of the agency contract.

IMPLIED AUTHORITY

One enters into the "gray" area of agency law when dealing with implied authority. An agent has authority to act on the insurance company's behalf when he/she **reasonably believes** that such authority has been given. For example, the insurance company cannot possibly list out all details of the express authority given to the agent. Thus, **implied authority** is evident. This authority is granted by the insurance company to the agent but is not written in the contract. Probably the best example of implied authority is the use of a conditional receipt. When the agent accepts a check from an applicant for insurance, he/she is binding the carrier to make every effort, within reason, to insure the applicant.

APPARENT AUTHORITY

This authority creates a legal minefield for both the agent and the insurance company. The best way to explain the abuse of apparent authority is to use an illustration.

Agent Herb works for the Prairie Mutual Life Insurance Company for four months. Due to lack of production, agent Herb's contract is terminated. Agent Herb keeps all company materials. Agent Herb sells a policy to Hal. Hal relies on the apparent authority placed in Herb by Prairie Mutual.

RATIFICATION

At times, insurance professionals sell products which they are not licensed to sell. In these situations, the insurance company is not obligated to honor the insurance professional's acts. However, if the company does issue the policy, this is called ratification. **Ratification is simply the validation of an unauthorized act.**

Ratification needs five elements:

1. The person (insurance professional) who performed the act must have purported to act on behalf of the **principal** (the insurance company).
2. The insurance professional must have represented himself/herself as an agent of the insurance company.
3. The client must have believed he/she was dealing with an authorized agent of the insurance company.
4. Only the **principal** in whose name the action was taken can ratify the agents action.
5. The **principal** must ratify the entire transaction not just parts.

FOUR LEGAL IMPLICATIONS OF AGENCY

The agency contract between an agent and an insurance company includes four legal implications.

1. The agent represents the interests of the insurance company. This means that the agent's legal responsibility and obligation are to the insurance company not to a potential client. We will discuss these agent obligations a bit later.
2. The agent is given power to act on behalf of the insurance company. The agent can create legal liability for the insurance company under the

insurance contract.

3. The acts of the insurance agent are considered acts of the insurance company. When a debit agent collects

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premiums, this is considered collection by the insurance company.

4. Knowledge of the insurance agent is considered to be knowledge of the insurance company. If the agent has knowledge of health matters pertinent to the issuance of insurance, it is assumed that this information is also available to the carrier.

EIGHT OBLIGATIONS OF THE AGENT TO THE INSURANCE COMPANY

The agency agreement spells out the contractual obligation of an insurance agent to his/her carrier. Most importantly, the agency agreement establishes a **fiduciary** relationship between an insurance agent and the insurance company. The agent must always act in the best interest of the carrier.

1. OBLIGATION OF LOYALTY

An agent must act solely for the benefit of the insurance company in all matters connected with his/her agency agreement.

2. OBLIGATION TO AVOID CONFLICTS OF INTEREST

This area has different meaning depending upon whether an insurance professional is a captive agent or an independent agent.

Captive agent will be held to a stricter standard. For example, a captive agent cannot serve two carriers

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selling competing products at the same time. It is possible for a captive agent to sell products not offered by his/her own carrier but sold through another carrier.

An **independent agent** represents both the carrier and the client at different points in the transaction. The client is represented during the selection process. Once a determination has been made in regard to the coverage to be selected, the independent agent owes the carrier his loyalty during the application, underwriting and recording keeping process.

3. OBLIGATION TO OBEY

This obligation is very important in today's litigious environment. Many insurance companies have strict instructions in regard to solicitation of business and client communication. These instructions limit the types of illustrations being used and the types of letters being sent to prospects. Obviously these new instructions are being issued to protect both the agent and the insurance company and should be obeyed.

4. OBLIGATION OF CAREFUL SOLICITATION

A goal of any insurance company is to cover as many healthy insureds as possible. Another important

factor is for the agent to seek out those prospects who can pay both the initial and future premiums. Some companies pay on the advanced annual payment schedule, which creates temptation to some agents. Receiving seven or eight months commission as the first commission can lead to high policy lapse ratios (not to mention high agent turnover rate). The agent should always attempt to write quality business for the insurance company.

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5. OBLIGATION TO PERFORM WITH SKILL AND CARE

An agent must execute his/her duties with the level of skill ordinarily possessed by individuals engaged in the same type of business. An agent is obligated not to engage in business in which he/she is not capable of performing. If the agent is dealing in an area with which he/she has little experience, it would be best to bring in a specialist.

6. OBLIGATION OF FULL DISCLOSURE OF INFORMATION

An agent has an important duty to make full disclosure of all pertinent information that will affect the approval process of the application to the insurance company. The agent's obligation is to alert the company of facts about the applicant known to the agent.

Full disclosure is evident at two stages of the application taking stage. First, during the application process and second, during the claim process. For example, in a life insurance situation, the agent must

list the applicant as a smoker even if the applicant states "he only smokes occasionally".

The main point is that the agent is the field underwriter. The insurance agent must act on the carrier's behalf. The agent should "take the information" and avoid making any judgments.

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7. OBLIGATION OF BUSINESS TRANSACTION EXECUTION

This obligation arises most frequently in regard to premium payments and submission of applications. If the premium is not transmitted within a reasonable time frame, the possibility exists that a policy could lapse. This will place the client in a position of vulnerability. However, it also places the insurance company in a prone position as it could lead to charges that the company is obligated to honor any claims due to questionable behavior of its agent.

The insurance company is also placed into a situation of risk if an application is not submitted on a timely basis. In most cases, a binding receipt has been given to the client as part of the application process. This makes the carrier liable for claims until the application has been formerly acted upon. Without the application, the insurance company cannot either accept or reject thus being able to protect itself from liability.

8. OBLIGATION TO ACCOUNT FOR PREMIUMS

Many agents are authorized by their insurance companies to collect the initial premium payments in order to hasten the underwriting process. Payment to an agent is considered payment to the agent's insurance company. Obviously, any funds collected are held in trust. Keep in mind, most states consider it illegal to co-mingle premium dollars with personal funds. It is sound business practice to maintain a separate bank account for the handling of premium dollars to avoid any hint of impropriety.

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There are three additional areas of possible abuse concerning the fiduciary obligations that agents face. These situations are replacement, use of free look provision, and rebating.

REPLACEMENT

Replacement of previously purchased insurance may or may not be valid depending upon individual client needs and circumstances. This area has been highly regulated as abuses by agents can have serious implications for insurance companies.

In general, replacement of a policy should not be executed where it is clearly disadvantageous to the client. Replacement is also ill advised where it is used by an agent as a systematic method of obtaining new business.

The proper steps to take when a replacement situation arises should be:

- Be sure to provide the client with a written

comparison showing the advantages and disadvantages of retaining the old policy versus obtaining the new coverage.

- Provide the insurance company with all requested information regarding the replacement on the insurance application.

By determining client needs through proper questioning and fact-finding skills the need to replace will be diminished. Coordinated with a systematic prospecting system the need for replacement will be eliminated.

ABUSE OF FREE LOOK RULES

Most states mandate that insurance prospects be given a "free look." □ State laws give an insurance prospect 10-20 days to

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decide if they wish to accept the insurance policy as issued.

The purpose of this "free look" provision is to protect consumers from high-pressure sales tactics. If the consumer declines the coverage within the allowed period, he/she is entitled to a full refund.

The "free look" period begins from the **date of policy delivery**.

Agents should remember that their basic fiduciary duties to their insurance companies are always paramount. Abuse of "free look" is violation of the fiduciary role that the company has bestowed on the agent.

ABUSE OF REBATE RULES

Rebating is knowingly permitting, or offering to make, or making, any contract or agreement as to such contract other

than is plainly expressed in the issued insurance contract. However, most agents know rebating as paying, allowing, or giving, or offering to pay, allow, or give, directly or indirectly, as an inducement to an insurance contract, any rebate of premiums payable on the contract. In competitive situations, a rebate can "make" or "break" a sale. When an agent offers to rebate part of his/her commission to a client in order to make a sale, the agent is violating his/her fiduciary duty to the insurance company.

LEGAL RELATIONSHIP OF A BROKER TO AN INSURANCE COMPANY

The role of a broker differs from that of an agent. A true broker is in the business of bringing insurance buyers and sellers together. A broker acts in the interest of the **insurance applicant** in regard to the procuring of insurance and filling out the insurance application. However, a broke

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acts on behalf of the **insurance company** when collecting the insurance premiums and delivering the policy.

There are many large brokerage firms, such as Alexander and Alexander, Willis Coroon and Marsh & McLennan, that play an important part in the placement of property and liability insurance. These firms often specialize in placing large, multinational corporate accounts and pride themselves on their knowledge of highly unusual insurance markets.

In exchange for assisting the applicant to obtain insurance coverage, the broker receives a commission from the insurers with whom coverage is placed.

BROKER=S DUTIES

As stated, a broker's primary responsibility is to his/her client. Brokers serve their clients by finding the appropriate insurance coverages to meet the client's needs. In addition to serving their clients, brokers are held to the same standards as agents in terms of their responsibilities to the general public. In other words, because the business of insurance requires honesty and good faith, the broker is prohibited from engaging in any marketing practice that involves unfair competition or a deceptive act. Like agents, in most states brokers are required to undertake a program of continuing education to remain knowledgeable and current in areas that pertain to insurance principles, coverages, laws and regulations in order to retain their license.

CONSULTANTS AND FINANCIAL PLANNERS - ROLES AND RESPONSIBILITIES

Insurance consultants and financial planners are quite different from agents and have different fiduciary responsibilities.

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An insurance consultant advises clients about insurance. This individual provides services which analyze policy provisions. A true consultant is compensated through fees for his/her services and is not commission driven through the sale of insurance policies.

The National Association of Insurance Commissioners Model and Brokers Act requires that insurance consultants be licensed. The Model Act also requires that there be a written agreement between the consultant and client prior to the performance of any services. The Model Act also spells out the fiduciary obligations of a consultant to his/her client. The consultant "is obligated under his license to serve with objectivity and **complete loyalty** in the interest of his client alone."

As an insurance consultant one should make every effort to document the client's needs and such needs were objectively uncovered regardless of any relationship the consultant might have with an insurance company. The best way to achieve this is to utilize detail-oriented fact finders and checklists.

Today, many insurance professionals call themselves **financial planners**. Unfortunately, many of these professionals fail to realize there are differences between being an agent and being a financial planner. Being a financial planner requires additional education and licensing and it also extends the potential liability of the insurance professional.

Basically, a financial planner analyzes a client's current financial situation. Part of this process is to have the client state financial goals and prioritize future endeavors. A financial planner then could develop a plan that would help the client achieve such goals. This process requires time and

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often will include other financial advisors (attorney, accountant, estate planner, trust officer).

Operating as a financial planner is likely to require compliance with both state and federal licensing and registration regulations.

It is best for the insurance professional to accurately state what role he/she has in the insurance industry. Over the years, the use of the **financial planner** label has often been used by insurance agents and brokers. Without the additional education one cannot make such a claim. Of course, the insurance professional might be performing some type of financial planning in the interviewing process but this does

not make him/her a financial planner.

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CHAPTER 2 - PRACTICE QUESTIONS

1. **Insurance professionals are subject to state administrative rules and also to the legal concept of?**
 - A. Principal
 - B. Agency

- C. State Regulation
 - D. None of the above.
- 2. Insurance professionals act in three primary capacities. One of the capacities would be:**
- A. Financial planner
 - B. State regulator
 - C. Broker
 - D. None of the above.
- 3. Those whose solicit business on behalf of a particular insurance company are:**
- A. Captive agents
 - B. Brokers
 - C. Consultants
 - D. Financial planners

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- 4. Those who act on behalf of individual clients are:**
- A. Financial planners
 - B. Brokers
 - C. Consultants
 - D. All of the above

5. Insurance agents have all of the following obligations except:

- A. Loyalty
- B. Full disclosure
- C. Rebate commissions
- D. Account for premiums

Unit 2 - Answer

- 1. B
- 2. C
- 3. A
- 4. D
- 5. C

ETHICAL RESPONSIBILITIES TO POLICY OWNERS

3

INTRODUCTION

NOTES

Without a doubt, the most important duty that an insurance professional has is to look out for the welfare of his/her clients. Even though an insurance agent technically is an agent of the insurance company, serving the best interests of the policy-owner does go hand-in-hand. These interests are not in conflict. By recommending the various products offered by the insurance company along with the promotion of the various *needs-based selling*, the policy-owner is best served by both parties, the agent and the insurance company.

Before an individual becomes a policy-owner, he/she is a prospect. To convert the prospect to a policy-owner and then to a client entails three basic steps. *First*, the client must be sold to his/her needs, and not what the agent or insurance company desires to sell. *Second*, the agent must approach his/her profession as one of being more than a job, thus additional education is needed for the agent to be a true professional. *Third*, the agent must provide quality service after the sale in order to convert the policy-owner into a client.

PROFESSIONALISM

Most people start out in any occupation by considering their duties as a job. Being a professional, however, means much more than simply working at a job. There are a few characteristics of being a professional that stand out among the rest.

One. Being a professional means that the individual has progressed upon the entry level stages of his/her job and has distanced him/herself from the rest. Probably the single greatest attribute of a professional is obtaining more education through making a commitment to the insurance profession. This is achieved by seeking a mastery of the insurance industry through the use of the various academic study curriculums available. Life Underwriting Training Council Courses, American College offerings, the College of Financial Planning, and the Insurance Institute of America courses are a good start for an aspiring insurance profession.

Two. Being a professional also means that the individual is ethical. Because of the importance of this work to society as a whole, the insurance professional must follow high ethical standards. In short, the insurance professional must always work toward the best interest of the community, even if it means sacrificing his/her own self-interests.

Third. Being a professional also means working a demanding schedule. Gone are the usual normal business hours. Being a professional is demanding and time consuming. Society values those individuals that have achieved some level of competency. Doctors must spend countless hours in classrooms and residence programs before establishing a practice. Attorneys and accountants also must receive intense education and training before advancing to higher levels. If the insurance agent desires professional status, he/she must be

willing to "pay the price" to become an important member of the community.

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REWARDS OF BEING A PROFESSIONAL

Being a professional brings many rewards. Probably the most important reward is that the individual distinguished himself/herself from the other insurance population. Instead of clients regarding one as just being an agent placing policies (like countless others) the insurance professional, with the various industry designations, is viewed differently. Clients view insurance professionals as those who made a commitment to their profession. The added recognition will help the insurance professional expand his/her business. Another reward with being a professional would be the status and stature that one enjoys within the community. People tend to look at professionals as community leaders. All of us would rather speak with an accountant or with a CPA, about possible tax implications on our income, than a bookkeeper who has a basic high school degree. Insurance professionals are treated the same way. Why ask for advice about important insurance coverages from an insurance agent when a Chartered Life Underwriter or Chartered Financial Consultant lives in the same community? Yes, status and stature are very important.

Another advantage of being a professional is the lucrative benefits to be gained. Countless studies have been done indicating the income spread between the higher echelon insurance professional and the rank and file agent. We are not speaking of agents who attain the "million dollar table" or "top of the table" distinction. These members earn more because they sell more. The point being emphasized is that insurance professionals, with some type of designation, historically have earned more. Why? Simply put, those individuals made a time commitment to their business and have been rewarded for doing so.

Another reward for being a professional is the intangible benefit knowing that the advice given could help others reach their personal and financial goals. Just as a doctor is

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rewarded with the knowledge that he/she can heal a sick person, the insurance professional, armed with academic and technical knowledge, realizes that he/she can be instrumental in helping people plan for premature deaths, disability and emergencies. Also, the insurance professional will play a major role in preparing clients for wonderful retirements.

Yes, being a professional has many awards. It is demanding and requires many hours beyond the normal hours of business. It also requires a strong code of ethics and higher academic standards. However, it offers those individuals an opportunity to build lucrative practices, achieve independence through extensive prospecting techniques and leads to public recognition that cannot be emphasized enough.

PROVIDING SERVICE TO CLIENTS

As the insurance professional's practice grows he/she will realize the importance of service. Frequently such service will involve advice on a broad spectrum of topics. In some cases, technical subject matters will arise. Obviously, in order to answer such questions, the insurance professional must always be upgrading educational levels. With the insurance industry changing almost daily, the professional must also work at "keeping current." For example, many insurance professionals find themselves working in the complex world of estate planning. In order to competently render sound advice, as to how life insurance should be owned, the insurance professional must be proficient about tax codes, trusts and probate laws. One can see the importance of

education in the servicing area.

The insurance professional should realize that **service**, during and after the sale, is a critical step in building a clientele.

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The term **service** means many things to many people but for our purposes we will focus on the following five broad areas of service as they relate to the insurance industry:

1. **Educating the client**, not only after the sale but also before and during it. Our goal is to have the client understand the application and underwriting process, along with the policy and any riders.
2. **Confidentiality**, always treating the client's financial and personal affairs with utmost confidentiality.
3. **Disclosure**, always disclosing all information needed by the policy-owner or applicant so that he/she can make an **informed decision**.
4. **Notifying** the client of any rejection, exclusions, or cancellations.
5. **Loyalty** to the client is of utmost concern. Part of this area would be providing a full range of services in order to assist the client in financial planning activities.

THE APPLICATION PROCESS - LIFE AND HEALTH

With the intense emphasis on production, today's insurance agents sometimes fail to realize the importance of the application process. The insurance professional must always be sure that the applicant provides accurate information to the questions on the application. The insurance professional has an ethical responsibility to educate prospective insureds to be sure that the applicant fully understands the nature of the application: why the information is required, how it will be evaluated, and the need for accuracy and honesty in answering all

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questions and the meaning of various terms such as "Waiver of Premium," "Non-Forfeiture Options," and "Conditional Receipt."

CONDITIONAL RECEIPT

Since this area is mostly overlooked and misunderstood, it should be covered.

A conditional receipt is given in exchange for the initial premium at the time of application.

It provides that the applicant is covered **immediately** from the date of application **as long as he/she passes the insurer's underwriting requirements**. If a medical examination or blood profile is required, the date of coverage begins when the applicant passes the medical examination.

This information about the conditional receipt should be made clear to the applicant. Many applicants are accustomed to homeowners or automobile insurance where the coverage begins immediately upon the issuance of the binding receipt. One can understand the confusion when life insurance is being purchased. It is the insurance professionals ethical responsibility to explain that the applicant is covered on the condition that he/she meets the required underwriting

requirements of the insurance company.

THE UNDERWRITING PROCESS - LIFE AND HEALTH

Even though many insurance policies are issued on the basis of the application alone, it is still sound business to explain the underwriting process. The explanation of the underwriting process should include three "checks and balances".

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1. **Medical Information Bureau.** The MIB serves as a huge clearinghouse of medical information concerning applicants and helps to disclose cases where an applicant conceals or submits misleading medical information.
2. **Inspection Report.** This report provides details on an applicant's lifestyle, finances, and exposure to abnormal hazards. These reports are usually ordered on applicants who apply for large amounts of insurance. Friends neighbors and/or employers may be contacted.
3. **The Credit Report.** This report is ordered when there is reason to question the applicant's ability to pay the premiums and to determine whether or not the applicant may be a poor credit risk.

In summary, the application process is important to all three parties involved; the applicant, the agent and the insurer.

All of the information on an insurance application has a direct bearing on whether the policy will be issued as requested, rejected, or amended. An agent who knowingly fails to

provide all the necessary information about a prospect is not serving anyone's best interests.

Consider, for example, the agent who "forgets" to disclose that the applicant is a dedicated bungi jumper. The agent figures that if this information is submitted to the insurer, the company would rate the case making it unaffordable to the applicant. A lost sale means lost commissions. Thus, the information is not revealed and the coverage is issued as standard. However, six months later, the insured dies while attempting another jump. The insurer probably will contest or deny the claim, citing concealment. Rather, than receiving

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the death benefit, the family receives a return of premium. How ethical was the agent? What service did he/she provide?

Precision and accuracy in completing the application are **always needed**. This will protect both the applicant and the insurer, and protect the agent from any possible liability claim.

CONFIDENTIALITY

In attempting to qualifying a prospect completing a financial questionnaire, analyzing needs, etc., insurance agents are privy to an applicant's personal and financial information. Personal information about a client should never be released without the prior approval from the client.

FULL DISCLOSURE

The agent not only has the responsibility of full disclosure to

the insurer but also to the prospect or client.

In this situation, full disclosure means informing the prospect or client of all facts involving a specific policy so an informed decision may be made. This also accomplishes other goals as it helps clients:

- Evaluate the relative costs of similar plans offered by a competitor.
- Understand the basic features of insurance.
- Select the most appropriate policy to meet the needs of the prospect/client.

There are two guides that are used by agents to help them comply with full disclosure:

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1. **NAIC Buyer's Guide** which was developed by the National Association of Insurance Commissioners as an aid to consumers who are thinking about the purchase of life insurance. It explains the basic types of life insurance and provides the consumer with suggestions to aid in its purchase. Included in the **Buyer's Guide** is an explanation of the surrender cost indexes used in the **Policy Summary**.
2. **The Policy Summary** includes two types of cost indexes; the life insurance surrender cost index and the life insurance net payment cost index. The *surrender cost index* is useful to applicants who wish to compare cash values of policies. The *net payment index* is helpful when a person compares the death benefits of policies. Both guides are helpful to agents who wish to explain the features and benefits of the life insurance policy they are presenting.

NOTIFYING THE CLIENT

The underwriting process for an insurance application can take time. Most companies try to complete their underwriting process in 21 days, however, delays may occur. Delays such as request for more information from the applicant, doctor reports, etc. An agent should keep the applicant informed as to the process of the application. For this reason, it is imperative that the agent **be prompt** in sending the application, after a thorough review, to the insurer. Many underwriting delays occur simply because the application is not complete.

Policy delivery. When an application is accepted, the agent should deliver the policy promptly. At delivery the agent should review the policy's features and benefits. This will help solidify the sale and also convert the policy-owner into a client.

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Rated policy delivery. When an applicant is rated or declined, the agent is responsible to find out the reasons for such action. Was it medical? Was it something that was overlooked by the underwriter? Should additional information be provided? In any event, the agent should be prepared to explain the rating or rejection to the client.

Assuming the rating or rejection is valid, the agent has the ethical responsibility to notify the client promptly.

SPECIAL SITUATIONS

In most cases, common sense should rule when rendering advice to clients. When an applicant becomes a policy-owner and client, service becomes extremely important. From time to time, questions will arise which will test the insurance

professionals technical knowledge when rendering service to clients. There are three general guidelines when asked to render opinions or advice that might be a bit out of the realm of insurance:

1. If the insurance professional is asked for technical advice, keep it as **general** as possible.
2. If the insurance professional must give specific advice it would be best to cite sources of common knowledge. It would best to stay in areas that already have definitive answers. *An example would be life insurance is not deductible as an expense on an individuals 1040 tax return.* If the law is still "up in the air," inform the client and move on.
3. Whenever possible, work as a member of a professional team. This aspect of the business has in the past, been overlooked by insurance agents. By becoming part of a team with other financial professionals, the insurance professional will be able to draw from a "think tank" that comprises of the financial disciples. Needless to say, this type of

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partnership will also add credibility to the insurance professionals practice.

THE APPLICATION PROCESS – PROPERTY AND CASUALTY

As on the Life and Health side of the business, the application process is an important first step in the selling of property and casualty insurance. All of the information submitted on an insurance application has a direct bearing on whether the policy will be issued as requested, whether the application will be rejected or whether another policy will be offered by the insurer.

Consider for example, a situation in which an agent does not disclose that the applicant for a homeowners policy is a retired bear trainer who kept a bear as a pet. The agent knows that if this information were revealed, the insurer would surely decline to issue the policy, leaving the prospect uninsured. Believing that it is in the prospect's best interest to have the insurance, the agent completes the application without noting the bear's existence. The agent explains to the prospect that omitting this "small detail" will keep the premium down and the applicant gratefully signs the application. Coverage is issued as a standard homeowner policy.

Six months later, a neighbor is attacked and injured by the bear. In all probability, the insurer will deny the claim, citing concealment. Rather than receiving protection under the policy, the homeowner is likely to receive a cancellation notice. What benefit did the policy provide? What service did the agent render?

This example illustrates the need for precision and accuracy in completing the application. It is vital that an agent

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understands this, and explains the need for full disclosure to a prospective insured.

ISSUING BINDERS

An agent who has been given binding authority may immediately bind the insurer on the risk. A **binder** is a written or oral acknowledgement that immediate coverage is temporarily in effect pending insurance of the policy. It has the full force and effect of the policy.

The binder will contain a time limit, the name of the insurer, the amount of insurance, the perils insured against, the type of insurance, a list of exclusions and so on. A copy of the binder should be sent to the insurance company immediately so there is no misunderstanding by either the insurer or the insured as to when coverage takes effect.

FIELD UNDERWRITING

Every agent or broker needs to engage in some type of field underwriting, the process of screening, the process of screening out unacceptable risks.

Some agents have the authority to issue policies for the risks they have underwritten. Copies of the application, binder of insurance and the policy are sent to the insurer. Even though a policy has been issued, the insurance company underwriter may send a notice of cancellation if he/she finds that the risk was poorly underwritten and does not meet company guidelines.

Agents can build a higher quality book of business and establish sound relationships with insurers by engaging in responsible field underwriting. This involves analyzing risks and exposures, taking steps to avoid or reduce risks, considering loss control efforts and submitting risks to the proper markets. However, the agent cannot perform all the

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needed underwriting services. The insurer is in a better position to check financial information and driving records of applicants, for example.

COMPANY UNDERWRITING AND RATING

As stated earlier, when a risk is submitted to an insurance

company underwriter, he/she makes a final decision whether to accept or reject the risk. In order to do this, a number of factors must be evaluated. One of the most basic and important factors is whether the applicant has an **insurable interest** in the property to be insured. Insurable interest exists only when a person or an institution can suffer a financial loss if that property is damaged or destroyed.

There must be a greater interest in preserving the property than destroying it. If there is not an insurable interest, buying insurance is similar to gambling, and the contract of insurance becomes unenforceable in the courts.

Once insurable interest has been established, company underwriters consider a number of factors when evaluating a risk. They examine the nature of risk; what hazards are present? What outside factors might affect the risk and what past losses have occurred?

Some risks are **class rated**, which means that the loss history of a class of risk have similar characteristics (i.e., female drivers, age 23, jointed masonry building in a particular urban area, etc.) was used to develop the premium rate. Class rates may readily be applied to most dwelling and some mercantile establishments because of their similarity of construction and use. Underwriters usually have the option of applying rate modifications, based on the loss history or special characteristics of a risk. For example, risks may be **experienced rated**, which means the insured's actual past loss experience plays a major role in the development of the rate. When an underwriter is familiar with a certain type

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of risk, he/she may use **judgement rates**, based largely on the underwriters knowledge and experience.

Unlike homeowners risks which are class rated, **commercial risks**, whether mercantile, manufacturing or mining, and **institutional risks** generally do not share similar

characteristics. Because of this, **specific rates** are applied to business, establishments, and public buildings by using schedules to determine the relative risk involved. The individual risk is inspected and measured against a theoretical average, receiving credits for factors that exceed the average and surcharges for factors that fall below the average. Various items that contribute to risk of loss from fire or other perils are weighed by an established standard to determine a rate of premium. These items include the building:

- Type of construction
- Location
- Occupancy or use
- Amount and types of fire protection; and
- Exposure or hazards from surrounding buildings

For example, it is logical that occupancy as a cabinet making enterprise in an unprotected frame (wood) building would represent a different degree of risk than occupancy as a metal file cabinet manufacturer in a non-combustible building and would, therefore, generate a different rate.

SELLING TO NEEDS

An insurance professional has one reason for calling on a prospect; to offer a needed product or service that will benefit the prospect. The obstacle that the agent faces is to **find the need** and then offer a solution. No one ever profits

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if the prospect is "**bullied**" or coerced into a buying decision. Misleading a prospect not only creates bad impressions but can also lead to legal problems. Chances are these types of prospects will lapse their policies and be sure to recommend

to associates and friend not to do business with the agent.

Fortunately, most agents recognize that selling to fit needs is the best approach to offering valuable services and products to prospective clients. They know that specific types of insurance policies are designed to meet specific needs. Matching these policies to individual needs is the cornerstone of any successful insurance practice. Needs selling also involve the skills of problem analysis, action planning, and product recommendations and plan implementation.

The first step (after the prospecting phase) in needs selling is to use a thorough fact finder that will help determine the client's risk tolerance. Naturally, some clients will accept more risk in planning for their insurance coverages than others. By determining needs, goals and risk tolerance the insurance professional is provided with the valuable information necessary to make a recommendation. The insurance professional must remember one critical precept: **not all clients will need the same product or service.**

The bottom line in selling to the client's needs is to find out what those needs might be. Once again, the importance of a thorough fact finder cannot be emphasized enough.

In addition, it would be wise to back up the fact finder with a series of checklists. These checklists will help to uncover information not divulged on the fact finder, but, information that is needed to assist the insurance professional to make accurate and precise recommendations.

Unit 3 - Responsibilities to Policy Owners

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SUMMARY

Once the applicant becomes a policy-owner, the insurance professional must strive to convert the policy-owner into a long-lasting client. With superior service, increased educational and technical skills, and ethical business practices, there will be no reason for the client to become dissatisfied.

All clients should receive periodic reviews to ensure that their insurance programs are keeping current with their needs, and objectives.

By "*taking care*" of clients in an ethical manner, the insurance professional will build a lucrative and rewarding practice with a fair measure of community visibility and stature.

CHAPTER 3 - PRACTICE QUESTIONS

1. **The most important duty that an insurance professional has is:**
 - A. Establish a large clientele
 - B. Look out for welfare of clients
 - C. Offer legal advice
 - D. Gain technical knowledge

2. **All applicants should first be converted into:**
 - A. Policy-owners
 - B. Partners
 - C. Clients
 - D. All of the above.

3. **All of the following are basic steps to convert a prospect to a client except:**
 - A. Client is sold according to needs
 - B. Client is serviced by an insurance professional
 - C. Client is serviced by an insurer attorney
 - D. All of the above.

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4. **To be successful, an insurance agent must:**
 - A. Bully Prospects
 - B. Sell the same product to all prospects
 - C. Be a professional
 - D. Sell the products with the highest commission

5. **The underwriter, for Commercial Property Coverage, will consider all of the following EXCEPT:**
 - A. Type of construction
 - B. Occupancy or use
 - C. Amount & type of fire protection
 - D. Age of the insured

Unit 3 - Answers

1. B
2. A

3. C
4. C
5. D

ETHICAL RESPONSIBILITIES TO THE PUBLIC

4

INTRODUCTION

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In reality, the insurance professionals and agents have a lot to do with the projection of a certain image toward the public. Mainly because the insurance professional initiates contact with a prospect, determines the prospect's need for insurance, recommends and then implements the proposed plan. The first impression is always the most lasting. Coupled with the opportunity for a long-lasting relationship with the client, the first impression becomes that much more critical.

The insurance professional represents an industry that is loaded with technical information. Public perception will be severely hampered by unethical agents. Just as we stated in the first chapter, the insurance professional has two basic ethical responsibilities to the public:

1. To inform the public about insurance with the utmost, highest level of professional integrity; and
2. To strive for the highest level of professionalism in all public contacts in order to create and maintain a strong positive image of the industry.

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Throughout this chapter, we will focus on the above responsibilities and look at some of ethical practices, which have tarnished the industry. We will also discuss property and casualty insurance, and the manner in which it is marketed to the public.

PROPERTY AND CASUALTY INSURANCE COVERAGE

Property casualty insurance is usually classified by several major lines of insurance: fire insurance and allied lines, marine insurance, casualty insurance, multiple line insurance and fidelity and surety bonds. **Property insurance**, such as fire or homeowners policies, covers the loss or damage to real estate or personal property from fire, lightning or other covered perils. **Marine insurance** (also called transportation insurance) covers goods in transit against pure risks related to transportation, whether those goods are shipped over land (**inland marine**) or water (**ocean marine**).

A broad field of insurance called **casualty insurance** encompasses almost everything not covered by fire or marine insurance: automobile insurance, general liability, burglary and theft, worker's compensation, glass coverage and other miscellaneous lines

The agent may also sell **multiple-line** or package policies that combine property and liability coverages. Finally, an agent may sell **fidelity** and **surety bonds** that provide the insured with protection against losses caused by the dishonest or fraudulent acts of employees or that provide monetary compensation in the case of a bonded person's inability to perform certain acts, such as the completion of the construction of a building.

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PROPERTY – CASUALTY INSURANCE MARKETING SYSTEMS

Property and casualty insurance is marketed by independent agents, exclusive agents or captive agents, and brokers. Exclusive agents sometimes offer insurance from the insurer as a lower cost, due to lower commissions and reduced expenses resulting from centralization of underwriting, policy issuance and claims processing in the direct writing systems. Independent agents and brokers offer insurance consumers the most options, because they work with multiple insurers. The agents have a wider choice of coverages, prices and services for their policyholders. Historically, independent agents have been the predominant producers in this field.

INDEPENDENT AGENCY SYSTEMS

Many agents belong to a marketing system known as the **Independent (American) Agency system** (sometimes called the □Big I). The Independent Insurance Agents of America (IIAA) has helped consumers become familiar with the □Big I□ through advertisements that tout the value of the independent agent as the □more than one company agent.□

The independent agent may represent any number of insurance companies on a commission or fee basis for the business produced. These agents are **not** employed by the insurance companies they represent. They are independent business people who represent several insurance companies, pay all their own agency expenses and make all decisions about how their agency operates.

Consumers who purchase insurance through independent agents are considered by both agents and insurers to be the **agent=s** customers rather than those of the insurer, and the

insurance company does not generally deal directly with the insured.

Unit 4 – Responsibilities to the Public

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EXCLUSIVE AGENTS

The exclusive agency system is prominent among large property-casualty insurance companies, exclusive or captive agents represent one insurance company or group of companies only. These agents are paid a salary, commission or a combination of both. Under restrictions imposed by the insurer, the insured is considered to be the **company=s** client rather than the agent=s. Companies using captive agents own and control the account, policy records and renewals. If the agent relationship or employment of a captive agent terminates, the agent loses all rights and interest in the renewal business and related commissions.

DIRECT WRITERS

A direct writer is an insurance company that sells its policies through employees or agents who represent it exclusively. These agents usually receive a salary, or a salary plus commission for the business they produce. Some insurers, such as specialty fire insurance companies that emphasize loss prevention in insuring large, well established industrial and institutional properties, negotiate their contracts primarily through salaried representatives in direct contact with executives of the business being insured. A direct writer maintains complete control and ownership of its policies and renewals.

ROLE OF INSURANCE IN SOCIETY

Without reviewing the staggering dollar amounts that the insurance industry collects each year it is important for all

insurance professionals to realize that insurance plays a major role in the lives of most people in the United States.

Life insurance attempts to protect the breadwinner of the family in case of a premature death of the breadwinner. Disability insurance protects the "money machine" in case of a living death. Property insurance protects homes and

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business from loss due to fire and natural disasters. Liability coverage protects individuals from loss due to accidents. Medical insurance not only provides a cushion against economic disaster, but in many instances helps speedy recoveries because patient's can focus on getting better and not paying expensive bills.

The uniqueness of the insurance industry is that, although insurance affects so many people, very few really know that much about it. It is this unawareness that has caused many consumers to become negative when it comes to insurance. By being ignorant as to insurance, consumers have "left the door open" to those unethical insurance agents who take advantage of people by simply inducing them to buy policies that are either unnecessary or do not live up to the agent's hype.

In a way, this activity is a two-edge sword for the insurance professional. On one hand, the professional, since she/he works in the same industry, must be able to answer for the "sins" of their brethren; on the other hand, the professional insurance agent, by offering the public an honest and fair explanation of the policies and services that he/she represents, will certainly distinguish (and distance) themselves from the unethical agent. As the old saying goes "the cream always rises to the top!"

There are two types of ethical problems that have been prevalent in the industry:

1. Deceptive use of advertising material, and
2. deceptive sales presentations.

Unit 4 – Responsibilities to the Public

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DECEPTIVE ADVERTISING MATERIAL

Two facts cannot be denied about the insurance industry and the general public:

1. As noted, the average insurance buyer knows very little about insurance and relies on the advice and recommendation by an insurance agent.
2. By the time a consumer realizes that a policy does not quite live up to its advance billing, it could be too late to change.

The potential for deceptive advertising by both companies and agents is significant, with severe consequences to the consumer.

The states have enacted laws regulating insurance advertising. The foundation for many of these state's laws is the NAIC Model "*Unfair Trade Practices Act*" which cites false advertising as an unfair trade practice and it is strictly forbidden. Advertising, includes print and radio material, descriptive literature, sales aides, slide shows, brochures, sales illustrations, policy illustrations, TV adds, etc. Any kind of communication or presentation used to promote the sale of an insurance policy would be included.

The purpose of the NAIC Model Act was to establish some badly needed guidelines to ensure that both insurance companies and their agents promote their products properly and accurately, without outlandish exaggerations. The act forbids any misrepresentations of the benefits, terms, conditions or features of any insurance policy, including

Unit 4 – Responsibilities to the Public

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dividends. It also bars any misrepresentation of an insurer's financial condition or its legal reserve system. It also prohibits the names or titles of insurance that do not represent their true character. Life insurance advertising cannot use the terms "investment," "savings" or "profit" in a misleading way. Health insurance advertising must disclose provisions regarding renewability, cancellation, termination or modification of benefits.

The burden of compliance with state insurance advertising law falls on insurance companies, since most advertisements or promotional pieces, regardless of the writer or presenter, are considered the responsibility of the insurer whose policies are being advertised. In reality, most of the advertising and sales literature an agent uses is prepared by the insurer with the legal department's input. The ethical issue is not the material issue itself, but **how the material** is used.

The fact remains that many unethical agents still prepare their own promotional or advertising copy and use it in the marketplace. With the advent of sophisticated computer and printing systems, one can imagine the copy that is being used on the public. From the agent's standpoint, most home offices tend to be institutionalized, with little "sizzle", therefore making insurer promotions useless. Also, when

agents submit their own advertisements to the insurer, long time delays occur. As noted, the agent is under pressure for some level of production and therefore attempts to gain a competitive edge using his/her own devices. The fact remains that with the litigious society we all live in today, it is best to act ethically and use home office copy when marketing.

NAIC Guidelines for Insurance Advertising

1. All insurance advertisements must be truthful and not misleading in fact or implication. Words or phrases that are clear only through familiarity with insurance terminology cannot be used.

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2. All information required to be disclosed (i.e., exceptions, limitations of benefits and exclusions from coverage) must be printed conspicuously next to the statements to which the information relates and displayed in such prominence that it is not minimized, confusing or misleading (in short, no fine print).
3. Deceptive words, phrases or illustrations may not be used to describe a policy, its benefits, the losses to be covered or premiums payable.
4. Testimonials must be genuine, represent the current opinion of the author, be applicable to the policy advertised and be accurately reproduced.
5. Disparaging remarks or statements about another insurer, agency or agent of another insurer, their products and services may not be used in any advertisement.
6. The identity of the insurer must be clear in all

advertisements, as well as the name, address and phone number of the agent placing the advertisement.

DECEPTION SALES PRESENTATIONS

Deceptive sales presentations and bogus use of sales illustrations have created numerous problems for the industry.

The question remains. What constitutes a deceptive sales presentation? Any presentation that gives a prospect or client the wrong impression about any aspect of an insurance policy is considered deceptive. Of course, with such a definition, it is difficult for the presenter to anticipate the impressions one will receive with a particular presentation.

The fact remains that an ethical insurance professional will implement the **golden rule** when making a presentation.

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Probably the best way to determine if a presentation is deceptive is if full disclosure is not made. Any presentation that includes misleading or inconclusive product comparisons is considered deceptive. Deceptive sales presentations can be quite outlandish. For example, a comparison of a term policy and a whole life policy based on premium rates is misleading and incomplete. An example of a common deception would be explaining life insurance as a "tax shelter." Yes, the cash values will accumulate tax deferred, but failing to mention that premiums are not tax deductible leads to deception.

The health insurance policy that is presented by failing to explain conditions under which the policy is canceled and the premium increased is a form of deception. A popular form of deception is using a policy illustration that shows excessive projected dividends or totally unrealistic interest rate assumptions or presenting current value as if they were guaranteed.

Computerized policy illustrations have led to many deceptive policy illustrations. The easy way in which variables may be utilized appear to be too much temptation for the unethical agent. In general, too many insurance sales are based on pie-in-the-sky numbers and assumptions instead of real needs and benefits.

The ethical agent will always attempt to perform a needs-based evaluation of a client's financial situation before running a series of inflated policy illustrations. When a policy illustration is used, the ethical agent will take the responsibility for knowing the assumptions it contains, and will be sure these values are realistic and credible before they are used in any presentation form.

Because of the growing problems with policy illustrations the American Society of CLU and CHFC developed specific guidelines for such use. The society maintains, and as ethical standards require, deceptive policy illustrations have no place in the insurance industry. The prospective insurance buyer is

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deceived. Such deception is revealed when that buyer makes a claim for benefits that turn out to be limited or nonexistent.

RECENT SCANDALS

The past five years has seen numerous insurance scandals. The end result is diminished confidence in the insurance industry as a whole, which makes it very difficult for all to practice insurance. Another effect of such scandals is that increased legal actions by individual clients causes the entire industry to be further scrutinized by government, local state and federal.

In many instances, such scandals could have been avoided through client education.

In other instances problems could have been avoided through the adherence to the professional codes discussed earlier. A major problem in the industry is **solvency**. With recessionary forces impacting the insurance industry, some companies found it difficult to maintain business as usual.

It seems every night, a picture and interview of retirees losing annuity checks comes into our living rooms. Questions arose concerning the ethics of many agents. Did they use these companies because they paid higher commissions or rewarded such production with luxurious trips? Did the management of these companies invest wisely, or were risky bonds the primary cause of many insurer failures?

The solvency crisis had a profound effect on the public. Policyholders were forced to evaluate the stability of the insurance industry and the ability of the industry to serve their needs came into question.

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REPLACEMENT

In some cases replacement has merit but these cases are not usually publicized. The public has heard of the situations where policy replacement was not in the best interest of the client. New terms became familiar public concerns, twisting, churning and piggybacking stories have been presented to the public. Unethical insurance agents seeking out policyholders who have build up cash value within older policies only to purchase newer, fully commissionable policies. The result was once again, government attention. State regulators are giving closer attention to the replacement issue. It seems that state governments are telling the insurance industry, "if you

cannot police yourself, we will do it for you”.

PRODUCT MISREPRESENTATION

Insurance agents have recently made the term financial planner popular. Instead of stating they are insurance agents, some have given themselves a promotion to financial planner or retirement representative.

These same agents have a tendency to describe their product as a "savings vehicle" or "retirement plan."□

Such practices confuse consumers. These practices have created an onslaught of complaints to insurance departments with crackdowns by state regulators.

IMPROPER LICENSING

Most agents have the proper licenses for the products being sold. However, a few insurance representatives did not when they ventured into a new field, selling stock brokerage limited partnership products. The biggest problem was they did not understand the product they were pushing on an unsuspecting

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public. Many consumers were sold high-risk products although they preferred low risk investments. One can imagine the results when these investors discovered that valuable retirement savings had evaporated. The image of the insurance industry was further tarnished!

FRAUD

An age-old problem has always been forgery in the industry. Many agents have signed a client's name to some type of

document in order to facilitate the approval process. Signing a client's name to a document is never proper. Throughout time, this has been nicknamed "windowing." To say the least, this practice, which has been written about in various newspapers, has done nothing to help the reputation of the insurance industry.

NO NEEDS SELLING

Agents are failing to identify customer needs. Because these needs are not identified, customers are being sold products which just are not suitable for their needs. One of chief reasons for this misdeed is that agents just aren't educated enough. As noted before, education and increased technical skill will "professionalize" an insurance practice.

Another reason for the selling of unsuitable products includes trying to make the easy sale with a particular product simply because it has attractive benefits. Other agents sell unsuitable policies because of the high commission to be gained from such products.

REDLINING

Many insurers argue that they need to control potential losses and they should be permitted to limit coverage or even refuse to write homeowners coverage in areas where losses have been frequent or severe. However, under the provisions of

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the **Fair Housing Act**, a licensed individual or company may not refuse to provide homeowners or renters insurance solely on the basis of the geographical location of the insured's property. Rejecting coverage solely because of a risk's geographical location is known as **redlining**. The practice of redlining occurs when a company literally "draw a red line"

around a specific geographical location and refuses to insure properties located within its boundaries.

When a coverage is issued in a redline area, another form of discrimination takes place that involves charging higher premiums for comparable policies, charging higher rates for inferior policies and refusing to provide replacement cost coverage on the structure and contents of home in minority neighborhoods. Some insurers and their agents justify their refusal to write coverage because the homes in these neighborhoods are too old or their value is too low.

The U.S. Department of Housing and Urban Development (HUD) prosecutes insurance companies that intentionally engage in practices that have the intent and effect of denying, limiting, or restricting home owners insurance for people living in minority neighborhoods throughout the United States.

QUESTIONS OF UNISEX RATING FOR AUTO INSURANCE

As part of its ratemaking process, insurance companies use their past loss experience and industry statistics. For example, in addition to the insurer's own loss data, industry statistics on hurricanes, tornadoes, fires, crime rates, the cost of living, etc. are also used as part of the data to establish premium rates for a type of insurance. Actuaries in property-casualty insurance have also used **gender** in determining rates for automobile insurance premiums. They contend that men and women should pay different rates because their loss experiences are different. Based on its statistics, the insurance industry contends that female drivers should pay

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less for their automobile coverage because they have fewer and less expensive claims than male drivers. However, some consumer groups, such as the National Organization for Women see gender-based rating as discriminatory, arguing that

under this system women (who generally live about eight years longer than men) will naturally pay more for all forms of insurance over their lifetimes than men. They have proposed that unisex rating, which means that the pooled loss experience of both males and females, is used to calculate the rates charged, be used for all types of insurance.

Unisex rating is now used in many group life and health insurance plans that are experience rated.

BUSINESS DILEMMA: IS IGNORANCE A VIABLE EXCUSE?

Good business practices can be learned. A study of the recent scandals that have beset the insurance industry indicate that many times an agent failed to realize that his/her actions would be considered unethical. For example, a new agent, unfamiliar with the technical requirements, advises a client that a retirement account may be funded with unearned income. Bad advice? Absolutely! Done purposely? Probably not! Net result: The client could be called down for an audit, slapped with a tax bill and has nothing but ill feelings for the agent, insurance company and the industry as a whole. Was this action unethical? Yes. Even though it was not done purposely, it still was incorrect and quite unethical.

The point is that the agent should have called upon the agency or home office technicians for help in this case. Taking a retirement course would have helped also. An agent should recognize that instincts should not be the only guide in balancing customer needs. Agents should be familiar with professional codes and if needed, should seek advice on the application of ethical principles. Ignorance does not make one insulated from being unethical. Ignorance is only an

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excuse! Education adds to expertise. It also increases ones awareness of ethical questions that will arise in various situations that the insurance profession will encounter while building his/her practice.

PROFESSIONAL OBLIGATIONS

There have been many studies performed by the insurance industry as a whole to determine the proper ways an insurance professional should deal with the public. We have narrowed the results to three basic obligations.

One. Place the client's interests above self-interest. Professionals are loyal to their clients and are dedicated to protecting their client's welfare. This means they remain **independent** and **objective** in their judgment and evaluations and recommend plans or policies that most **benefit the client**. When a policy-owner asks for help or advice, the agent is quick to follow up, embracing client service as an important responsibility.

Two. Being dedicated to the insurance industry and supportive of all its member companies and representatives. A true professional aligns himself/herself with colleagues and competitors alike, knowing that all represent the same products and services, and that all should share a commitment to the purpose and goals of these products and services.

Three. The insurance professional is obligated to offer quality plans and represent quality companies. A professional agent represents only those companies with solid financial standings and accurately informs prospects and clients of an insurer's financial position as part of the sales process.

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The professional's obligation is **not** to make disparaging remarks about the competition, fail to be objective with others in business dealings, fail to provide prompt, honest answers to client's questions and fail to provide products and services of the highest quality in the eyes of the customers.

SUMMARY

As we conclude this chapter, the insurance professional must remember that building a successful practice takes time. By making a long term commitment to the business and realizing that every business will have "peaks and valleys" the insurance professional will better adapt to the business. It is important to understand that the foundation of the business is the ethical behavior of the principals involved.

The American College's Charter Life Underwriter (CLU) pledges probably sums up this philosophy best as it states:

"In all my professional relationships, I pledge myself to the following rule of ethical conduct: I shall, in light of all conditions surround those I serve, which I shall make every conscientious effort to ascertain and understand, render that service which, in the same circumstance, I would apply to myself."

CHAPTER 4 - PRACTICE QUESTIONS

- 1. What is/are the main reason(s) the insurance professional has a lot to do with the projection of a certain image to the public?**
 - A. The professional makes the initial contact
 - B. The professional determines the prospect needs
 - C. The professional implements the proposed plan
 - D. All of the above.

- 2. The insurance industry is loaded with:**
 - A. Technical information
 - B. Unethical agents
 - C. Captive agents
 - D. Deceptive advertising material

- 3. The insurance professional has an ethical responsibility to the public:**
 - A. To deceive the public
 - B. To out smart the public

- C. To strive for the highest level of professionalism
- D. To ignore the Unfair Trade Practices Act

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- 4. The coverage that protects the breadwinner from premature demise would be:**
 - A. Disability Insurance
 - B. Life Insurance
 - C. Property and Casualty Insurance
 - D. Health Insurance
- 5. One of the biggest problems in the insurance industry is:**
 - A. Deceptive advertising material
 - B. Ethical agents
 - C. Too many products
 - D. Not enough agents

1. D
2. A
3. C
4. B
5. A

ETHICS AND THE LAW

5

INTRODUCTION

NOTES

The purpose of this chapter is to review the regulation of the business of insurance by federal and state law. We will also discuss the ethical standards mandated by most states. Finally, we will focus on the ethical standards of financial planning and the federal regulation applicable to many agents, the **Investment Adviser Act**.

FEDERAL REGULATION OF INSURANCE

The Constitution of the United States allows the federal government the power "**to regulate commerce with foreign nations and among the several states.**" This power has seldom been used with regards to insurance.

Federal regulation of the insurance industry is accomplished in five ways:

1. Through the powers reserved to the federal government under the **McCarran-Ferguson Act**.
2. Through special tax provisions that apply to insurance companies and the products they offer. These provisions can be found in the Internal Revenue Code.

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3. Through legislation regulating the health insurance industry.
4. Through legislation of securities and various insurance products.
5. Through pension regulation.

McCARRAN-FERGUSON ACT

Congress enacted this act in 1948, which spelled out the role of the federal government in regard to the regulation of the insurance industry.

Basically this law states that the federal government retained the power to control insurance matters that were considered national in character. This power includes the oversight of the State Insurance Departments. The states, however, were left with the major burden of insurance regulation. This also included the regulation of matters relating to the ethical conduct of business by insurance professionals.

INTERNAL REVENUE CODE

The code contains precise provisions, which spell out the

manner in which mutual and stock carriers are to be taxed. The code also contains provisions, which affect the tax status of products sold by insurance companies. A good example would be the tax favors built up within the life insurance product, as well as the tax-free nature of death proceeds.

Insurance professionals should have a working knowledge of the code. Failure to provide clients with such valuable information would not only be a disservice, but could lead to a lawsuit.

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HEALTH LEGISLATION

In recent years, the federal government has shown much more interest in the regulation of the health insurance industry. The reason for this interest has been two fold:

1. The abuses that have occurred in the senior market as the federal program Medicare was being unethically utilized, and
2. The somewhat callus attitude that the companies have taken in protecting those with health problems.

Presently, the abuse of the Medicare supplement market has been lessened with the institution of the standardization of supplemental Medicare policies. It is our belief that once this program has been proven successful, the rest of the health insurance market will also see radical change as the federal government will extend such standardization to basic health care plans.

SECURITIES REGULATION

With the popular explosion of variable products in the marketplace, the Securities and Exchange Commission (SEC) has become much more active in overseeing this market.

The National Association of Securities Dealers (NASD) has also played a prominent role in this area, as it has set specific procedures for licensing.

PENSION LEGISLATION

Many insurance companies have chosen pension marketing as their niche in the insurance industry. With the multitude of qualified retirement plans in the marketplace, both the

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Internal Revenue Service and Labor Department are playing major roles in this area. The Internal Revenue Service scrutinizes each plan to be sure it meets federal guidelines for tax deferral. The Labor Department reviews plans to be sure that discrimination does not occur.

The landmark piece of legislation in the pension area was the Employee Retirement Income Security Act of 1974 (**ERISA**). ERISA's provisions apply to professionals who are involved in the areas of pension planning and administration. It is critically important for the insurance professional to be well versed in these laws, as running a foul of these rules will open the insurance professional to many problems and possible liability exposure.

In summary, the insurance professional who works in these technical markets should purchase **Errors and Omission Insurance** (E&O). Today, most agency managers and insurance companies will insist that insurance agents representing them, must have this protection.

Under this type of liability protection, the insurance professional is the insured and is covered for legal defense and settlement costs (up to a stipulated maximum) stemming from professional services he/she rendered or failed to render.

The professional services E&O insurance coverages include the sale of insurance and employee benefit plans, along with the advice, and administrative activities associated with or for the agent's or agency plans. Errors and omissions insurance is available on an individual or group basis. Whether or not this coverage is needed is an individual decision. However, for those professionals working in pension and the advanced markets, it should be mandatory.

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STATE REGULATION

The major burden of insurance regulation rests with the state governments. Regulation in the states is carried out by the state insurance departments as these departments oversee the operation of insurance companies, agent licensing and insurance marketing.

Throughout our history it seems that the federal government just could not decide who should have the immense responsibility of regulating the insurance industry.

As early as 1868, through the case of **Paul vs. Virginia** the United States Supreme Court ruled that "*Issuing a policy of insurance is not a transaction of commerce*" thus marketing the regulation of insurance under the domain of the states and not subject to federal regulation.

Then, in 1944, the Supreme Court reversed its position in **Paul vs. Virginia** when it ruled on **United States vs. Southeaster Underwriters Association**. In the case, the court ruled that insurance transactions across state lines were considered commerce and subject to antitrust laws, thus placing insurance regulations directly under the control of the federal government. The effect of this decision was quite extensive. The states became very concerned as the different State Insurance Departments controlled the insurance companies. By taxing the companies the states were able to generate badly needed revenue. This possible loss of revenue greatly concerned the states. The insurance companies were equally concerned as they believed that the sharing of data with other companies, for rating making purposes could be construed as the formation of a monopoly.

The final piece of the puzzle that gave the states the job of regulating and taxing companies was **Public Law 15**, better known as **the McCarran-Ferguson Act of 1948**.

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Though state laws regarding sales and marketing practices by insurance agents vary, there is a great deal of uniformity in the principle and intent of these laws. All are designed to protect the interests of consumers by ensuring fair, reasoned and ethical conduct by the agent.

We will focus on some of the more important of these laws.

UNAUTHORIZED INSURERS

By law, only insurers that are authorized or licensed by a state may issue policies in that state. It is the agents responsibility to be sure that the insurers he/she represents are licensed to do business in the state. Some states will hold the agent directly responsible for any insurance contract he/she places with an unauthorized insurer. Generally, a

state's guaranty fund only covers the liability of authorized companies, so anyone purchasing policies from unauthorized or unlicensed companies would be at risk if those insurers failed to meet their claims.

MISREPRESENTATION

As earlier noted, any written or oral statement that does not accurately describe a policy's features, benefits or coverage is considered a misrepresentation, and all states have enacted laws that penalize agents who engage in this practice.

DEFAMATION

Defamation is any false or malicious communication written or oral, that injures another's reputation, fame or character. It is important to understand that both individuals and companies can be defamed. The spreading of rumors or falsehoods about the character of a competing agent or the financial condition of another insurance company is inherently unethical if such statements are made, the individual better be sure that such statements are correct.

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REBATING/REPLACEMENT

As noted in an earlier chapter, both rebating and replacement have been widely abused in the marketplace. The states have enacted laws to discourage such practices as penalties, suspension and revocation of licenses could occur if these practices are continued and proved to be unethical in spirit.

TWISTING

Twisting is the unethical act of persuading a policy-owner to drop a policy solely for the purpose of selling another policy without regard to possible disadvantages to the policy-owner.

Twisting involves some kind of misrepresentation by the agent to convince the policy-owner to switch insurance companies and/or policies. Virtually every state prohibits the act of twisting and will penalize the offender.

LICENSE SUSPENSION OR TERMINATION

The law deals with unethical acts harshly. This is because what states consider unethical, they have made illegal. In most states, an agent's license can be suspended or terminated for the following fourteen reasons:

1. Giving any indication that future policy dividends are guaranteed;
2. Describing a premium as a "deposit" unless the payment establishes a debtor-creditor relationship and clearly shows when and how the deposit may be withdrawn;

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3. Making a material untrue statement in the application for an agent's license;
4. Implying that a policy is being sold or issued by the investment department of a life insurance company;
5. Stating, or implying, that a policy is "self supporting" or that projected dividends under a participating policy will be sufficient to assure any benefits without any further payment of premium;

6. Conveying the idea that by purchasing a policy the applicant will become a member of a limited group of persons who will receive special advantages or favored treatment by the insurance company;
7. Stating that an insured will be guaranteed certain benefits should a policy lapse without giving an adequate explanation of non-feature benefits;
8. Using any method of policy cost comparison that does not take into account the time value of money;
9. Stating that a policy contains certain benefits not found in any other insurance contract;
10. Avoiding any clear and unequivocal statement that insurance is the subject of the solicitation.
11. Stating that a prospect must purchase a policy immediately or lose the opportunity to purchase it;
12. Disparaging a competitive agent or insurer, their policies, services or business methods;
13. Using such terms as "financial planner," "financial consultant," "investment counselor" or "financial counselor," implying that the agent is in an advisory

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business in which compensation is unrelated to sales, unless such is actually the case, and

14. Using amounts and numbers in such a way as to mislead the prospect with regard to the cost of the policy and any other significant aspect of the contract.

Knowledge and calculated awareness can help the honest and

ethical agent avoid many of the traps just listed.

FINANCIAL PLANNING

Financial planning as a specialty is a new field of expertise for the insurance agent. As noted earlier, financial planners are required to have additional education, training and experience.

Financial planning involves a variety of services and the use of various financial products. An individual who sells only life insurance plans is not a full-fledged financial planner and should not represent himself/herself as such.

The most recognized ways to become a financial planner is to matriculate and pass the various courses requirements with either the College for Financial Planning (CFP) or the American College (CFFC). Both designations are widely respected in the industry.

There are three organizations that set the standards for ethical conduct in financial planning:

1. The **Institute of Certified Financial Planners** (ICFP).
2. The **College for Financial Planning**.
3. **International Association of Financial Planners** (IAFP).

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Each of these organizations stresses the need for the insurance agent to consistently identify himself/herself as an insurance agent, to identify the company he/she represents and the nature of the sales call that the agent is making.

CONFLICTS

When an insurance agent moves from life underwriting to financial planning, the scope of ethical responsibility widens. If an agent has the qualifications to render advice or sell securities, the ethical standards of investment advising must be observed in addition to the ethical standards of insurance selling. For example, an agent subject to the Investment Advisors Act of 1940 who charges a fee for services, rather than a commission, is deemed to be a fiduciary of the client. As such, the agent is required to disclose to the client all material information that pertains to the services rendered. This could conflict with the agent's status as fiduciary of the insurer. On the one hand, the agent would have the duty of loyalty and care to the client, and on the other hand the same duties are owed to the insurer. The problem of conflict of interest intensifies if both a fee for service and a commission on the sale is charged.

THE INVESTMENT ADVISOR

Financial planners who engage in rendering investment advice as part of their services will fall under the jurisdiction of the Securities and Exchange Commission (SEC) and its Investment Advisors Act of 1940. There are many important statutes in this law but for the financial planners, two stand out:

1. If the financial planner is in the business of giving investment advice, and receives compensation for

doing so they must register as an investment advisor with the SEC; and

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2. Must conform to certain standards of ethical conduct as defined by the act. The SEC believes that financial planning involves a variety of services, principally advisory in nature. Since financial planning services involve the preparation of a financial program based on information furnished by the client, the discussion of insurance, savings, investments and other benefits will occur upon which, a program developed for the client will include recommendations for specific actions by the client.

The SEC determines if a person is providing financial planning services and is acting as an investment advisor, by asking three questions:

1. Does the person provide advice regarding securities?
2. Is the person in the business of providing such services?
3. Does the person provide such services for compensation?

The SEC's position as applied to a financial planner means that his/her services involve **rendering advice or analysis concerning securities, he/she is an investment advisor.** If so, the individual falls under the jurisdiction of the Act. Because of the nature of their business and the trust a client places in an advisory relationship, the standards of ethics to which investment advisors are expected to conform, are naturally quite high.

THE NAIC

All State insurance commissioners are members of the National Association of Insurance Commissioners. This organization's purpose is to examine various aspects of the insurance business and recommends appropriate state insurance laws and regulations.

The NAIC has four broad objectives:

1. To encourage uniformity in state insurance laws and regulations.
2. To assist officials in administering these laws and regulations.
3. To help protect the interests of policy-owner and
4. To preserve state regulation of the insurance business.

To promote uniformity among the various states in insurance regulation, the NAIC formulates and drafts what is called "**model legislation**". This term includes representative bills or statutes presented to the individual state legislatures for consideration and passage, creating insurance law for that state.

The NAIC created the "Unfair Trade Practices Act," which has been adopted by virtually every state. This Act seeks to regulate insurance practices by defining and prohibiting unfair trade and business practices. The Act also gives the state's insurance commissioner the power to investigate insurers and agents when any violation is suspected.

SUMMARY

An insurance agent's ethical responsibilities to the state in which he/she is licensed are the most strident, because they are set forth in statutes and regulations. These statutes call upon the insurance agents to use common sense and practice the **GOLDEN RULE**. These attributes, plus knowledge and awareness can help the ethical agent steer clear of many problem areas.

CHAPTER 5 - PRACTICE QUESTIONS

1. **The Constitution gives the _____ government the power to regulate insurance:**
 - A. Federal
 - B. State
 - C. Local
 - D. None of the above.

2. **One way the Internal Revenue Service regulates insurance would be:**
 - A. Instituting higher tax rates
 - B. Lower allowable deductions
 - C. Tax the status of different products
 - D. Increase withholding tax

3. **The federal government organization that sets procedures for proper licensing of security sales people would be:**
 - A. National Association of Independent Agent
 - B. National Association of Security Dealers
 - C. Securities and Exchange Commission

D. National Association of Insurance Commissions

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- 4. State insurance commissioners oversee:**
- A. Agent licensing
 - B. Insurance marketing
 - C. Insurer activity
 - D. All of the above.
- 5. Although the various states have their own laws regulating the insurance industry the main cause of concern is to:**
- A. Protect the agent
 - B. Protect the companies
 - C. Protect small business
 - D. Protect the consumer

Unit 5 – Answers

- 1. A
- 2. C

3. B
4. D
5. D