

# Insurance Regulation

Up to this point, the concepts that you have covered have been ones that apply to the insurance industry as a whole. Now that you have examined insurance policies and their provisions, you can turn your attention to regulations and definitions that apply only to this state. You'll learn about a variety of topics, from the duties of the Insurance Department to licensing laws. This chapter is full of definitions and numbers for time limits and dollar amounts. Make sure that you know them for your exam.

## TERMS TO KNOW

**Aggrieved** — injured party; someone entitled to begin a lawsuit or request a hearing

**Cease and desist** — to stop or discontinue

**Coercion** — forceful act or threat aimed to influence a person to act against his or her will

**Commission** — payment to the agent by the insurance company for placing insurance, usually a percentage of the policy premium

**Commissioner** — the head of the state Department of Insurance

**Home office (domicile)** — a state in which an insurer is organized and has its main place of business

**Inducement** — an offer that attempts to influence the other party

**Insolvent** — unable to meet financial obligations

**Line of authority** — a type of insurance a producer or a business entity is authorized to transact

**Reciprocity/Reciprocal** — a mutual interchange of rights and privileges

**Statute** — a formal written law enacted by legislature; insurance statutes can be found in the state Insurance Code

## A. Licensing

Insurance professionals must be properly licensed for a specific line of authority in order to transact insurance. The purpose of licensing is to ensure that a producer meets educational and ethical standards required to fulfill producer's responsibilities to the insurer and to the public. Licensing regulations set out the requirements, procedures, and fees relating to the qualification, licensure, and appointment of insurance producers.

### 1. Process and Types

The following lines of authority are available in Pennsylvania:

- *Life* - coverage on human lives;
- *Accident and health* - coverage for sickness, bodily injury or accidental death, and disability income;
- *Property* - coverage for the direct and consequential loss or damage to property of every kind;

- *Casualty* - Coverage against legal liability;
- *Variable life and variable annuities* - coverage under variable life and/or variable annuities;
- *Personal lines* - noncommercial property and/or casualty coverage;
- *Credit* - debt insurance (limited line);
- *Motor vehicle rental* - auto rental insurance (limited line); and
- *Limited lines* - any other type of insurance as determined by the Commissioner.

In order to apply for a resident insurance producer license in this state, an applicant must complete approved prelicensing course of study and pass a licensing examination. Upon completion of prelicensing education and examination, an applicant must submit the following documents to the Department of Insurance:

- A completed application;
- Fingerprints, used by the Department to obtain national criminal history records information from the Federal Bureau of Investigation (FBI), along with fees for obtaining those records;
- Documentation verifying that the applicant has met the licensing education and examination requirement; and
- License fee.

The licensing examination will not be required, if the applicant is a business entity or a person who

- Has the following professional designations:
  - Chartered Life Underwriter (CLU), and is applying for a life or accident and health license;
  - Chartered Property and Casualty Underwriter (CPCU), and is applying for a property, casualty or accident and health license;
  - Certified Insurance Counselor (CIC) and is applying for a life, accident, and health or property and casualty license;
- Has any other professional designation for which the requirements are waived by the Commissioner;
- Is licensed in another state as an insurance producer for the lines of authority for which the person is seeking a resident license;
- Is applying for limited line credit insurance, or any other limited line of insurance;
- Will be licensed in domestic mutual fire insurance, appointed to an insurer that does not sell automobile insurance; or
- Will be appointed with a fraternal benefit society.

An insurance producer license may be issued only in the name of the applicant or business entity for one or more lines of authority. The license is nontransferable and is issued for a maximum period of **2 years**.

## **Producer**

An insurance producer is a person who sells, solicits or negotiates contracts of insurance. It is unlawful to act as a producer without a license. It is unlawful for insurance contracts to be produced except through a duly licensed producer.

*Individuals* applying for insurance producer licenses must

- Be at least **18 years** of age;

- Have not committed any prohibited act;
- Satisfy the pre-examination education requirements, including 3 hours of ethics;
- Pass the insurance producer licensing examination (for the appropriate line of authority);
- Pay all applicable fees; and
- Possess general fitness, competence, and reliability.

When applying for insurance producer licenses, *business entities* must

- Have one or more designated licensees, in good standing with the Department;
- Apply for licensure in the same lines of authority held by the designated licensees;
- Have not committed any prohibited acts;
- Be owned, operated, and managed by persons possessing general fitness, competence, and reliability;
- Pay all applicable fees; and
- Meet any other criteria established by the Department.

## **Nonresident Producers**

An individual or business entity currently licensed as a resident producer in another state, may apply to the Department for a nonresident producer license, for line of authority equivalent to their existing license.

In such instances, this individual must submit an application to the Department, or provide an updated copy of the individual's home state application. In addition, applicants must provide proof of the individual's current home state license, and pay the required license fee.

If the nonresident applicant is seeking a license for a line of authority for which the individual is not licensed in his or her home state, Pennsylvania's prelicensing requirements must be met for that line of authority before an application may be made to the Department.

The Department may waive all licensing requirements if a nonresident applicant is already licensed in his or her home state, and this home state awards licenses to Pennsylvania's producers on the same basis. This exchange is known as **reciprocity**.

The Department may verify an individual's licensing status through the Producer Database maintained by the NAIC.

If a licensed person is moving to Pennsylvania, he or she may become licensed as a resident by submitting a completed application within **90 days** of establishing residence in Pennsylvania with proof of licensing or a letter of clearance from the prior home state, and pay the appropriate fees.

## **Temporary License**

If necessary, the Commissioner may issue a nontransferable temporary producer's license without requiring a written examination in any of the following cases for the continuation of a producer's existing business:

- To the surviving spouse, next of kin, or personal representative of a deceased producer;
- To the spouse, next of kin, employee, or conservator of a licensed producer who is disabled due to sickness, injury, mental or physical disability;
- To the designee of a licensed producer who enters active service in the armed forces of the United States; or
- Any other person in an extenuating circumstance where the Commissioner deems that the public interest will best be served by the issuance of a temporary license.

Temporary producer licenses may be granted for **up to 180 days**. The Department may immediately and without notice revoke a temporary license if it is in public interest.

## **Managers and Exclusive General Agents**

An **exclusive general agent** is a licensee which has been granted sole authority to act directly or indirectly as an insurance producer for a domestic insurer with respect to a specific portion of the insurer's business or within a specific territory, has the authority to bind coverage on behalf of the insurer and either separately or together with affiliates or subproducers, directly or indirectly produces and underwrites in any **1 year** an amount of gross direct written premium equal to or more than **25%** of the surplus (as regards policyholders) as reported in the last annual statement of the insurer. As any other producer license applicant, an exclusive general manager must be found sufficiently fit, competent and reliable to satisfy the department's standards for licensure.

A **manager** is a person that negotiates and binds ceding reinsurance contracts on behalf of a domestic insurer or manages all or part of the insurance business of an insurer and does not act as an agent for that insurer.

In most cases, individuals are forbidden from engaging in activities requiring a manager or exclusive general agent's license – without being appropriately licensed. However, the following persons are not required to be licensed as managers or exclusive general agents:

- A licensee whose authority is limited to the production of insurance business with limited underwriting authority;
- A manager or exclusive general agent operating under a management contract or exclusive general agency agreement entered into prior to December 22, 1965; and
- A person subject to regulation as a managing general agent.

Anyone without proper licensing, that is caught acting as a manager or exclusive general agent, is guilty of a **third-degree misdemeanor** and faces a **fine of up to \$1,000 for each day of their offense**.

## **Exemption from Licensing**

An insurance producer license is not required of any officer, director or employee of an insurer or organizations employed by insurers, provided they are not directly or indirectly involved with the actual sale of an insurance contract and **do not receive any commission**.

Furthermore, the following individuals are NOT required to hold an insurance producer license:

- A director or employee of an insurer whose activities are limited to executive, administrative, managerial, or clerical;
- The director or employee of a special agent assisting insurance producers by providing technical advice and assistance to licensed insurance producers;
- A person who secures and furnishes information for group insurance or performs administrative services related to mass-marketed property and casualty insurance;
- An employer or association engaged in the administration or operation of a program of employee benefits for the employer's or association's own employees;
- Employees of insurers or organizations engaging in the inspection, rating or classification of risks, or in the supervision of the training of insurance producers and who are not individually engaged in the sale of insurance;
- A person whose activities are limited to advertising without the intent to solicit insurance;
- A nonresident who sells, solicits or negotiates a contract of insurance for commercial property and casualty risks to an insured with risks located in more than one state insured under that contract; or
- A salaried full-time employee who counsels or advises their employer relative to the insurance interests of the employer or subsidiaries.

## 2. Maintenance and Duration

### Renewal

A producer license will remain in effect unless suspended or revoked, as long as it is properly renewed. A license must be renewed **biennially (every 2 years)**. In order to renew, producers must submit proper renewal forms, accompanied by payment of the required fees (\$55 for resident and \$110 for nonresident), and proof of the completion of continuing education. Any producer renewing a license who has not previously submitted fingerprints will have to do so upon renewal.

A producer who allows his or her license to lapse may reinstate the license within **1 year** by submitting a renewal form, paying the required fee of \$165, and providing verification of completing the required continuing education hours for the previously licensed and lapsed periods.

If the reinstatement is *within 60 days* of license lapse, reinstatement will occur retroactively with the reinstatement effective on the date the license lapsed. If the request for reinstatement is *beyond 60 days* from the date of lapse, the license will be reinstated prospectively, with reinstatement effective the date that the license is reinstated.

If a producer is unable to comply with the license renewal requirement due to **military service** or other **extenuating circumstance**, the producer may request the Department to waive the continuing education requirement, and permit the producer to request renewal. The request for a waiver will need to include sufficient detail and supporting documentation.

### Continuing Education

Continuing education (CE) rules are established to protect the public by maintaining high standards of professional competence in the insurance industry, and to maintain and improve the insurance skills and knowledge of licensed producers.

All insurance producers must successfully complete a minimum of **24 credit hours** of continuing education every **2 years**. A licensee may carry forward any excess credit hours from one licensing period to the next – up to a maximum of 24 credit hours. All continuing education programs and courses must be approved by the Commissioner.

Insurance producers who have the authority to sell annuities must complete at least **4 CE credits** in an approved annuity training course.

### Assumed Names

An insurance producer license issued by the Department will only be issued in the name of the applicant or business entity. If a licensee is doing business under a fictitious name other than the name appearing on the producer license, the licensee is required to notify the Commissioner in writing prior to use of the fictitious name.

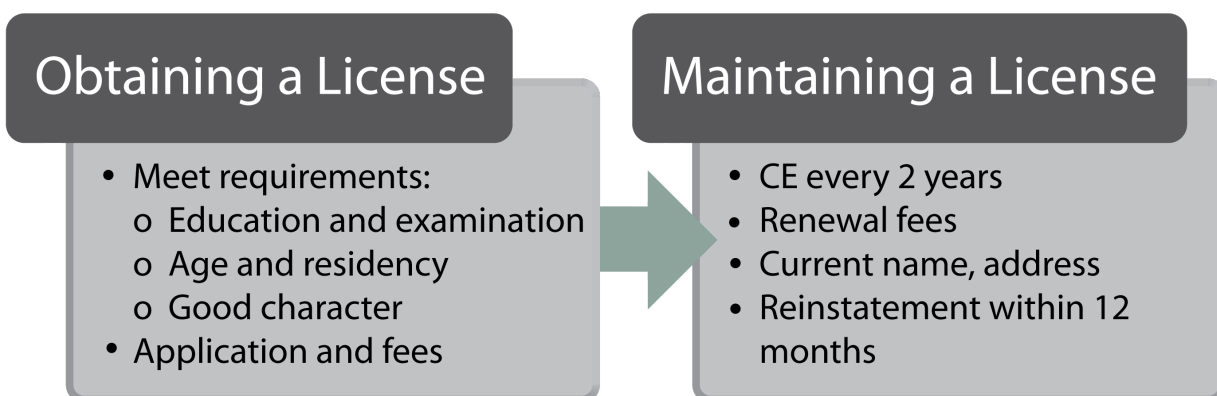
### Change of Contact Information

Every producer licensed in Pennsylvania must notify the Department in writing within **30 days** of any change of address, telephone, and e-mail address. The producer must also notify all the entities for which the producer holds an appointment.

### Reporting of Actions

Licensees must make a report of any administrative action taken against them in another jurisdiction or by another governmental agency within **30 days** of the final disposition of the matter. If a licensee is charged with criminal conduct, the licensee must provide the department with all of the following documents within 30 days of their availability:

- A copy of the criminal complaint, information or indictment;
- A copy of the order resulting from a pretrial hearing, if any; and
- A report of the final disposition of the charges.





# B. State Regulation

## 1. Commissioner's General Duties and Powers

The Commissioner of Insurance is **appointed by the Governor** with the consent of the senate, and holds office for the **term of 4 years**, and until a successor is appointed and qualified. The Commissioner must be a citizen of the state of Pennsylvania, and must be experienced in matters of insurance.

The Commissioner's main responsibilities include licensing insurance producers and companies, and approving, administering, or contracting the administration of the prelicensing education courses, insurance producer licensing examinations, and CE programs.

The Commissioner may also do all of the following:

- Secure or require any documents or information, including fingerprints, reasonably necessary to verify the accuracy of information provided on an application;
- Participate with the NAIC in a centralized insurance producer license registry for purposes of submitting or obtaining information on insurance producers, including licensing history, lines of authority and regulatory action;
- Approve forms to be used by individuals and business entities to apply to the department for an insurance producer license; and
- Approve additional limited lines of authority.

## Examination of Records

The Department of Insurance or its examiners may conduct an examination of any company authorized to transact insurance in this state. The purpose of the examination is to ensure that the companies remain solvent and conduct business of insurance in compliance with state laws and regulations pertaining to licensing, policy forms, rates, claims, and market conduct.

The Department must conduct an examination of every insurer least once every **5 years**, or as often as deemed appropriate. The Commissioner or any examiners may issue subpoenas and administer oaths to anyone on any matter that is relevant to the examination.

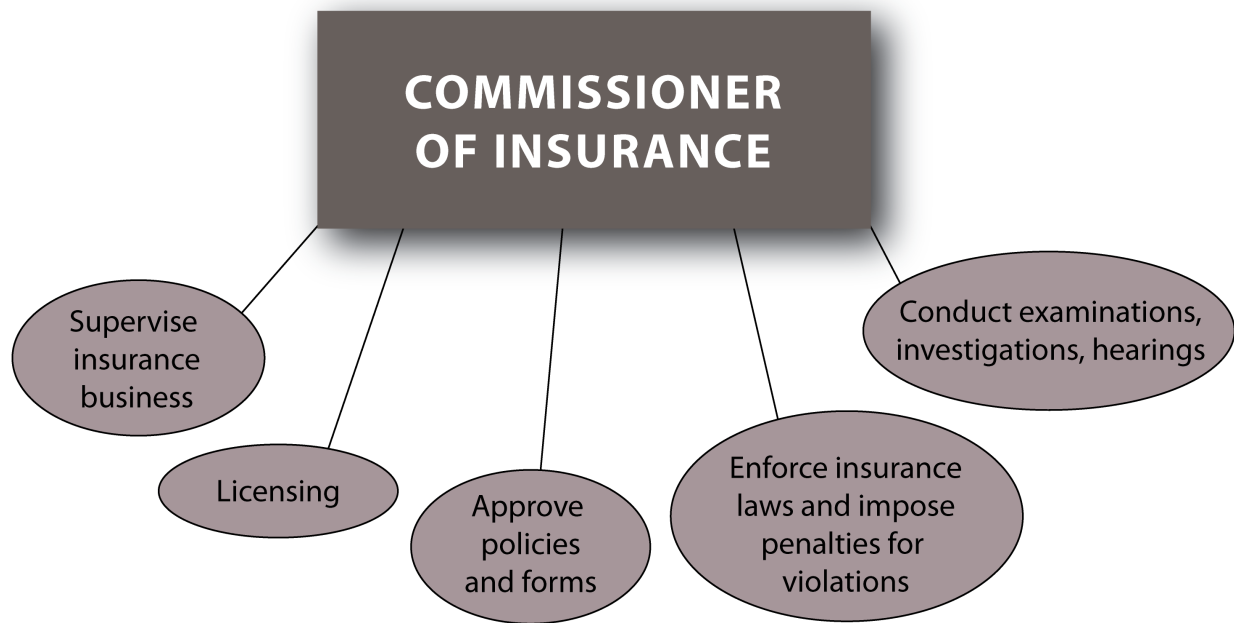
In lieu of an examination of a foreign or alien insurer, the Department may accept an examination report on the company, as long as the report was prepared by an NAIC-accredited insurance department.

Insurers are required to keep records in a way that the department may readily verify the examinee's financial condition and compliance with laws and to provide timely, convenient and free access to all records. Records must be readily accessible and usable for examination purposes. The department may conduct an exam when it sees fit. Records must be kept for **5 years from the last examination**.

The purpose of these examinations is to assess the insurance company's

- Financial condition;

- Ability to fulfill its financial obligations; and
- Compliance with state laws.



## 2. Company Regulation

### Certificate of Authority

Before an insurance company can legally transact insurance, it must first obtain a **certificate of authority** from the Commissioner. This certificate indicates that the Commissioner has examined the business and found it to be financially stable and organized in accordance with the Insurance Code.

Insurance companies must notify the Commissioner within 5 business days when there is any material change in their ownership, control, surplus or solvency.

If an insurance company violates the laws of the Commonwealth, the Commissioner may suspend or revoke the insurance company's certificate of authority, refuse to issue a new certificate of authority for a period up to 1 year, and/or impose a penalty between \$5,000 and \$25,000 for each violation.

### Solvency

The Commissioner and the Department of Insurance are charged with monitoring the financial strength and integrity of insurers authorized to conduct business in Pennsylvania in order to determine whether the continued operation of any insurer might be financially hazardous to policyholders, creditors, or to the public in general.

Whenever any life insurance company does not have on hand the net value of all policies in force (after all other debts and claims, including 50% of the capital, have been provided for), the Commissioner will notify the company and its agents that it cannot issue any new policies until such funds become available.



In addition to the required reserves, any insurance company (other than a life insurance company) is required to establish the appropriate statutory reserves, in accordance with the instructions for the calculation of such reserves (as published by the NAIC).

## **Policy Rates and Forms**

To assure the public that an insurer's **premium rates** are neither excessive nor inadequate to meet future obligations, the Pennsylvania Insurance Code requires insurers to file their premium rates with the Commissioner. All rate filings are subject to a **30-day** waiting period before they become effective. If the Commissioner disapproves of a filing, a hearing may be held **10 days** after the insurer is notified of that disapproval.

If the insurer feels that it was aggrieved in connection with a filing, it may apply for a hearing with the Commissioner. The Commissioner may hold that hearing **30 days** after receiving the application.

Corporations, associations, partnerships, and individuals may apply to the Commissioner for rating organization licenses. The Commissioner will make decisions on these applications within **60 days** of the date of their filing. Rating organization licenses will remain in effect for **3 years**. The fee for this license is \$25.

Every member of a rating organization must adhere to the filings made on its behalf – except that these insurers may file a uniform percentage change to be applied to the premiums produced by the rating system. Following a **30-day** waiting period, these deviation filings are effective for **1 year**.

Violations of the regulations for premium rates may result in fines of \$50 for each violation, not to exceed \$500.

The Commissioner will examine each rating organization as often as deemed necessary, but at least once every **5 years**.

**All forms**, including changes to previously approved forms, must be filed with the Commissioner. The Commissioner will approve or disapprove the form within **30 days**. If no action is reported within 30 days, the insurer can assume that the form is approved. The Commissioner may extend this period an additional 30 days by providing written notice. The Commissioner must notify the insurer of the reasons for any disapproval within 30 days after mailing written notice of the action.

Additionally, the following provisions must be included with most life policies:

- A grace period of either 30 days (or 1 month), within which the payment of any premium may be subject to an interest charge of up to 8%;
- A provision that the policy will become incontestable 2 years after it has been issued;
- A provision that allows the policy to participate in the surplus of the company beginning no later than the 5th policy year;
- Renewable term policies of up to 10 years may participate in the surplus in their 2nd policy year;

- A provision allowing for loan value after premiums have been paid for 3 full years;
- A provision that allows a policy to be reinstated 3 years after a default in premium payments; and
- A policy must cover any loss related to a pre-existing condition after 12 months.

Anyone violating this section faces misdemeanor charges and a fine of up to \$500. In addition, the Commissioner may pursue any of the following courses of action:

- Suspend the license of the offending person;
- Refuse to issue a new license to this person for 1 year; or
- Issue a fine of up to \$1,000 for each violation.

## **Producer Appointment**

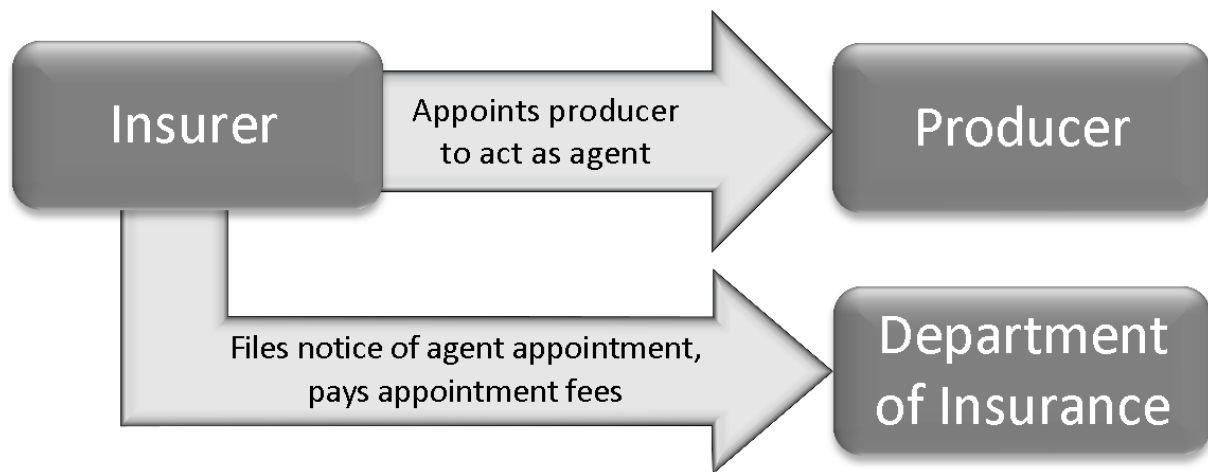
Every insurer must notify the Insurance Department of all appointments and terminations of appointments of producers in the format and within the time frame specified by the Commissioner. An insurer that appoints an insurance producer must file with the department a **notice of appointment**, stating for which companies within the insurer's holding company system the appointment is made. Upon receipt of the notice, the department will verify if the insurance producer is eligible for appointment.

An appointment fee of \$15 must be billed to the insurer annually for each producer appointed during the previous year. This fee must be paid within **30 days**.

If an insurer **terminates a producer's appointment**, the Commissioner must be notified within **30 days** after the effective date of the termination. If the reason for the termination is due to the producer's engaging in activity prohibited by the regulations, this information must be included in the termination notice.

The insurer then must mail a notice to the producer within **15 days** after the notification is sent to the Commissioner. The producer has a right to send comments to the Commissioner regarding the termination within **30 days** of receiving the notice.

Failure to report terminations or false reporting with malice may result, after a hearing, in suspension or revocation of the insurer's certificate of authority or a fine not to exceed \$5,000 for each violation.



## Unfair Claims Settlement Practices

The following are **unfair claims settlement practices** if committed openly and in conscious disregard of rules and regulations, or if committed with such frequency as to indicate a general business practice:

- Misrepresenting pertinent facts or insurance policy provisions relating to coverages;
- Failing to acknowledge and act reasonably promptly upon communications with respect to claims;
- Failing to adopt and implement reasonable standards for the prompt investigation of claims;
- Refusing to pay claims without conducting a reasonable investigation based upon all available information;
- Failing to affirm or deny coverage of claims within a reasonable time after proof of loss statements have been completed;
- Not attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear;
- Compelling insureds to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by such insureds;
- Attempting to settle a claim for less than the amount to which a reasonable person would have believed that such person was entitled by reference to written or printed advertising material accompanying or made part of an application;
- Attempting to settle claims on the basis of an application which was altered without notice to, or knowledge or consent of the insured;
- Making claims payments to insureds or beneficiaries not accompanied by a statement setting forth the coverage under which payments are being made;
- Making known to insureds or claimants a policy of appealing from arbitration awards in favor of insureds or claimants for the purpose of compelling them to accept settlements or compromises less than the amount awarded in arbitration;
- Delaying the investigation or payment of claims by requiring an insured, claimant or the physician of either to submit a preliminary claim report and then requiring the subsequent submission of formal proof of loss forms, both of which submissions contain substantially the same information;
- Failing to promptly settle claims, where liability has become reasonably clear under one portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage; or
- Failing to promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim or for the offer of a compromise settlement.

In this state, insurers must comply with the following regulations for claims settlements:

- Acknowledge the receipt of claims or any other pertinent communication within **10 working days**;
- Respond to inquiries from the Department within **15 working days**;
- After receiving notification of a claim, provide the necessary claim forms within **10 working days**;
- Complete investigations related to claims within **30 days** of notice. If the investigation cannot be completed during this time period, the insurer should give the insured notice (within 30 days of the initial notice), and provide further notice every **45 days** that the investigation continues; and
- Accept or deny any claims within **15 days** of their receipt. If the insurer needs more time, notice should be provided within **15 days**.

Furthermore, insurers are forbidden from negotiating directly with a claimant who is not represented by an attorney. In these cases, the claimant should be notified of any time limit affecting their rights. This notice will be given to first-party claimants within **30 days**, and to third-party claimants within **60 days**.

Upon payment of \$1,000 or more in settlement of a third-party liability claim, the insurer must send written notice to the claimant.

### **3. Producer Regulation**

#### **Appointment with the Insurer**

An insurance producer may not act on behalf of an insurer unless the insurance producer is appointed by the insurer. If an insurer authorizes a producer to solicit or negotiate insurance on its behalf, the insurer must certify the producer's appointment as a **representative of the insurer**.

#### **Fiduciary Responsibility**

Although the agents act for the insurer, they are legally obligated to treat applicants and insureds in an ethical manner. An insurance agent who agrees to obtain coverage for a client is obligated to exercise the same degree of care as would be expected from a reasonable, prudent, and competent professional in the field. Because an agent/producer handles the funds of the insured and the insurer, they have **fiduciary responsibility**. A *fiduciary* is someone in a position of trust. It is illegal for insurance producers to commingle premiums collected from the applicants with their own personal funds.

Failure to submit funds appropriately could constitute **embezzlement**. The producer may also be held liable for negligence and breach of contract with respect to clients in numerous areas.

Insurance producers acting as brokers have responsibilities to their insureds, identical to those insurance producers acting as agents, regarding the funds they collect in their capacity as brokers.

Violation of this regulation is a **misdemeanor** subject to a fine of \$5,000 for

each violation or 6 months of imprisonment.

## **Commissions and Fees**

An insurance entity or licensee may pay commissions or fees to a licensee for selling, soliciting or negotiating a contract of insurance *if the person is licensed* for activities related to the sale, solicitation or negotiation.

A person who is not properly licensed for activities related to a sale may receive commissions in the following cases:

1. If the person was licensed *at the time of the sale*, solicitation or negotiation; or
2. For referring a person that is interested in purchasing insurance as long as the referring person does not discuss specific terms and conditions of a contract. If the referral is primarily for personal, family or household use, the referring person cannot receive more than a one-time, nominal fee of a fixed dollar amount for each referral. The referral cannot depend on whether or not a sale occurs.

An insurance entity or licensee must not pay a commission or fee to a person if the person's license is suspended or revoked.

A licensee may charge a fee in addition to a commission to a person for the sale, solicitation or negotiation of a contract of insurance for commercial business. The fee charged by the licensee must be disclosed in advance in writing to the person and must be reasonable in relationship to the services provided. Insurance producers cannot charge a fee for the completion of an application for a contract of insurance.

## **Prohibited Acts**

A licensee or applicant for an insurance producer license is prohibited from performing any of the following activities:

- Providing incorrect, misleading, incomplete or false information to the department in a license application.
- Violating the insurance laws or regulations, or a subpoena, or order of the Commissioner of this or another state.
- Obtaining or attempting to obtain a license through misrepresentation or fraud.
- Improperly withholding, misappropriating or converting money or property received in the course of doing business.
- Intentionally misrepresenting the terms of an actual or proposed insurance contract or application for insurance.
- Admitting to or have been found to have committed any unfair insurance practice or fraud.
- Using fraudulent, coercive or dishonest practices, or demonstrating incompetence, untrustworthiness or financial irresponsibility in the conduct of transacting insurance business.
- Having an insurance producer license or other financial services license denied, suspended or revoked by a governmental entity.
- Forging another person's name on an application for insurance or on any document related to an insurance or financial service transaction.
- Cheating on an examination for an insurance producer license.
- Knowingly accepting insurance business which was sold, solicited or negotiated by a person who is not licensed as an insurance producer.

- Failing to comply with an administrative or court order imposing a child support obligation.
- Failing to pay state income tax or comply with any administrative or court order directing the payment of state income tax.
- Committing a felony or its equivalent.
- Committing a misdemeanor that involves the misuse or theft of money or property belonging to another person.
- Committing fraud, forgery, dishonest acts or an act involving a breach of fiduciary duty.
- Transferring insurance coverage to an insurer other than the insurer expressly chosen by the insured without the consent of the insured.
- Failing to notify the department of a change of address within 30 days.
- Demonstrating a lack of general fitness, competence or reliability sufficient to satisfy the department that the licensee is worthy of licensure.

## Producer Disclosure Requirements

Insurance producers who do not have company appointments are considered **representatives of the consumer** (formerly referred to as brokers). An insurance producer who acts on behalf of an insurance consumer is required to execute a written agreement with the consumer prior to acting on the consumer's behalf. The agreement must outline and describe the services provided by the producer, and provide **full and complete disclosure of the fee** to be paid to the insurance producer by the consumer for those services.

## Disciplinary Actions Hearings

Because the Commissioner's role is to enforce insurance laws and to protect the public from unfair trade practices, if the Commissioner suspects that an insurer or its agent has committed a violation or is engaged in an unfair trade practice, the Commissioner may issue a statement of charges and hold a hearing for any purpose deemed necessary (within the scope of the Insurance Code).

If a producer or adjuster is suspected of acting in violation of the Insurance Code, the Commissioner may request a **legal hearing**, and give written notice of the time and place of the hearing to the person in violation. The notice must be given at least **10 days** before the hearing, and must state the subject of the inquiry and specific charges, if any. No person will be excused from testifying or from producing any books, papers, contracts, agreements or documents at any hearing.

## Cease and Desist Order

Following the hearing, the Commissioner may issue a written order resolving the factual issues presented at the hearing and stating what remedial action, if any, is required of the person charged. Whenever it appears that a person has violated an insurance law of Pennsylvania or any rule or regulation made by the Commissioner, the Commissioner may issue a **cease and desist order**.

## Penalties and Fines for Violations



In addition to a cease and desist order, or in addition to any penalties that may be imposed by the court, the Commissioner may impose any of the following disciplinary actions, or a combination thereof:

- Denial, suspension, refusal to renew or revocation of the license;
- A civil penalty up to \$5,000 for each violation; and/or
- Any other action deemed appropriate.

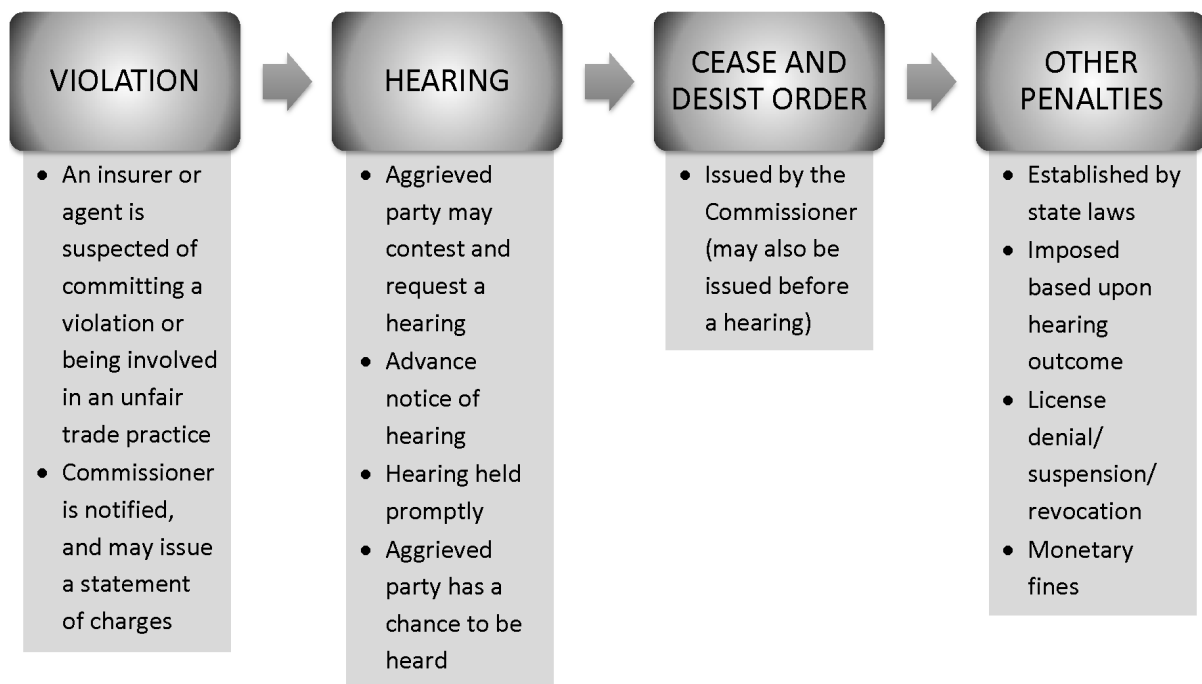
Licensees are required to provide a written response to a Department's inquiry within **30 days**. If a licensee fails to reply, the Department will send a notice specifying the violation and will give the licensee 15 days to correct the violation. Failure to correct such a violation will result in an administrative fine of \$100 per day per violation.

In addition to any penalties imposed by the Insurance Code, in an action filed by the Commissioner, the court may impose the following **civil penalties**:

- For each *intentional* act of engaging in an unfair method of competition or practice, a penalty of up to \$5,000 for each violation (not to exceed \$50,000 in any 6-month period); and
- For each *unintentional* act, a penalty of up to \$1,000 for each violation (not to exceed \$10,000 in any 6-month period).

A penalty of up to \$10,000 may be leveled for each violation of the Commissioner's cease and desist order.

## Violations and Penalties



### 4. Unfair Insurance Practices

Insurers and insurance producers may not engage in any trade practice that is defined as, or determined to be, an unfair method of competition or an unfair or deceptive act or practice in the business of insurance.

It is considered an unfair trade practice to knowingly engage in an unfair

method of competition with enough frequency that the commission of unfair marketing practices indicates a general business practice.

If, after a hearing, the Department determines that a producer or an insurer has committed an unfair trade or competition practice, the Department may issue an order requiring the person to cease and desist from engaging in the method of competition, act, or practice, and/or impose penalties for violation of insurance laws.

## **Misrepresentation**

It is illegal to issue, publish, or circulate any illustration or sales material that is false, misleading, or deceptive as to policy benefits or terms, or the payment of dividends. This also refers to verbal statements. Committing this illegal act is called **misrepresentation**.

## **False Advertising**

Advertising covers a wide scope of communication, from publishing an ad in a newspaper or magazine, to broadcasting a commercial on television or the Internet. Advertisements cannot include any untrue, deceptive, or misleading statements that apply to the business of insurance or anyone who conducts it. The violation of this rule is called **false advertising**.

It is prohibited to advertise or circulate any materials that are untrue, deceptive, or misleading. False or deceptive advertising specifically includes **misrepresenting** any of the following:

- Terms, benefits, conditions, or advantages of any insurance policy;
- Any dividends to be received from the policy, or previously paid out;
- Financial condition of any person or the insurance company; or
- The true purpose of an assignment or loan against a policy.

Representing an insurance policy as a share of stock, or using names or titles that may misrepresent the true nature of a policy also will be considered false advertising. In addition, a person or an entity cannot use a name that deceptively suggests it is an insurer.

Insurers must file all mail-order solicitations with the Department **30 days** prior to their first publication. After these advertisements are approved, they may be used for **2 years**.

A company must maintain, at its home office, a complete file of every advertisement used for a period of **4 years** or until the next regular examination (whichever is longer).

## **Rebates and Inducements**

**Rebating** is defined as any inducement offered to the insured in the sale of insurance products that is not specified in the policy. Both the offer and acceptance of a rebate are illegal. Rebates may include, but are not limited to, the following:

- Rebates of premiums payable on the policy;
- Special favors or services;
- Advantages in the dividends or other benefits; and
- Stocks, bonds, securities, and their dividends or profits.

It is unlawful to pay, offer or accept any of the following as an **inducement** to buy insurance:

- Any special favor or advantage in dividends or benefits;
- Any stocks, bonds, securities, or accrued dividends or profits; or
- Anything of value not specified in the insurance contract.

Insurance producers may give insureds or prospective insureds any object or consideration, other than money, valued at **\$100 or less**.

Any person who violates Pennsylvania statutes regarding rebates and inducements commits a **misdemeanor of the 3rd degree**.

## **Twisting**

**Twisting** is a misrepresentation, or incomplete or fraudulent comparison of insurance policies that persuades an insured/owner, to their detriment, to cancel, lapse, switch policies, or take out a policy **with another insurer**. Twisting is prohibited.

## **Defamation**

**Defamation** occurs when an oral or written statement is made that is intended to injure a person engaged in the insurance business. This also applies to statements that are **maliciously critical** of the *financial condition* of any person or a company.

## **Boycott, Coercion or Intimidation**

It is illegal to be involved in any activity of **boycott, coercion, or intimidation** that is intended to restrict fair trade or to create a monopoly. This would include unfair behavior that influences not only clients, but competing agents and brokers.

**Coercion** is to require, as a condition to a loan, that the applicant purchase insurance from a specific insurer.

## **Misappropriation of Funds**

**Misappropriation of funds** is the term used when a person in a fiduciary position has used funds in manner for which they were not intended, such as the wrongful taking or use of money belonging to another. *For example*, if an insurance producer, investment broker, or a trustee accepts funds from a client, and then uses the funds for their own personal use, it would be considered misappropriation of funds. Misappropriation of funds by insurance products is considered **theft**.

## **Unfair Discrimination**

**Discrimination** in rates, premiums, or policy benefits for persons within the **same class** or with the same life expectancy is illegal. No discrimination may be made on the basis of an individual's marital status, race, national origin, gender identity, sexual orientation, creed, or ancestry unless the distinction is made for a business purpose or required by law.

More specifically, insurers cannot discriminate between individuals of the same class, type of hazard, or life expectancies in relation to the following:

- The rate or dividends of the policy;
- The amount of premium, coverage, fees, rates, terms or conditions of the policy; and
- Underwriting standards by reason of race, religion, nationality, ethnic group, age, sex, family size, occupation, place of residence or marital status.

Note that gender and marital status may be taken into consideration when calculating the amount of insurance that can be purchased for a given premium. These factors may also be considered when determining the settlement options and nonforfeiture benefits available under a life insurance policy.

In individual policies containing a conversion privilege, insureds may not lose coverage due to a change in marital status.

## **5. Privacy of Consumer Financial Information**

Financial institutions are prohibited from sharing insurance coverage information (obtained when making a loan) with a third party for the purpose of selling or soliciting the purchase of insurance. However, if notice is given, and the customer does not sign and return such a form within **30 days**, such information may be shared.

A licensee must give a customer an accurate privacy policy initially and at least annually. If the customer relationship ends, the licensee is no longer required to provide notices.

A licensee may not disclose nonpublic personal financial information about a consumer to a nonaffiliated third party unless all of the following conditions are met:

- The licensee has provided to the consumer an initial notice;
- The licensee has provided to the consumer an opt-out notice;
- The licensee has given the consumer reasonable opportunity to opt out (30 days following the delivery of the notice); and
- The consumer does not opt out.

As used in this section of the Insurance Code, the term *opt out* means a direction by the consumer that the licensee not disclose his or her nonpublic personal financial information to a third party.

## **Disclosure Required**

Licensees who are employed by or affiliated with a financial institution who sell annuities or life insurance must solicit insurance and annuity sales in a

location which is distinct from the area where deposits or loans are discussed or accepted. If circumstances prevent compliance, the Commissioner may exempt the financial institution from this requirement.

In addition, prior to or at the time of an application, the financial institution producer must provide each person a **disclosure** that states that the insurance or annuity is

- Not a deposit;
- Not insured by the Federal Deposit Insurance Corporation (FDIC) or any other federal government agency;
- Not guaranteed by the financial institution; and
- Subject to risk, including the loss of principal.

## **6. Insurance Fraud Regulation**

The following actions are considered **insurance fraud** if conducted knowingly and with the intent to defraud a state or local government agency, or an insurer:

- Presenting documents and statement that contain false, incomplete, or misleading information concerning any fact material a claim;
- Presenting documents and statement that contain false, incomplete, or misleading information concerning a motor vehicle insurance rate filing, transaction, or action in response to an agency's request;
- Engaging insurance transaction activities without being properly licensed;
- Knowingly benefiting, directly or indirectly, from the proceeds derived from a violation of this act, due to the assistance, conspiracy or urging of any person;
- Borrowing or using another person's financial responsibility or other insurance identification card to present a fraudulent claim;
- For an owner, administrator or employee of any hospital, knowingly allowing the use of the hospital facilities by any person in furtherance of a scheme or conspiracy to violate any of the provisions of this act;
- Directly or indirectly soliciting a person to engage, employ, or retain him/herself or any other person to manage, adjust, or prosecute any claim or cause of action against a person for damages for negligence or for pecuniary gain.

The civil penalty for violation the Pennsylvania Insurance Fraud Prevention Act is up to \$5,000 for the first violation, \$10,000 for the second violation, and \$15,000 for each subsequent violation.

The purpose of the Insurance Fraud Protection Act of 1994 is to protect consumers and insurance companies from **white-collar insurance fraud**. The act requires that a person who has been convicted of any crime involving dishonesty or breach of trust must obtain consent from an insurance regulatory official prior to engaging in the business of insurance. The statute does not, however, specifically limit the applicability of this provision to any particular class or level of employees or individuals such as those involved in the management or financial affairs of the company. The statute is applicable to **any employee** previously convicted of a felony involving dishonesty or breach of trust.

The state Insurance Code has promulgated rules and regulations that help

prevent, combat, and reduce insurance fraud.

The **Insurance Fraud Prevention Authority** was established to develop and sponsor the implementation of statewide plans, programs and strategies to combat insurance fraud, improve the administration of the insurance fraud laws, and provide a forum for identification of critical problems for those persons dealing with insurance fraud.

The **Insurance Fraud Prevention Trust Fund** was created to fund the investigation and prosecution of insurance fraud. As a condition of transacting insurance in Pennsylvania, each insurer must pay an annual assessment into this Fund.

The **Section of Insurance Fraud** within the Office of Attorney General is responsible for investigating and prosecuting insurance fraud. Every insurer, every employee of an insurer, and every licensed producer must cooperate fully with the Section of Insurance Fraud, and notify the section when they believe that an insurance fraud has been or is being committed.

## **Consent Agreement**

A person who is accused of violating insurance fraud statutes of the Insurance Code may enter into a **consent agreement**. By so doing, the accused does not admit or deny the charges, but agrees to pay a fine. The consent agreement may not be used in a subsequent civil or criminal legal action, but if the person is licensed, the Commissioner may be notified and additional administrative actions may be taken against the person. The consent agreement does not prevent criminal prosecution for violation of the Commonwealth's laws.

## **7. By the Numbers - Summary Chart**

In order to perform your best on the state regulations portion of the exam, make sure you memorize these numbers and their definitions.

### **Department of Insurance Regulations:**

**10 days** Written notice of a hearing for a person suspected of prohibited behavior

**30 days** Waiting period before rate filings go into effect

**10 days** Hearing on rate filing after insurer is informed of disapproval

**5 years** Commissioner will examine each insurer

**30 days** For Commissioner to approve or disapprove changes to a form

### **Licensing and Appointment Requirements:**

**18** Age requirement for resident producer license

**3 hours** Ethics education included in prelicensing education requirements

**90 days** After moving to Pennsylvania for nonresident to become licensed as a resident

**2 years** License renewal period

**180 days** Temporary producer's license valid without written examination

**24 hours** Continuing education required every 2 years

**24 hours** Continuing education that may be carried to the next renewal period

**1 year** To reinstate a lapsed license with current effective date

**\$165** Lapsed license fee

### **Miscellaneous Producer Regulations:**

**30 days** To report action taken against producer in another jurisdiction or charges of criminal conduct



**30 days** To notify the Department of change of address

**30 days** To provide a response to the Department's inquiry

**15 days** To correct the violation if a person failed to respond to the Department's inquiry within 30 days

**Important Dollar Amounts:**

**\$5,000** Civil penalty for each *intentional* violation of insurance laws regarding unfair methods of competition

**\$50,000** Aggregate penalties for *intentional* violations within 6 months

**\$1,000** Civil penalty for each *unintentional* violation of insurance laws regarding unfair methods of competition

**\$10,000** Aggregate penalties for *unintentional* violations within 6 months

**\$100** Fine per day for failure to correct any violation

## C. Federal Regulation

### 1. Fair Credit Reporting Act

The **Fair Credit Reporting Act** established procedures that consumer-reporting agencies must follow in order to ensure that records are confidential, accurate, relevant, and properly used. The law also **protects consumers** against the circulation of inaccurate or obsolete personal or financial information.

The acceptability of a risk is determined by checking the individual risk against many factors directly related to the risk's potential for loss. Besides these factors, an underwriter will sometimes request additional information about a particular risk from an outside source. These reports generally fall into 2 categories: Consumer Reports and Investigative Consumer Reports. Both reports can only be used by someone with a legitimate business purpose, including insurance underwriting, employment screening, and credit transactions.

**Consumer reports** include written and/or oral information regarding a consumer's credit, character, reputation, or habits collected by a reporting agency from employment records, credit reports, and other public sources.

**Investigative Consumer Reports** are similar to consumer reports in that they also provide information on the consumer's character, reputation, and habits. The primary *difference* is that the information is obtained through an investigation and interviews with associates, friends and neighbors of the consumer. Unlike consumer reports, these reports cannot be made unless the consumer is advised in writing about the report within **3 days** of the date the report was requested. The consumers must be advised that they have a right to request additional information concerning the report, and the insurer or reporting agency has **5 days** to provide the consumer with the additional information.

**Know This!** Insurance applicants must be notified in writing whenever insurers request investigative consumer reports.

The reporting agency and users of the information are subject to civil action for failure to comply with the provisions of the Fair Credit Reporting Act. A person who knowingly and willfully obtains information on a consumer from a consumer reporting agency under false pretenses may also be fined

and/or imprisoned for up to 2 years.

An individual who **unknowingly** violates the Fair Credit Reporting Act is liable in the amount equal to the loss to the consumer, as well as any reasonable attorney fees incurred in the process.

An individual who **willfully** violates this Act enough to constitute a general pattern or business practice will be subject to a penalty of up to \$2,500.

Under the Fair Credit Reporting Act, if a policy of insurance is declined or modified because of information contained in either a consumer or investigative report, the consumer must be advised and provided with the name and address of the reporting agency. **The consumer has the right to know what was in the report.** The consumer also has a right to know the identity of anyone who has received a copy of the report during the past year. If the consumer challenges any of the information in the report, the reporting agency is required to reinvestigate and amend the report, if warranted. If a report is found to be inaccurate and is corrected, the agency must send the corrected information to all parties to which they had reported the inaccurate information within the last 2 years.

Consumer reports cannot contain certain types of information if the report is requested in connection with a life insurance policy or credit transaction of less than \$150,000. The **prohibited information** includes bankruptcies more than 10 years old, civil suits, records of arrest or convictions of crimes, or any other negative information that is more than 7 years old. As defined by the Act, *negative information* includes information regarding a customer's delinquencies, late payments, insolvency or any other form of default.

## **2. Fraud and False Statements**

It is considered **unlawful insurance fraud** for any person engaged in the business of insurance to willfully, and with the intent to deceive, make any oral or written statement that are either false or omit material facts. This includes information and statements made on an application for insurance, renewal of a policy, claims for payment or benefits, premiums paid, and financial condition of an insurer.

Anyone engaged in the business of insurance whose activities affect interstate commerce, and who knowingly makes false material statements may be fined, imprisoned for up to **10 years** or both. If the activity jeopardized the security of the accompanied insurer, the punishment can be up to **15 years**.

Anyone acting as an officer, director, agent or other insurance employee who is convicted of embezzling funds faces the aforementioned fines and imprisonment. However, if the embezzlement was in an amount less than **\$5,000**, prison time may be reduced to 1 year.

Federal law makes it illegal for any individual convicted of a crime involving dishonesty, breach of trust or a violation of the **Violent Crime Control and**

**Law Enforcement Act of 1994** to work in the business of insurance affecting interstate commerce without receiving a **letter of written consent** from an insurance regulatory official — a **1033 waiver**. The consent of the official must specify that it is granted for the purpose of 18 U.S.C. 1033. Anyone convicted of a felony involving dishonesty or breach of trust, who also engages in the business of insurance, will be fined, imprisoned for up to 5 years or both.

Section 1034, Civil Penalties and Injunctions for Violations of Section 1033, states that the Attorney General may bring a **civil action** in the appropriate U.S. district court against any person who engages in conduct that is in violation of Section 1033 of not more than **\$50,000** for each violation, or the amount of compensation the person received as a result of the prohibited conduct, whichever is greater.

### **3. Privacy (Gramm-Leach-Bliley Act)**

The Gramm-Leach-Bliley Act stipulates that in general, an insurance company may not disclose nonpublic personal information to a nonaffiliated third party except for the following reasons:

- The insurance company clearly and conspicuously discloses to the consumer in writing that information may be disclosed to a third party;
- The consumer is given the opportunity, before the time that information is initially disclosed, to direct that information not be disclosed to the third party; or
- The consumer is given an explanation of how the consumer can exercise a nondisclosure option.

The Gramm-Leach-Bliley Act requires **2 disclosures** to a customer (a consumer who has an ongoing financial relationship with a financial institution):

1. When the customer relationship is established (i.e., a policy is purchased); and
2. Before disclosing protected information.

The customer must also receive an annual privacy disclosure, and have the right to opt out, or choose not to have their private information shared with other parties.

### **4. Do Not Call Registry**

In 2003, the Federal Trade Commission (FTC) and the Federal Communications Commission (FCC) worked together to create the **National Do Not Call Registry**, allowing consumers to include their telephone numbers on the list to which solicitation calls cannot be made by telemarketers. Insurance companies need to comply with this regulation when making solicitation phone calls.

To comply with the telemarketing sales rules, telemarketers must not do any of the following:

- Call any number on the National Do Not Call Registry or on that seller's Do

Not Call list;

- Deny someone a right to be placed on any Do Not Call Registry;
- Call outside permissible calling hours (before 8 a.m. and after 9 p.m.);
- Abandon calls;
- Fail to transmit caller ID information;
- Threaten or intimidate a consumer or use obscene language; or
- Cause any telephone to ring or engage a person in conversation with the intent to annoy, abuse, or harass the person called.

Some **exceptions** to the Do Not Call Registry include the following calls:

- From or on behalf of organizations which have established a business relationship with the consumer (for the last 18 months from the date of a sale or transaction);
- For which the consumer has given prior written permission;
- Not commercial or that do not include unsolicited advertisements; and
- By or on behalf of tax-exempt nonprofit organizations.

To keep in compliance with the Do Not Call rules, organizations must consult the registry every **31 days**. Any phone numbers on the registry must be dropped from the organization's call lists.

## D. Ethics

*This section will recap some of the most important points regarding insurance producer ethics. The information will provide you with a greater understanding ethical principles and practices; however, it will not appear on the state exam.*

### 1. Ethics: Principles and Practices

The purpose of this part of the course is to provide the foundation of knowledge and understanding that an individual needs to function ethically in his or her role as an insurance professional. Our concentration will be on the social, professional, and legal aspects of ethics.

It seems that in many news reports that a person reads or listens to these days, some insurance company or insurance agent is receiving negative publicity as a result of bad professional judgment or poor ethical conduct. Bad news usually attracts far more attention than that paid to the legions of insurance agents who perform their daily sales and service tasks in a thoughtful, fair, and ethical manner. Their exemplary work will be discussed in detail.

As you will discover, ethics can be studied on two levels:

1. Philosophically, where a code of personal ethics helps you gain personal and professional satisfaction; and
2. Practically, where a code of personal ethics helps you avoid controversy and misunderstandings, which increases your personal efficiency as an agent.

### Ethics Defined

**Ethics** is a derivative of the Greek word *ethikos*, meaning "moral" and *ethos*, meaning "character." By textbook definition, ethics is "a branch of philosophy

that deals with the values of human life in a coherent, systematic, and scientific manner." The Oxford English Dictionary defines ethics as "the department of study concerned with the principles of human duty" and the "rules of conduct recognized in certain associations or departments of human life."

You won't find universal agreement among philosophers as to what, exactly, is ethically right. Immanuel Kant, a German philosopher, believed what is right is based on pure reason. On the other hand, Jeremy Bentham, early 19th-century British philosopher, believed *right* to be that which will produce the greatest good. Religious philosophers, like St. Thomas Aquinas, say that *right* is determined by the will of God, and *wrong* is anything contrary to God's will.

For the purpose of our work, we will use Albert Schweitzers definition of ethics:

*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.*

Dr. Schweitzer, who was a French medical missionary and philosopher, applied this idea of "duty beyond the group" to all humanity. He believes that the ultimate goal of ethics is the fullest measure of justice for all. If we were to distill the philosophy of Dr. Schweitzer into three words, they would be "regard for others."

## **Avoiding Conflicts of Interest**

Ethically, an insurance agent who has signed an exclusive contract with his or her insurer cannot serve two principals at the same time. As a "captive" agent, he or she owes a singular loyalty to that insurer. It would be unethical for that agent to represent two insurance companies selling the same policies. In addition, an agent has the ethical obligation to inform his or her company about any other related services that he or she provides and receives payment for. An agent who does part-time preparation and filing, for example, or who serves as a consultant to a local business, should inform his or her company of this activity. The insurer can then determine if there is a **conflict of interest**.

Independent agents also face this issue when they attempt to serve their clients while being contracted to an insurer. Conflicts can be avoided if independent agents follow these guidelines for dual-agency:

- The agent represents the insurance company when insurance is being applied for and when it is in the process of being underwritten, in recordkeeping and in claim settlement or other insurer-related activities.
- The agent "represents" his or her client only during the process of helping the client select the insurance plan best suited to the client's needs.

## **2. Ethics for Insurance Agents**

Consider these questions:



*Is it ethical for an insurance agent to use for a prospect list the names of individuals who registered for a new home in a supermarket drawing?*

*Is it ethical for an insurance agent to call himself or herself a financial planner or an estate planning specialist without the proper training, experience, or qualifications?*

*Is it ethical for an insurance agent to show a prospect a policy illustration without explaining the difference between guaranteed and nonguaranteed benefits?*

Of course, the answer to all of these questions is "**NO.**" None of these situations shows proper ethical behavior by an insurance agent. No matter how extreme these examples might seem, they represent ethical responsibilities that an insurance agent is expected to fulfill. An agents four primary ethical responsibilities are to the following:

- Insurer;
- Policyowners;
- General public; and
- State.

Each of these areas will be discussed in detail in the following sections, but lets take a brief look at them now.

### **Ethical Responsibilities to the Insurer**

The duties of an insurance agent to his or her insurer are established by the concept of agency. This concept is tangibly represented by the agency contract, which both parties agree to and sign. Within the scope of that contract, the insurance agent owes to his or her insurer the duties of honesty, good faith, and loyalty. He or she also is obligated to reveal to the insurer all material facts concerning the agency.

In carrying out his or her duties, the insurance agent is the direct representative of the insurer. His or her day-to-day activities are a direct reflection on the insurer's image within the community. Should the agent behave unethically, everyone in that community is given to believe that the insurer is also unethical.

### **Ethical Responsibilities to Policyowners**

The professional agent can meet his or her ethical responsibilities to an insured policyowner by filling needs and providing quality service. Service is a primary function of the insurance industry. The way that service is provided often determines the agent's future, since clients are a good source for future sales and references.

In addition to quality service, the agent also owes the policyowner the same degree of loyalty that he or she provides to the insurer. The agent is also charged with the ethical responsibilities of full disclosure, confidentially, timely submission of all applications, and prompt policy delivery.



## **Selling to Needs**

Before an individual becomes a policyowner, he or she is a prospect. The transition from prospect to policyowner-and ultimately from policyowner to client-comes about when an agent follows two basic rules: **sell to needs** and **service the sale**.

In doing so, the agent will also live up to the ethical duties that he or she has to policyowners.

An insurance agent has one principal reason for calling on a prospect: to offer a product or service that will benefit the prospect in some way. An agent must sell the kinds of policies that will best fit the prospect's needs and in amounts that he or she can afford to pay. No one profits-not the insurer, not the agent, and especially not the policyowner-if an individual is coerced or misled into buying too much insurance or purchasing coverage that doesn't suit specific needs.

Fortunately, most agents recognize that selling to fit needs is the best approach to the products and services that they represent. They know that specific types of insurance policies are designed to meet specific needs and that matching policies to needs produces the maximum effect, to the benefit of the policyowner. They also know that needs selling involves problem analysis, action planning, product recommendation, and plan implementation. This requires two important commitments on the agents part:

- A commitment to obtain and maintain the knowledge and skills necessary to carry out those tasks; and
- A commitment to educating the prospect or client about the products and plans that may be implemented.

## **Service the Sale**

Selling to needs is only part of what an agent must do to meet the ethical responsibilities that he or she owes to a policyholder. Service during and after the sale is just as important. Quality and productivity experts such as W. Edwards Deming and Joseph M. Juran see service as a process in which the customer's wants and needs are anticipated and then satisfied. Most companies today are committed to giving their customers quality service.

In fact, the quality of a company's level of service is perceived as the most important single factor affecting a business unit's performance in the long run. Since 1972, the Strategic Planning Institute (SPI) of Cambridge, Massachusetts, has collected data to determine what corporate strategies influence performance. SPIs studies consistently show that successful companies stress quality service over their competitors.

## **Service Begins with the Application**

In securing coverage for your client, your main responsibility as an agent is to act reasonably under the circumstances. This means that you must also adhere to your ethical responsibilities to the insurer and see that the prospect completes the application accurately and completely.

At this point, your primary responsibility is to the insurer because you are acting as its agent during the application process. Remember that the insurer is relying upon you for full disclosure of all pertinent information regarding the applicant. However, you also have an ethical responsibility to educate your prospective insured to make sure that he or she fully understands the nature of the application process:

- Why the information is required;
- How it will be evaluated;
- The need for accuracy and honesty in answering all questions; and
- The meaning of terms such as "waiver of premium", "automatic premium loan", "nonforfeiture options", and "conditional receipt."

## **Confidentiality**

In the course of qualifying a prospect, completing a financial questionnaire, analyzing needs, or working on an estate or business plan, insurance agents are privy to a client's personal and financial information. Ethics require that the agent respect the sensitive nature of this information and keep it confidential. Personal information about a client should never be released without proper approval from the client.

## **Commitment to Knowledge and Skills**

The relationship between the professional insurance agent and the policyowner is usually built upon the policyowner's trust in the agent's knowledge and skills. The policyowner must rely on the agent to provide informed options and trusts that the recommendations for insurance are in the client's best interest.

An agent thus has an obligation to ensure that this trust is justified. This means that an agent has the ethical responsibility to obtain the necessary knowledge and skills needed to evaluate and service the insurance needs of clients. Indeed, the term "professional" implies knowledge and skill. If the agent feels that he or she is not properly trained to perform the needed service, then another professional should be called in to assist.

An agent must also keep his or her base of knowledge and skills current. To this end, the agent must be committed to a program of continuing education. He or she must also stay informed of the latest developments affecting a client's interests. In recent years, there has been an increasing trend toward insurance professionalism. Agents should be competent professionals with a high degree of technical knowledge so that they can match a prospect's need with the appropriate solution.

## **Commitment to Educating the Prospect and Client**

Client's trust must be earned, nurtured, and constantly reinforced. The agent who remembers this basic rule is the agent who communicates to his or her client the reasons why a particular insurance policy or program is being recommended and how it will serve the client.

Individuals who understand what a particular insurance plan or policy will do for them are more likely to buy, more likely to be satisfied with their insurance, and more likely to keep their business on the books. This communication and education continues long after the particular policy or program is sold and becomes part of the overall insurance program designed for that client. As noted earlier, the professional agent has established his or her client's insurance program based on needs. These needs should be reviewed annually, supported by explanation and communication of the programs put in place to meet those needs.

## **Ethical Responsibilities to the Public**

The insurance agent has more control over the public's attitude toward insurance than sales representatives for most other consumer products. This is because the insurance agent initiates contact with a prospect, determines a prospect's need for insurance, recommends a certain product or solution, makes the sales presentation, and finally develops a long-term relationship with after-sale service. In many cases, the prospect has little or no direct contact with the insurance company.

Because this special relationship involves a great deal of contact between the consumer and agent (and because the public generally understands very little about insurance), public perceptions of the industry itself are based on how well or how poorly an agent does his or her job. Thus, the professional insurance agent has two main ethical responsibilities to the public:

- To inform the public about insurance with the highest level of professional integrity; and
- To strive for an equally high level of professionalism in all public contacts in order to maintain a strong, positive image of the industry.

## **Ethical Responsibilities to the State**

The responsibility to regulate the insurance industry is shared by the federal and state governments. However, 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 the category of "marketing practices," while other states refer to it in the context of "unfair trade practices."

Whatever it is called, all states have established a code of ethical standards for insurance agents by defining through laws and regulations what an agent can and cannot do. Although these laws differ from state to state, there are enough similarities to discuss them in general terms. This will be the subject of the next section, in which ethical standards for financial planning and the Investment Advisers Act will also be discussed.

Ethical issues are attracting increasing attention in the business of life insurance. While most states have adopted "Unfair Trade Practices", which defines practices which constitute unfair methods of competition or unfair or deceptive acts or practices, the products offered by life insurance agents have become very complicated. An agent's explanation of the link between

their advantages and disadvantages, as well as his/her suggestion of a specific product may determine the financial situation of a client for years.

Also, the complexity of the products makes adequate regulation of insurance companies and their producers extremely difficult. Assessing an agent's activities may be hard, even with detailed regulation. It is impossible to include every possible unethical action in the law; therefore, it is possible for an action to be unethical, even if it is not designated as illegal under the Insurance Code. For these reasons and others, it is necessary in today's climate that producers assume the responsibility for being knowledgeable with regard to the products that they sell and refrain from improper solicitations. No misrepresentation of any kind should be made to an insured or to an insurance company.

### **Underwriting Process Keeping the Applicant Informed**

The underwriting process for an insurance application can be time-consuming. Most insurance companies strive to complete the process within a 21-day period, assuming that there are no delays. Delays can occur whenever an underwriter needs additional information from the applicant and relays that request through the agent, or when a counteroffer, different policy, or different rate is made to the applicant (again through the agent).

An agent's ethical responsibilities to his or her client during the underwriting process center around promptness and policy delivery.

### **Promptness**

An insurance agent needs to ensure that there are no unnecessary delays in the underwriting process. Thus does not mean that the agent has to rush from an applicant's home to the nearest post office to mail an application. It does mean, however, checking the application for accuracy and giving careful thought to it before the application is actually submitted. Many underwriting delays occur simply because the application is not complete or is not clear.

Applications should be submitted as soon as possible. The time frame will vary, of course, depending on the plan of insurance and the complexity of the case. An agent must take these factors into account to act in an efficient manner. If it appears that the underwriting process may take longer than anticipated, the agent should notify the applicant of the delay.

### **Policy Delivery**

Most policies are issued as applied for. In such cases, the agent owes his or her new policyowner prompt delivery of the policy and a review of its features and benefits. Not only does this help solidify the sale, it also represents a step toward making the policyowner a lasting client.

On the other hand, some policies will be rated or rejected. When this happens, the agent has two responsibilities:

1. To personally review the rating or rejection. *Was it medical? Was there an unfavorable medical report? Was something overlooked or not made known to the underwriter? Should additional information be submitted? Is the rating or rejection proper? Should the application be reconsidered?* In any event, the agent should have as much information as possible and be able to explain the rating or rejection to the applicant.
2. Assuming that the rating or rejection was valid, to notify the applicant promptly. To withhold this information is a breach of ethics and could actually harm the applicant and his or her family.

### **3. Avoiding Unethical Practices**

#### **Deceptive Use of Advertising Material**

There are two indisputable facts about insurance and the buying public:

1. The average insurance buyer knows very little about insurance and relies on the advice and recommendations of the insurance agent; and
2. By the time a consumer finds that a particular policy does not meet his or her needs or does not live up to the agent's promises, it may be too late to purchase another policy.

The potential for deceptive advertising or promotion by companies and agents alike is significant, and the consequences to the consumer can be quite grave. Accordingly, all states have enacted laws regulating insurance advertising. The basis for many of these state statutes is the NAIC's model Unfair Trade Practices Act, which expressly cites false advertising as an unfair trade practice and prohibits it. In this context, the term "advertising" is quite broad. It includes print and radio material, descriptive literature, sales aids, slide shows, prepared group talks, brochures, sales illustrations, policy illustrations, and TV commercials—in short, almost any kind of communication or presentation used to promote the sale of an insurance policy.

The purpose of the NAIC model act is to establish guidelines to ensure that insurance companies and their agents promote their products properly and accurately, without exaggerating the benefits or minimizing the drawbacks. *For example*, the act forbids any misrepresentations of the benefits, terms, conditions, or features of any insurance policy, including dividends. The act also bars any misrepresentation of an insurer's financial condition or its legal reserve system, and it prohibits names or titles of insurance that do not represent their true character.

Some states have enacted regulations that separately address life insurance and health insurance advertising. Life insurance advertising, for instance, cannot use the terms *investment*, *savings*, or *profit* in a misleading way. Health insurance advertising must disclose provisions regarding renewability, cancellability, termination, or modification of benefits.

Generally speaking, the burden of complying with state insurance advertising law rests on insurance companies because most advertisements or promotional pieces, regardless of the writer or presenter, are considered to be the responsibility of the insurer whose policies are being advertised. In practice, most of the advertising and sales literature that an agent uses is



prepared by the insurer under the careful eye of its legal staff. For an agent, then, the ethical issue isn't necessarily the material itself but instead how the material is used and the deceptive sales presentation that may result.

## **Deceptive Sales Presentations**

Deceptive sales presentations have probably generated more complaints of unethical agent behavior than any other activity. In addition to the life insurance CEOs in the United States, concern over this activity is shared by the National Association of Life Underwriters (NALU) and the American Society of CLU & ChFC, as well as by the Independent Insurance Agents of America. The topic has also been addressed by the U.S. Congress in committees studying insurance company activity.

What constitutes a deceptive sale? Any presentation that gives a prospect or client the wrong impression about any aspect of an insurance policy or plan is deceptive. Any presentation that does not provide complete disclosure to a prospect or client is deceptive. Any presentation that includes misleading or inconclusive product comparisons is deceptive. Even if the deception is unintentional, the agent has done the consumer a great disservice.

Deceptive sales presentations can be blatant. For example, a comparison of a term policy and a whole life policy based only on premium rates is obviously misleading and incomplete. Yet, deception does not have to be so apparent to be unethical. What about describing a personal life insurance policy as a "tax shelter" but failing to mention that premiums are not deductible and that surrendered cash values may be subject to tax? What about recommending a certain kind of health policy without explaining the conditions under which it could be canceled or the premiums increased? While any of these ploys might help make the sale, they are all misleading and unethical.

## **Policy Illustrations**

Of all the companies surrounding the marketing and the sales of life insurance, none resonate so loudly as those over the use and misuse of policy illustrations. As insurance policies changed over the years, with the emphasis on the growth, return, and investment aspects of permanent plans; the "unbundling" of a policy's accumulation and protection elements; and the flexibility of premium payments, insurers and agents discovered that one of the best ways to demonstrate the complex mechanics of a policy was through the use of the computerized policy illustration.

Unfortunately, these illustrations have also been used to "predict" a policy's potential and its future performance based on assumptions that may or may not be realized. Vanishing premiums, huge cash values, in-force lifetime benefits - all of these things have been extolled to sell a life insurance policy, without the explanation that they are based on nonguaranteed numbers projected into the future. What did not accompany these illustrations was an understanding on the part of the consumer that the values they were being shown would materialize only if the underlying assumptions came true.

Along with the changing dimensions and features of today's life insurance



products comes a subtle shift in risk back to the buyer. The more flexible the policy, the more aggressive the assumptions and the more sensitive the product will be to changes in mortality, expense, and interest rates. However, this fact has been buried, ignored, or glossed over intentionally and unintentionally in too many sales presentations. Current and illustrative values have been spotlighted, and guaranteed values have been pushed backstage. In many sales situations, the policy illustration became the focus of the presentation (i.e., the illustration became the product).

The consequences of illustration-based selling became apparent in the early 1990s. Individuals who purchased life insurance policies in the mid-1980s (when interest rates were high) with the expectation that they would pay premiums for only seven or eight years found out that their policy's accumulated values were sufficient to "vanish" but were charged against the policy's value. Others who bought plans with the idea that premiums of a few hundred dollars a year would produce values of a million dollars by the time they were ready to retire discovered that they were far from their goals.

The experiences described above gave momentum to the charge that the misuse of policy illustrations has created a "crisis" situation in the insurance industry. Consumer groups, politicians, and journalists have declared that life insurance buyers are being misled by many in the insurance industry who abuse the use of policy illustrations and don't distinguish between values and benefits that are guaranteed and those that are not. For some agents and some companies, the allegations have led to lawsuits.

The problems associated with policy illustrations have compelled the industry to respond. Insurance companies are redesigning their disclosures to promote better understanding by consumers as to policy pricing, company and product performance, and illustration assumptions. They're instructing their agents to show illustrations based on a variety of assumptions, not merely those in which current assumptions prevail against the guarantees. However, perhaps the most significant initiatives, given their combined impact and reach, come from the NAIC and the American Society of CLU & ChFC. The NAIC has draft model legislation on policy illustrations, and the American Society has developed an illustration questionnaire to help agents understand the assumption that is used to design and create sales illustrations.

## **Attitude Toward Competition**

Agents should avoid criticizing other agents; such activity is detrimental to everyone in the business. Any criticism of other company's policies should be avoided. An incomplete comparison is misleading and harmful to the public, and it can even result in the revocation of the license of the guilty party.

If you are asked to evaluate an insurance company's reputation, you should refer your questioners to one of the widely-respected insurance company rating systems. These evaluate each insurance company's financial status and look at reserves, underwriting, investments, and management and rate the companies accordingly. Some of the most widely-known and respected

are AM Best Company, Standards and Poors, and Weiss Rating, Inc.

In addition, some situations, such as the handling of death claims or a national disaster, call for insurance professionals to lay aside all thoughts of competition and join hands to provide the best possible service for the people involved.

#### **4. Ethics vs. Values**

**Ethics** is the rightness of what you do. **Values** are what you believe in—what you hold important.

Values that represent how an individual should behave are considered to be moral values, such as respect, honesty, fairness, and responsibility. Statements around how these values are applied are sometimes called moral or ethical principles.

Many people do not realize the connection between values and ethics. They live each day without recognizing the cumulative impact of their individual actions. Leading an ethical life requires that we establish our values carefully and then work every day to live up to those values.

#### **Core Ethical Principles**

We build more a principled life with the small choices that we make each day. If we are to lead more ethically-based lives, we must all develop the ability to recognize ethical considerations. We must all become better at recognizing these opportunities to elevate our existence.

These core ethical values can serve as a tool to identify ethical considerations. Whenever honesty, integrity, promise-keeping, fidelity, loyalty, fairness, caring, compassion, respect for others, and personal responsibility come into play, it always involves the consideration of ethics.

Ethical decision-making is a process of evaluating and choosing among alternatives. The goal is to eliminate unethical options and select the best ethical alternative. To consistently make ethical decisions, one must accomplish two fundamental things:

1. Evaluate alternative courses of conduct on the basis of core ethical principles; and
2. Choose the action that best advances those principles.

There are many definitions of ethics, but it is generally accepted that any definition would include the following core ethical values and the long-term commitment to their implementation:

1. **Honesty:** Is truthful, straightforward, sincere, and candid. It is not deceptive, tricky, or misleading.
2. **Integrity:** Is honorable. It has courage of conviction; it stands up for beliefs and puts principle over expediency. It is not hypocritical, weak, or dishonorable.
3. **Promise-keeping:** Always strives to keep commitments.

4. **Fidelity/Loyalty:** Commits to being reliable and dependable.
5. **Fairness:** Strives to be equitable, open, just, and unprejudiced. It does not discriminate on an improper basis. It is not arbitrary or self-serving.
6. **Caring/Compassion:** Is considerate, kind, sharing, and charitable. It is not selfish, manipulative, or controlling.
7. **Respects for Others:** Respects freedom, dignity, and rights of others.
8. **Personal Responsibility:** Considers consequences and accepts responsibility for actions and inaction. It doesn't shift blame or make excuses.

## **Rationalization as a Tool**

There are a variety of reasons why we do not take the actions necessary to earn the high ethical ratings that we give ourselves. To make ourselves more comfortable with our actions, we often revert to rationalizations. Have you ever heard yourself say any of the following?

1. "I'm simply fighting fire with fire."
2. "If it is legal, it must be okay."
3. "I was just doing it for you."
4. "We all do it; it's just how you play the game."
5. "If it doesn't hurt anyone, it's okay."
6. "It's necessary to get the order."
7. "Business is business. I'll be as ethical as the competition allows."
8. "I deserve it: I have it coming."

Rationalizations make it easier to live with ourselves when we do the things that we want to do, rather than the things that we know we should be doing.

## **The Bottom Line**

History is made and lives are changed not by those who follow the crowd, but by those who are prepared to take the ultimate risk and stand up for what is right.

It is always a challenge to do the right thing in a competitive environment. But each time we make a decision to stand for what is right, even if it costs us something, we reinforce our own moral character and influence others.

We do not develop that ability overnight. It is developed in small steps as we do the right thing each day. Unfortunately, many of us do not even recognize the opportunities that exist.

There are 4 basic principles of a highly-ethical individual:

1. The individual is at ease when interacting with diverse customers.
2. The individual is obsessed with fairness. The individual's ground rules emphasize that the other persons interests count as much as his/her own.
3. The individual assumes personal responsibility for his/her actions, and he/she is responsible for himself/herself first and then to his/her organization.
4. The individual sees his/her activities in terms of purpose. This method of viewing an individual's activities is highly valued by the members of the industry or organization. Purpose ties the individual to the organization--and the organization to the environment.

The following are characteristics of a highly-ethical organization or industry:

1. There exists a clear vision and picture of integrity throughout the industry.
2. The vision is owned and embodied by top management in the industry, over time.
3. The reward system is aligned with the vision of integrity.
4. Policies and practices of the industry are aligned with the vision - no mixed messages.
5. It is understood that every significant decision has ethical value dimensions.
6. Everyone in the industry is expected to work through conflicting value perspectives.

## **The Benefit of Applying Ethics**

There are many obvious moral benefits to adhering to ethical standards, but there are other benefits of ensuring that ethics are followed in the industry and in the workplace:

Attention to business ethics has substantially improved society. A number of decades ago, children in our country worked 16-hour days. Workers limbs were literally torn off, and disabled workers were condemned to poverty and often starvation. Conglomerates controlled some markets to ensure that prices were fixed and small businesses were choked out. Price-fixing crippled normal market forces. Employees were terminated based upon personalities. Influence was applied through intimidation and harassment.

Then society reacted and demanded that businesses place a higher value on fairness and equal rights. Antitrust laws were instituted. Government agencies were established. Unions were organized. Laws and regulations were established. Ethics programs help to maintain a moral course in turbulent times.

Attention to business ethics is critical during times of fundamental change. At such times, there is often no clear moral compass to guide leaders through complex conflicts about what is right or wrong.

Continuing attention to ethics in the workplace sensitizes leaders and staff to acting consistently.

Ethical standards support individual growth.

Attention to ethics in the industry helps an agent to face realities, both good and bad, in the industry and within himself. In this regard, an agent may feel full of confidence and can admit and deal with whatever comes his way.

Ethics programs are a form of insurance; they help to ensure that policies and practices are legal and can stand the test of public or shareholder scrutiny.

There are an increasing number of lawsuits in regard to the effects of products and services on the consumer. Attention to ethics ensures highly ethical policies and procedures in the workplace. Analysts believe that it is far better to incur the cost of mechanisms to ensure ethical practices now, rather than to incur the costs of litigation later.

Ethical standards help to avoid criminal acts of omission and can lower fines.

Ethics standards, such as an insurance agents code of ethics, tend to detect ethical issues and violations early on, so they can be addressed. In some cases, when an organization is aware of an actual or potential violation and does not report it to the appropriate authorities, it can be considered a criminal act.

Ethical guidelines adopted on an industry-wide basis potentially decrease fines if an organization or individual has clearly made an effort to operate ethically.

Ethical standards help to manage values.

Ethics programs identify preferred values and ensure that the individuals behavior is aligned with those values. This effort includes recording the values, developing policies and procedures to align behavior with preferred standards, and then training personnel about the policies and procedures. Ethical standards are highly useful for managing strategies, such as expanding market shares, reducing costs, and managing diversity.

Ethical standards promote a strong public image.

Attention to ethics is also a strong public relations tool. Admittedly, managing ethics should not be done primarily to enhance public relations. But the fact that an organization regularly gives attention to ethics can portray a strong, positive image to the public.

People see those organizations as valuing people more than profit, as striving to operate with the utmost integrity and honor. Aligning behavior with values is critical to effective marketing and public relations programs.

Here's the bottom line: Applying ethical standards legitimizes managerial actions, strengthens the coherence and balance of the industry, improves trust in the relationship between individuals and groups, and supports greater consistency in the standards and qualities of products.

## E. Chapter Recap

This chapter focused on state-specific regulations for insurers and producers. Let's recap some of the important requirements and processes.

LICENSING REQUIREMENTS	
Licensing Process	<ul style="list-style-type: none"><li>• Complete prelicensing education</li><li>• Pass examination</li><li>• Submit application and fees</li><li>• Submit fingerprints</li></ul>
Types of Licenses	<ul style="list-style-type: none"><li>• Individuals: resident and nonresident</li><li>• Business entities</li></ul>

**Maintenance and Duration**

- Temporary license - valid for 180 days; issued to maintain the existing business
- Must be renewed every 2 years
- Can be reinstated within a short period of time after lapse
- Continuing education - must be completed every reporting period
- Disciplinary actions:
  - License denial, suspension, revocation or refusal to renew
  - Cease and desist order
  - Monetary penalties

**STATE REGULATIONS****Commissioner of Insurance**

- Regulates the internal affairs of the Department of Insurance
- Does not write laws
- Examines all authorized insurers

**Agent Regulation**

- Only one license of the same type is allowed per agent
- Must be licensed in the line of authority for which the agent transacts insurance
- Avoid unfair trade practices

**Insurer Regulation**

- Must obtain Certificate of Authority
- Responsible for agent appointments
- Must meet solvency requirements
- Avoid unfair trade practices or unfair claim settlements

**FEDERAL REGULATION****Fair Credit Reporting Act**

- Protects consumers from circulation of inaccurate and obsolete personal financial information
- Consumer reports and investigative consumer reports

**Insurance Fraud**

- Act of fraud: willfully, and with the intent to deceive, making false statements or omitting material facts
- Fines and imprisonment for fraud that affects interstate commerce
- 1033 waiver - written consent from an insurance regulatory official to allow someone convicted of a crime involving dishonesty to work in the business of insurance

**Privacy: Gramm-Leach-Bliley Act  
Do Not Call List**

- Rules regarding disclosure of nonpublic personal information to nonaffiliated third parties
- National Do Not Call Registry
- Strict telemarketing rules
- Insurers must consult the current registry every 31 days