

2nd Edition

Life and Health Insurance

License Exam Manual



KAPLAN FINANCIAL
EDUCATION

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LIFE AND HEALTH INSURANCE LICENSE EXAM MANUAL, 2ND
EDITION

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2

Insurance Regulation

2. 1 INTRODUCTION

The general public has an interest in making sure that insurance activity actually is provided as a service and not a disservice. Insurance is highly regulated to protect the public interest and to make sure coverage is available on an equitable basis.

Another reason the insurance business is regulated is the large amount of money involved in the industry. Insurance companies control vast sums of money that, if misused, could impact consumers and even the economy.

2. 2 LEARNING OBJECTIVES

After completing this lesson, you will be able to:

- explain the role of the Insurance Commissioner in insurance regulation;
- describe the role of company ratings and how such information may be used with prospects;
- describe the role of state guaranty associations; and
- explain the requirements for maintaining a producer license.

2. 3 REGULATION OF THE INSURANCE BUSINESS

Regulation of the insurance industry is divided among a number of authorities. The three major channels of regulation of the insurance industry are:

- federal regulation;
- state regulation; and
- self-regulation.

2. 3. 1 Federal Regulation of the Insurance Industry

Most insurance regulation takes place at the state level, but there are some important regulations at the federal level. Federal jurisdiction applies to individuals or companies whose activities affect interstate commerce, which includes most insurance activity. Federal regulation of insurance is primarily used as a means to oversee areas not covered by state regulation of the industry. The most important sources of federal regulation are outlined below and include both legislative and judicial aspects.

2. 3. 1. 1 *Paul v. Virginia*

The case of *Paul v. Virginia* established that the transaction of insurance across state lines was not interstate commerce and therefore should be regulated by local law. This decision held for 75 years.

2. 3. 1. 2 *South-Eastern Underwriters Decision*

The South-Eastern Underwriters Association Supreme Court decision overturned *Paul v. Virginia* and stated that insurance transacted across state lines was, in fact, interstate commerce.

2. 3. 1. 3 *McCarran-Ferguson Act*

Congress enacted the McCarran-Ferguson Act in 1945. This act stated that the federal government had the right to regulate the business of insurance, but only to the extent that such business is not regulated by state law. The main intent of the law was to exempt the insurance industry from most of the provisions of the federal antitrust laws.

2. 3. 1. 4 *Privacy*

Because of the abundance of personal information and the numbers of agencies collecting and using personal information, it is vital that controls be established to protect the public from inaccurate or misused information.

2. 3. 1. 4. 1 Disclosure Authorization

It is the responsibility of a producer to explain to an applicant the various resources from which the insurer will obtain information regarding that applicant's insurability.

In almost every state, applicants for insurance must be given advance written notice of an insurer's practices regarding the collection and use of personal information related to insurance transactions.

Written disclosure authorization forms must be furnished stating who is authorized to disclose personal information, the kind of information that may be disclosed, the reason information is being collected, and how it will be used.

The applicant's signature on the disclosure form authorizes the insurer to collect and disseminate information in the manner described in the notice. The authorization is good only for a certain period. At the end of this period, another authorization must be obtained.

2. 3. 1. 4. 2 Penalties

A fine of \$10,000 or up to one year in jail is the penalty for any person who obtains information about a client without having a legitimate reason to receive it.

2. 3. 1. 5 *Fair Credit Reporting Act*

All insurers and their producers must comply with the federal Fair Credit Reporting Act regarding information obtained from a third party concerning the applicant.

2. 3. 1. 5. 1 Consumer Rights

Consumers who feel that information in their files is inaccurate or incomplete may dispute the information, and reporting agencies may be required to reinvestigate and correct or delete information. Insurance companies may use consumer reports, or investigative consumer reports, to compile additional information regarding the applicant. If applicants feel that the information compiled by the consumer inspection service is inaccurate, they may send a brief statement to the reporting agency with the correct information.

2. 3. 1. 5. 2 Notice to Applicant

A **Notice to Applicant** must be issued to all applicants for life or health insurance coverage. This notice informs the applicant that a report will be ordered concerning their past credit history and any other life or health insurance for which they have previously applied. The agent must leave this notice with the applicant along with the receipt.

2. 3. 1. 5. 3 Penalties

Violators of the Fair Credit Reporting Act may be subject to fines and imprisonment and may be required to pay any actual damages suffered by a consumer, punitive damages awarded by a court, and reasonable attorney's fees. The maximum penalty for obtaining consumer information reports under **false pretenses** is \$5,000, imprisonment for one year, or both.

2. 3. 1. 6 Consumer Reports

Consumer reports include written, oral, and other forms of communication that a consumer reporting agency has regarding a consumer's credit, character, reputation, or habits and are used or collected to determine whether a consumer is eligible for credit, insurance, employment, or other purposes. Consumer reports may be issued only to persons who have a legitimate business need for the information.

2. 3. 1. 7 Investigative Consumer Reports

An investigative consumer report includes information on a consumer's character, general reputation, personal habits, and mode of living that is obtained through investigation—that is, interviews with associates and friends and neighbors of the consumer. Such reports may not be made unless the consumer is clearly and accurately told about the report in writing. The consumer also must be notified that she is allowed to request an accurate disclosure of the report.

2. 3. 1. 8 Pretext Interviews

A **pretext interview** is an interview whereby a person, in an attempt to obtain information about another person, pretends to be someone else, misrepresents the true purpose of the interview, or refuses to properly identify himself.

Generally, pretext interviews are prohibited. However, such an interview may be conducted when there is evidence of criminal activity, fraud, or misrepresentation.

2. 3. 1. 9 *Consumer Reporting Agencies*

Consumer reporting agencies collect information on individuals, prepare reports, and make the reports available to persons or organizations with a legitimate reason to receive such information. These agencies may operate for profit (e.g., Experian or Equifax) or agencies may be nonprofit (e.g., the Medical Information Bureau or a credit union).

A consumer may choose to have her name and address excluded from any list provided by a consumer reporting agency in connection with a credit or insurance transaction that is not initiated by the consumer. The consumer simply needs to notify the agency that she does not consent to any use of a consumer report in connection with any credit or insurance transaction that is not initiated by the consumer.

Credit agencies are required to provide a notification system, including a toll-free telephone number, to allow consumers to request exclusion of their information. This notification is valid for two years. If notification is made in writing on a signed notice of election form issued by the agency, it is valid until the consumer revokes the request. The consumer may revoke the request at any time.

2. 3. 1. 10 *Fraud and False Statements*

Certain types of false or fraudulent statements have been specifically outlined in federal law as punishable by a fine, a prison sentence, or both. Persons engaging in the business of insurance whose activities affect interstate commerce are prohibited by federal law from knowingly (and with the intent to deceive):

- making any false material statement or report that willfully and materially overvalues any land, property, or security in connection with any financial reports or documents presented to an insurance regulatory official or agency, or an agent or examiner acting for an insurance regulatory official for the purpose of influencing the actions of such individual;
- making any false entry of material fact in any book, report, or statement of such person engaged in the business of insurance with intent to deceive any person, including any officer, employee, or agent of such person, engaged in the business of insurance regarding the financial condition or solvency of such business;
- willfully embezzling, abstracting, purloining, or misappropriating any of the monies, funds, premiums, credits, or other property of any person engaged in the business of insurance; or
- corruptly influencing, obstructing, or impeding the due and proper administration of the law under which any proceeding is pending before any insurance regulatory official or agency or any producer or examiner appointed by such official or agency to examine the affairs of a person engaged in the business of insurance.

The punishment for any of the offenses described here may include fines, imprisonment, or both.

2. 3. 1. 11 *Financial Services Modernization*

Also known as the Gramm-Leach-Bliley Act (GLBA), this legislation was passed in 1999 to remove Depression-era barriers between commercial banking, investment banking, and insurance. This law allows financial holding companies to engage in any activities that are financial in nature. Regulation of these holding companies is managed on a functional basis. This means that regulatory authority is based on what activity is occurring, rather than on what type of company is engaging in the activity. For example, the sale of insurance is regulated by state insurance regulators even if the company making the sale is a bank or securities brokerage.

Financial holding companies have the potential to capture unprecedented amounts of information about their customers. This law also establishes a minimum federal standard for financial privacy. The law requires that technical, administrative, and physical safeguards be established:

- to ensure the security and confidentiality of customer records and information;
- to protect against any anticipated threats or hazards to the security or integrity of such records; and
- to protect against unauthorized access to or use of such records or information that could result in substantial harm or inconvenience to any customer.

Anyone about whom a company collects information is a **consumer**. A customer is a consumer who has an ongoing relationship with the financial institution.

In some cases, consumers and customers are given the opportunity to keep the company from sharing the information it has about them. This is known as the right to **opt out**. Health information, such as that acquired during a medical exam, is subject to a stricter **opt-in** standard, meaning that companies may not share some health information without receiving specific permission to do so.

2. 3. 1. 11. 1 **Disclosure Requirements**

GLBA requires that a company make two primary disclosures to customers: one at the time of the establishment of the customer relationship and the second before the company discloses protected information. The first disclosure is to be made at the time a consumer becomes a customer, usually by purchasing a policy. At this point, the company is required to give a clear and conspicuous disclosure to the new customer regarding its policies and procedures for customer privacy. The customer must, at least on an annual basis, receive an updated notice containing the same information.

The second disclosure required by GLBA explains the customer's right to opt out of information sharing. Each customer must be given the right to opt out and must be told explicitly how that right may be exercised.

2. 3. 1. 12 *Other Regulating Agencies*

Some insurance products are regulated by both the federal and state governments. For example, the Securities and Exchange Commission (SEC) and the state Insurance Departments regulate variable contracts. Variable annuities and variable life insurance are insurance company products, but these products present a degree of investment risk to the buyer and, accordingly, have also been identified as securities in accordance with SEC regulations.

2. 3. 2 **State Regulation of the Insurance Industry**

Most insurance regulation takes place at the state level. The body of laws at the state level is called the **Insurance Code**. State regulation consists of statutes and rules and regulations. **Statutes** are the body of law developed by the legislative branch of government. They outline, in general terms, the duties of the Commissioner and the activities of the Department of Insurance. **Rules and regulations** are developed by the Department of Insurance to expand upon statutory requirements and legislative intent.

2. 3. 2. 1 *Commissioner's Scope and Duties*

The Insurance Code of each state authorizes the establishment of a department of insurance to administer and enforce the insurance laws. In each state, a public official will head the department, and the title of the official will be the **Commissioner**, **Superintendent**, or **Director of Insurance**. This person has broad powers to supervise and regulate the insurance affairs within the state.

Note that the Commissioner does not make the insurance laws. He is simply in charge of making certain all insurance operations within the state are in compliance with the laws made by the state legislature.

Exercise 2.A

1. All of the following are powers and duties of the Commissioner, Superintendent, or Director of Insurance EXCEPT
 - A. issue a certificate of authority
 - B. make insurance laws
 - C. examine books, records, and documents of an insurer, agent, or broker
 - D. approve insurance policy forms sold within a state

Answers to the exercises can be found at the end of the Unit 2 answers and rationales.

2. 3. 2. 2 *Regulating Insurance Companies*

The state Insurance Code prescribes the procedures that must be followed for an insurance company to be formed. It specifies the manner in which the company must be organized, the requirements for incorporation, and the amounts for minimum capital and surplus.

2. 3. 2. 3 *Insurer Solvency*

Insurance companies collect premiums before losses are paid. If the insurer later becomes insolvent, customers will have paid for protection the company is no longer in a position to provide. Protection against insurer insolvency is one of the principal concerns of the insurance industry. Insurance insolvency regulations govern such areas as the organization and ownership of a new company, capital and surplus requirements, reserves, accounting, investments, annual statements, and the rehabilitation and liquidation of impaired insurers.

The Department of Insurance has the right to compute the reserve liabilities of a company, to value its assets, and to approve or disapprove its investments, dividends, and expenses. and The Department of Insurance also has the power to require a company to deposit securities to cover its liabilities in the state.

Various state statutes impose capital and surplus requirements and require the preparation of annual financial statements and periodic examinations of insurers by the Department of Insurance. These laws establish initial financial requirements and help in the early detection of financial problems.

2. 3. 2. 3. 1 Annual Statement

Each insurance company must report its financial condition in an annual statement.

2. 3. 2. 3. 2 Investments

All states have regulations that are intended to ensure that insurers invest only in high-quality assets to prevent insolvencies. Life insurance companies may invest funds in concerns that are fairly stable in value. These safe investments include municipal bonds, corporate bonds, real estate mortgages, and even policy loans.

2. 3. 2. 3. 3 Company Financial Ratings

Producers have a responsibility to place coverage with financially sound carriers. Evaluating the financial health of an insurance company is a complex task. There are several organizations that rate the financial strength of insurance carriers on the basis of an analysis of a company's claims experience, investment performance, management, and other factors. These organizations include AM Best, Inc., Standard & Poor's Insurance Rating Services, Moody's Investors Service, Duff & Phelps Credit Rating Company, and Weiss Ratings. These ratings are one of the most widely used indicators of financial health (or the lack of it) in the insurance industry.

The firms do not all rate every company, and each firm has different criteria for which companies will be rated. Each firm also uses a different method for evaluating the financial strength of insurance companies. There are at least four different rating scales in use among the five firms.

Scaled in Use by Financial Rating Services	
Firm	Scale, Highest to Lowest
A.M. Best Company	A++, A+, A, A-, B++, B+, B, B-, C++, C+, C, C-, D, E, F
Weiss Research	A+, A, A-, B+, B, B-, C+, C, C-, D+, D, D-, E+, E, E-, F+, F, F-
Standard & Poor's/ Duff & Phelps	AAA, AA+, AA, AA-, A+, A, A-, BBB+, BBB, BBB-, BB+, BB, BB-, B+, B, B-, CCC, CC, D
Moody's Investors Service	Aaa, Aa1, Aa2, Aa3, A1, A2, A3, Baa1, Baa2, Baa3, Ba1, Ba2, Ba3, B1, B2, B3, Caa1, Caa2, Caa3, Ca1, Ca2, Ca3, C1, C2, C3

2. 3. 2. 3. 4 Examination of Insurers

The state Department of Insurance must examine the financial affairs, transactions, and general business records of domestic insurers in accordance with specific state insurance laws. Generally, these laws will state that the Commissioner of Insurance may examine the insurer's records as often as necessary but at least once every three to five years.

The nonfinancial regulatory activities of an insurance department fall under the broad heading of market conduct. **Proper market conduct** means conducting insurance business fairly and responsibly. In a market conduct examination, state Department of Insurance investigators examine the business practices and operations of an insurer and its agents to determine their authority to conduct insurance business in the state. During a market conduct examination, state examiners investigate the records and practices of an insurance company and determine whether the company is in compliance with state laws regulating the sales and marketing, underwriting, and issuance of insurance products.

2. 3. 2. 3. 5 Rehabilitation and Liquidation

Despite regulatory controls, some insurers become insolvent or find themselves in financial difficulty. In this event, the Department has the authority to assume control over company funds and management. If an insurer becomes impaired (in financial difficulty), the Department will attempt to put the insurer back in sound financial standing. If an insurer becomes insolvent (unable to meet financial obligations), the Department will attempt to make the insurer solvent again. Rehabilitation efforts are undertaken if the Department believes that an impaired insurer has a chance of restoring solvency. Liquidation proceedings are instituted when the insurer is insolvent and cannot be restored to solvency.

2. 3. 2. 4 Guaranty Associations

State **guaranty associations** are organized to protect claimants, policyholders, annuitants, and creditors of financially impaired or insolvent insurers by providing funds for the payment of claims and other related policy benefits. Associations are composed of insurers authorized to transact insurance business within the state. Association membership exceptions include fra-

ternal organizations and nonprofit companies. Member insurers are assessed certain sums of money to cover the association's operating expenses. If insurer insolvency occurs, each member insurer will be assessed additional fees to cover the insolvency.

2. 3. 2. 5 *Marketing and Advertising Life and Health Insurance*

States often regulate the marketing and advertising of life and health insurance policies to ensure truthful and full disclosure of pertinent information when selling these policies. As a rule, the insurer is held responsible for the content of advertisements of its policies. Advertisements cannot be misleading or obscure or use deceptive illustrations and must clearly outline all policy coverages as well as exclusions or limitations on coverage (such as preexisting condition limitations).

Most states require insurers to keep a permanent advertising file of all advertisements used in the state until the next regular examination of the insurer by the Department of Insurance or for a specified minimum number of years, usually two or three.

Also, many states require the delivery of a buyer's guide and policy summary or outline of coverage at the time of policy delivery. The **buyer's guide** is a document providing basic information about insurance policies, and the **policy summary** (life insurance) or **outline of coverage** (health insurance) is a written statement describing the elements of the policy being sold. Generally, it must include the agent's name and address, the name and office address of the insurer, and the generic name of the policy and each rider.

2. 3. 2. 6 *Regulating Producers*

Producers may function as either agents or brokers. Agents represent their companies, and brokers represent their clients.

2. 3. 2. 6. 1 **Licensing Regulation**

Although much progress has been made in making producer licensing more uniform, it is important to refer to your *State Law Supplement* for more information on licensing regulations in your state.

2. 3. 2. 6. 2 **License Required**

Under the statutes of most states, no person is permitted to act as an insurance producer without being currently licensed as a producer for the class or classes of insurance involved. Acting as a producer includes selling, soliciting, or negotiating insurance.

2. 3. 2. 6. 3 **Exceptions to License Requirements**

Each state identifies exemptions from the licensing requirements. Generally speaking, people who are not paid commissions for selling insurance do not need a license.

2. 3. 2. 6. 4 **Nonresident Producer Licensing**

The majority of states allow for reciprocity in nonresident licensing. Reciprocity means a mutual exchange of privileges. In the case of producer

licensing, it means the recognition of two states of the validity of licenses or privileges granted by the other.

Check your *State Law Supplement* to see what the rules are in your state.

A nonresident producer who moves from one state to another state or a resident producer who moves to another state must file a change of address and provide certification from the new resident state within 30 days of the change of legal residence. No fee or license application is required.

2. 3. 2. 7 *Obtaining a License*

2. 3. 2. 7. 1 **Application for Examination**

A resident individual applying for an insurance producer license has to pass a written examination unless exempt. The exam is developed to test the knowledge of the individual concerning the lines of authority for which the application is made, the duties and responsibilities of an insurance producer, and the insurance laws and regulations of the state.

2. 3. 2. 7. 2 **Exemptions from Examination**

A person licensed as an insurance producer in one state who moves to another state has 90 days after establishing legal residence to become a resident licensee. Prelicensing education is generally not required to obtain a line of authority previously held in another state.

2. 3. 2. 7. 3 **Issuance of License**

Licenses contain the licensee's name, address, personal identification number, date of issuance, lines of authority, expiration date, and any other information the Commissioner deems necessary.

2. 3. 2. 7. 4 **Temporary Agent Licenses**

In most states, temporary agent licenses may be issued for up to 180 days to:

- the surviving spouse or court-appointed personal representative of a licensed producer who dies or becomes disabled in order to maintain the producer's business;
- a member of a business entity licensed as an insurance producer, upon the death or disability of an individual designated in the business entity application or the license; or
- the designee of a licensed insurance producer entering active service in the armed forces of the United States.

A temporary license may not continue after the licensee disposes of the business.

2. 3. 2. 8 *Maintaining a License*

2. 3. 2. 8. 1 **Change of Address**

Every licensee must promptly give to the head of the Department of Insurance written notice of any change of business address. Most states require this notice be made within 30 days.

2. 3. 2. 8. 2 **Assumed Names**

An insurance producer doing business under any other than the producer's legal name is required to notify the Commissioner before using the assumed name.

2. 3. 2. 8. 3 **Office and Records**

Every resident producer must have and maintain in the state issuing the license a place of business accessible to the public. The designated place of business must be where the licensee principally conducts transactions under the license. Licenses must be conspicuously displayed in a part of the place of business that is customarily open to the public. The producer must keep at the place of business the usual and customary records pertaining to insurance transactions.

2. 3. 2. 8. 4 **Continuation, Expiration, and Renewal of License**

Producer licenses generally remain in effect unless they are revoked or suspended, as long as the appropriate fee is paid and the continuing education requirements are met by the due date.

An insurance producer who is not able to comply with the license renewal procedures because of military service or some other extenuating circumstance (for example, medical disability) may request a waiver.

2. 3. 2. 8. 5 **Appointment**

If a producer is going to function as an agent of an insurer, the producer generally needs to be appointed by that insurer. To appoint a producer as its agent, the appointing insurer needs to file a notice of appointment within 15 days from the date the agency contract is executed or the first insurance application is submitted.

Note that producers are licensed by the state and appointed by an insurer. Loss of an appointment does not necessarily mean that the producer has lost his license. It simply means that the producer may no longer represent that particular company, although he is still licensed within the state.

2. 3. 2. 8. 6 **Termination of Appointment**

Subject to a producer's contract rights, if any, an insurer may terminate any of its appointed producers at any time. The insurer must give prompt written notice of the termination and the date to the Department of Insurance (and to the producer when reasonably possible) and must file a statement of facts related to the termination and reasons for it.

If the appointment was terminated because the producer was found to have done something that would be grounds for revocation, denial, or suspension of his license, the insurer is obligated to notify the Commissioner, generally within 30 days.

2. 3. 2. 8. 7 License Denial, Nonrenewal, or Revocation

The Commissioner may place on probation, **suspend, revoke, or refuse to issue or renew** an insurance producer's license or may levy a civil penalty for:

- providing incorrect, misleading, incomplete, or materially untrue information in the license application;
- violating insurance laws or violating any regulation, subpoena, or order of the Commissioner or of another state's Commissioner;
- 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 insurance business;
- intentionally misrepresenting the terms of an actual or proposed insurance contract or application for insurance;
- having been convicted of a felony;
- having admitted or been found to have committed insurance unfair trade practices or fraud;
- using fraudulent, coercive, or dishonest practices or demonstrating incompetence, untrustworthiness, or financial irresponsibility in the conduct of business in this state or elsewhere;
- having an insurance producer license or its equivalent denied, suspended, or revoked in any other state, province, district, or territory;
- forging another's name to an application for insurance or to any document related to an insurance transaction;
- improperly using notes or any other reference material to complete an examination for an insurance license;
- knowingly accepting insurance business from an individual who is not licensed;
- failing to comply with an administrative or court order imposing child support obligations; and
- failing to pay state income tax or comply with an administrative or court order directing payment of state income tax.

If the Commissioner **nonrenews** or **denies** an application for a license, the applicant or licensee must be notified and advised, in writing, of the reason for the denial or nonrenewal of the license.

A civil fine may be imposed in addition to or instead of license denial, suspension, or revocation.

2. 3. 2. 9 *Regulated Practices*

2. 3. 2. 9. 1 **License for Controlled Business Prohibited**

Coverage written on a producer's own life or health and on the lives or health of such persons as the producer's relatives or business associates is called **controlled business**. Because of the effect that controlled business could have on the insurance industry if people became licensed solely to sell insurance to family and friends, such activities are limited.

2. 3. 2. 9. 2 **Unfair Trade Practices**

The Unfair Trade Practices Act is divided into two parts: unfair marketing practices and unfair claims practices. In each state, statutes define and prohibit certain trade and claims practices that are unfair, misleading, and deceptive.

2. 3. 2. 9. 3 **Misrepresentations**

A **misrepresentation** is simply a lie. It is a violation of unfair marketing practices for any person to make, issue, or circulate any illustration, sales material, or statement that is false, misleading, or deceptive. Misrepresentations include (but are not limited to):

- misrepresenting the benefits, advantages, or terms of a policy;
- misrepresenting policy dividends by implying or stating that they are guaranteed;
- misrepresenting the financial condition of an insurer by means of an inaccurate or incomplete financial comparison; and
- misrepresenting an insurance policy by using a name or title that is untrue or misleading or by indicating that an insurance policy represents shares of stock.

In some cases, misrepresentation can occur unintentionally. To prevent this, the producer must know the products being sold and accurately explain these products to a population largely ignorant about insurance. To assist in explaining the products being sold, many states require that life insurance buyer's guides be distributed by an insurance company to its prospects to explain basic insurance plans and identify the types of insurance available.

2. 3. 2. 9. 4 **False or Deceptive Advertising**

It is an unfair trade practice for any person to formulate or use an advertisement or make a statement that is untrue, deceptive, or misleading regarding any insurer or person associated with an insurer.

2. 3. 2. 9. 5 **Twisting**

Twisting occurs when a producer convinces a policyowner to lapse or surrender a present policy in order to sell him another one, usually from a different company. Any attempt by the producer to misrepresent another insurer by falsely making statements about the financial condition of the company or by giving an incomplete comparison of policies is an unfair trade practice.

2.3.2.9.6 Churning

Closely allied with twisting is **churning**, which is the practice of using misrepresentation to induce replacement of a policy issued by the insurer the producer is representing, rather than the policy of a competitor. The impetus behind churning is to allow the producer to collect a large first-year commission on a new policy. Churning is the result of a producer putting his interests above those of the client.

2.3.2.9.7 False Financial Statements

It is a violation of unfair marketing practices for any person to deliberately make a false financial statement regarding the solvency of an insurer with the intent to deceive others.

2.3.2.9.8 Defamation

It is an unfair trade practice for any person or company to make oral or written statements or to circulate literature that is false, maliciously critical, or derogatory to the financial condition of any insurer or that is calculated to injure anyone engaged in the insurance business.

2.3.2.9.9 Discrimination

It is illegal to permit discrimination between individuals of the same class or insurance risk in terms of rates, premiums, fees, and policy benefits because of their place of residence, race, creed, or national origin.

2.3.2.9.10 Rebating

Splitting a commission with a prospect is prohibited in almost every state. **Rebating** is any inducement in the sale of insurance that is not specified in the insurance contract. An offer to share commissions with the insurance applicant is an inducement in the sale of insurance that is not part of the insurance policy, and thus, constitutes rebating. Rebates include not only cash but also personal services and items of value.

2.3.2.9.11 Illegal Premiums and Charges

It is unlawful for a person or insurer to collect premiums or make charges that are not specified in the insurance contract.

2.3.2.9.12 Boycott, Coercion, and Intimidation

It is a violation of the act for a person or organization to commit or be involved in an act of boycott, coercion, or intimidation that is intended to create a monopoly or restrict fair trade in the transaction of insurance.

Exercise 2.B

Match the following definitions of unfair trade practices with the proper terms.

- | | | |
|---------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------|
| ___ 1. | Making a false or misleading statement regarding the benefits, advantages, or terms of a policy | A. Illegal premiums and charges |
| ___ 2. | Making an oral or written statement that is false, malicious, or derogatory to the financial condition of any insurer and is done with the intent to harm | B. Boycott, coercion, and intimidation |
| ___ 3. | Using threat or force to create a monopoly or restrict fair trade in the transaction of insurance | C. Discrimination |
| ___ 4. | Inducing an insured to lapse, forfeit, or surrender a policy based on misrepresentations or making an incomplete comparison of another policy from a different company | D. Rebating |
| ___ 5. | Making false statements regarding the solvency of an insurer with the intent to deceive | E. Misrepresentation |
| ___ 6. | Offering any inducement in the sale of insurance that is not specified in the contract such as commission splitting | F. Churning |
| ___ 7. | Formulating an advertisement that is untrue, deceptive, or misleading | G. Defamation |
| ___ 8. | Charging a different rate for individuals of the same class and life expectancy | H. False advertising |
| ___ 9. | Replacing a policy repeatedly with the same company allowing the producer to collect continuous first year commissions | I. Twisting |
| ___ 10. | Collecting additional charges from the insured that are not specified in the contract | J. False financial statements |

Answers to the exercises can be found at the end of the Unit 2 answers and rationales.

2. 3. 2. 10 *Unfair Claims Practices*

Claims settlement practices are regulated in the public interest for two main reasons.

It is for the purpose of settling claims that insurance companies have collected policyowners' money.

When insureds are denied claims or claim payments are delayed or altered, the consequences go beyond the policy benefits and can drastically affect other areas of the insured's financial situation. The unfair claims practices provisions are designed to protect insureds and claimants from any claims settlement practices that are unfair, deceptive, or misleading. The following are considered unfair claims practices:

- Misrepresenting pertinent facts or insurance policy provisions relating to coverage at issue
- Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies
- Failing to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies
- Refusing to pay claims without conducting a reasonable investigation based on 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 he was entitled by reference to written or principal advertising material accompanying or made part of an application
- Attempting to settle claims on the basis of an application that was altered without notice, knowledge, or consent of the insured
- Making claims payments to insureds or beneficiaries not accompanied by statements setting forth the coverage under which the payments are being made
- Making known to insureds or claimants a policy of appealing 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 a claim 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 to influence settlement under other portions of the insurance policy coverage
- Failing to promptly provide a reasonable explanation of the basis relied on 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

Some states have added another provision that makes it an unfair claim practice to offer a settlement or payment in any manner prohibited by law.

2.3.2.10.1 Penalties

Following an investigation and a hearing, if the Department of Insurance finds that any person or insurer is engaged in any unfair trade or unfair claims practice, the Commissioner may issue a **cease and desist order** prohibiting the individual or company from continuing the practice. Failure to comply with the cease and desist order can result in a substantial fine. In addition, fines and loss of license also may be imposed for a company or person guilty of violating the Unfair Trade Practices Act.

The Department of Insurance also may issue a **consent order**, which is a disciplinary action in which the party at fault (the insurance company or agent) agrees to discontinue a particular practice (usually an unfair trade or claims practice) through a written agreement with the Department of Insurance.

2.3.3 Self-Regulation

The last channel of regulation of the business is self-regulation. There are several intercompany organizations and industry associations that impose codes of ethical behavior on their members, including national, state, and local agent associations and associations made up of insurance companies.

2.3.3.1 NAIC

Although without legal authority as a group, the **National Association of Insurance Commissioners (NAIC)**, an association of state Commissioners, also imposes a strong influence in the area of the industry's self-regulation. The NAIC is the organization that has done the most to standardize law between the states. The model laws passed by the NAIC include the Individual Accident and Sickness Policy Provisions Law, Standard Nonforfeiture and Valuation Laws, Fair Trade Practices Act, Unauthorized Insurers Service of Process Act, Insurance Holding Company System Regulatory Act, Variable Contract Law, Group Life Definition and Standard Provisions Bill, and Credit Life and Credit Health Insurance Regulation Bill.

U N I T T E S T

1. Pretext interviews are
 - A. always illegal
 - B. not permitted without a warrant sworn by a sitting judge
 - C. generally accepted practice in the industry
 - D. not permitted unless some evidence of criminal activity exists
2. A customer is anyone
 - A. about whom a company collects information
 - B. with whom a company has an ongoing relationship
 - C. who prohibits the sharing of nonpublic personal information
 - D. who permits the sharing of nonpublic personal information
3. The federal government
 - A. is the primary authority for regulating the business of insurance
 - B. does not get involved in regulating the business of insurance
 - C. has the right to regulate the business of insurance to the extent that such business is not regulated by state law
 - D. is prohibited by executive order from regulating any aspect of the insurance business
4. Insurance laws generally are written by
 - A. the federal government
 - B. the state legislature
 - C. the state Department of Insurance
 - D. the Commissioner
5. The head of the state Department of Insurance (usually called the Commissioner) is responsible for all of the following EXCEPT
 - A. examining individual insurance policies before issuance
 - B. administering and enforcing state insurance laws
 - C. imposing penalties for violations of the Insurance Code
 - D. issuing insurance licenses and certificates of authority
6. The nonfinancial regulatory activities of an insurance department fall under the broad heading of
 - A. company conduct
 - B. regulatory conduct
 - C. market conduct
 - D. producer conduct
7. Which of the following individuals would NOT be exempt from a producer licensing requirement?
 - A. Alicia works in an insurance office conferring directly with or offering advice to prospective purchasers about the benefits, terms, and conditions of insurance policies and urges a person to apply for policies Alicia thinks would be a good match.
 - B. Brenda works for an insurer acting in the capacity of a special agent or agency supervisor assisting insurance producers by providing technical advice and assistance to licensed insurance producers on nonsales-related areas.
 - C. Connie gathers information for the purpose of enrolling individuals under a group life insurance plan at her company. Connie also issues certificates and assists in administering the plan.
 - D. Del inspects, rates, and classifies risks. At times, Del also supervises the training of insurance producers.
8. Producers may act as
 - A. agents representing the insurance company
 - B. brokers representing the individual seeking insurance
 - C. either agents representing the insurance company or brokers representing the individual seeking insurance
 - D. neither agents representing the insurance company nor brokers representing the individual seeking insurance
9. Most insurance regulation takes place at
 - A. the international level
 - B. the national level
 - C. the state level
 - D. the local level

10. Applicants for insurance must be given advance notice including all of the following types of information EXCEPT
- the persons who are collecting information
 - the kind of information to be collected
 - the sources of information
 - the persons with access to personal information
11. Under the financial privacy safeguards of the Gramm Leach Bliley Act, an individual about whom a financial institution collects information is
- a customer
 - a consumer
 - a client
 - a patron
12. Under the financial privacy safeguards of the Gramm Leach Bliley Act, an individual with whom a financial institution has an ongoing relationship is
- a customer
 - a consumer
 - a client
 - a patron
13. The Commissioner of Insurance has all of the following powers EXCEPT
- conducting investigations and examinations
 - making reasonable rules and regulations
 - promulgating insurance law
 - approving insurance policy forms sold within the state
14. Nonfinancial regulatory activities of an insurance department fall under the broad heading of
- market regulation
 - conduct regulation
 - market conduct
 - insurance conduct
15. Associations organized to protect claimants, policyholders, annuitants, and creditors of financially impaired insurers are known as
- insurance associations
 - department associations
 - liability associations
 - guaranty associations
16. Which of the following people would be required in most states to obtain an insurance license?
- Rachel, a salaried employee of a large department store chain, who counsels her employer on insurance-related matters
 - Adam, who works in an advertising agency, supervising the advertising business of a major insurer
 - Henry, who works as an underwriter for a small insurer
 - Sarah, who sells insurance to businesses only
17. A person licensed as an insurance producer in another state who moves to this state has how many days after establishing legal residence to become a resident licensee without taking prelicensing education or an examination?
- 30
 - 60
 - 90
 - 120
18. Which of the following individuals is least likely to be granted a temporary license?
- Georgia, whose insurance producer-husband passed away unexpectedly, leaving her with a business to either learn or sell
 - Kim, who wants to try selling insurance on a temporary basis before investing the time and money into being licensed
 - Dave, an employee of a business entity, when the individual designated as the licensee in the business entity is disabled in an auto accident and unable to return to work for several months
 - Lee, whose insurance producer-fiancée was recalled to active duty by the Navy and appointed Lee her designee
19. Business written on the producer's own life or interests is known as
- controlled business
 - personal business
 - conflicted business
 - producer business

20. Which of the following is considered an unfair claims practice?
- A. Splitting a commission with a prospect
 - B. Failing to affirm or deny coverage within a reasonable time after proof of loss
 - C. Convincing a policyowner to lapse or surrender an existing policy to sell another policy
 - D. Making any oral or written statement that is false, maliciously critical, or calculated to injure a competing producer
21. An organization that establishes model laws that are often adopted by states with only slight differences is
- A. the National Association of Insurance Companies
 - B. the National Association of Independent Commissioners
 - C. the National Association of Insurance Consultants
 - D. the National Association of Insurance Commissioners

ANSWERS AND RATIONALES TO UNIT TEST

1. **D.** Pretext interviews are not permitted unless some evidence of criminal activity exists.
2. **B.** A customer is anyone with whom a company has an ongoing relationship.
3. **C.** The federal government has the right to regulate the business of insurance to the extent that such business is not regulated by state law.
4. **B.** Insurance laws generally are written by the state legislature.
5. **A.** The Commissioner is not responsible for examining individual policies prior to issue.
6. **C.** The nonfinancial regulatory activities of an insurance department fall under the broad heading of market conduct.
7. **A.** Alicia would not be exempt from a producer licensing requirement.
8. **C.** Producers may act either as agents representing the insurance company or as brokers representing the individual seeking insurance.
9. **C.** Insurance is state regulated as defined by the McCarron-Ferguson Act.
10. **A.** Applicants for insurance do not have to be given advance notice of the persons who will be collecting information.
11. **B.** Under the financial privacy safeguards of the Gramm Leach Bliley Act, an individual about whom a financial institution collects information is a consumer.
12. **A.** Under the financial privacy safeguards of the Gramm Leach Bliley Act, an individual with whom a financial institution has an ongoing relationship is a customer.
13. **C.** The Commissioner of Insurance does not have the power to promulgate insurance laws.
14. **C.** Nonfinancial regulatory activities of an insurance department fall under the broad heading of market conduct.
15. **D.** Associations organized to protect claimants, policyholders, annuitants, and creditors of financially impaired insurers are known as guaranty associations.
16. **D.** Sarah would be required to obtain an insurance license in most states.
17. **C.** A person licensed as an insurance producer in another state who moves to this state has 90 days after establishing legal residence to become a resident licensee without taking prelicensing education or an examination.
18. **B.** Kim is least likely to be granted a temporary license.
19. **A.** Business written on the producer's own life or interests is known as controlled business.
20. **B.** Failing to affirm or deny coverage within a reasonable time after proof of loss is considered an unfair claims practice.
21. **D.** The National Association of Insurance Commissioners establishes model laws that are often adopted by states with only slight differences.

UNIT 2 EXERCISE ANSWERS

Exercise 2.A

1. **B**

Exercise 2.B

1. **E**

2. **G**

3. **B**

4. **I**

5. **J**

6. **D**

7. **H**

8. **C**

9. **F**

10. **A**

Glossary

A

absolute assignment Policy assignment under which the assignee (person to whom the policy is assigned) receives full control over the policy and also full rights to its benefits. Generally, when a policy is assigned to secure a debt, the owner retains all rights in the policy in excess of the debt, even though the assignment is absolute in form. (See assignment)

accelerated benefits rider A life insurance rider that allows for the early payment of some portion of the policy's face amount should the insured suffer from a terminal illness or injury.

acceptance (See offer and acceptance)

accident and health insurance Insurance under which benefits are payable in case of disease, accidental injury, or accidental death. Also called health insurance, personal health insurance, and sickness and accident insurance.

accidental bodily injury provision Disability income or accident policy provision that requires that the injury be accidental in order for benefits to be payable.

accidental death and dismemberment (AD&D)

Insurance providing payment if the insured's death results from an accident or if the insured accidentally severs a limb above the wrist or ankle joints or totally and irreversibly loses eyesight.

accidental death benefit rider A life insurance policy rider providing for payment of an additional benefit when death occurs by accidental means.

accidental dismemberment Often defined as "the severance of limbs at or above the wrists or ankle joints, or the entire irrevocable loss of sight." Loss of use in itself may or not be considered dismemberment.

accidental means provision Unforeseen, unexpected, unintended cause of an accident. Requirement of an accident-based policy that the cause of the mishap must be accidental for any claim to be payable.

accumulation unit Premiums an annuitant pays into a variable annuity are credited as accumulation units. At the end of the accumulation period, accumulation units are converted to annuity units.

acquired immune deficiency syndrome (AIDS) A life-threatening condition brought on by the human immunodeficiency virus; insurers must adhere to strict underwriting and claims guidelines in regard to AIDS risks and AIDS-related conditions.

acute illness A serious condition, such as pneumonia, from which the body can fully recover with proper medical attention.

adhesion A life insurance policy is a "contract of adhesion" because buyers must "adhere" to the terms of the contract already in existence. They have no opportunity to negotiate terms, rates, values, and so on.

adjustable life insurance Combines features of both term and whole life coverage with the length of coverage and amount of accumulated cash value as the adjustable factors. Premiums may be increased or decreased to fit the specific needs. Such adjustments are not retroactive and apply only to the future.

administrative-services-only (ASO) plan Arrangement under which an insurance company or an independent organization, for a fee, handles the administration of claims, benefits, and other administrative functions for a self-insured group.

admitted insurer An insurance company that has met the legal and financial requirements for operation within a given state.

adult day care Type of care (usually custodial) designed for individuals who require assistance with various activities of daily living, while their primary caregivers are absent. Offered in care centers.

adverse selection Selection "against the company." Tendency of less favorable insurance risks to seek or continue insurance to a greater extent than others. Also, tendency of policyowners to take advantage of favorable options in insurance contracts.

agency Situation wherein one party (an agent) has the power to act for another (the principal) in dealing with third parties.

agent Anyone not a duly licensed broker, who solicits insurance or aids in placing risks, delivering policies, or collecting premiums on behalf of an insurance company.

agent's report The section of an insurance application where the agent reports personal observations about the applicant.

aleatory Feature of insurance contracts in that there is an element of chance for both parties and that the dollar given by the policyholder (premiums) and the insurer (benefits) may not be equal.

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Notes