

California Two-Hour Ethics

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I Ethics and the Law

For a society to function, rules are necessary. Without rules and enforcement, there can only be anarchy. Ideally, the values basic to a civilized society are handed down to individuals through customs. These are rules of behavior that over generations have been found to help make it possible for people to live together peacefully. Observing these rules is largely a result of family training and peer pressure.

There are always individuals who through ignorance, lack of training, or sheer perversity will not follow the rules. Penalties for rule-breakers make up the basic legal system of a society, backing up customs with force. Every civilized society is founded on law, and none has ever survived without it.

Ethics goes further than law in determining everyday behavior. Law cannot cover every aspect of human relationships. Personal ethics, or individual morality, has been called "what one does when nobody is looking." Law, on the other hand, sets standards for behavior in situations involving other people, and backs those standards with the power invested in law enforcement.

Professional Behavior

A professional serves the public, not simply an employer, and he or she is therefore held to higher ethical standards than are other individuals. Professional behavior may be defined in terms of four essential attributes: a high degree of generalized and systematic knowledge; primary orientation to the community interest rather than to individual self-interest; a high degree of self-control of behavior through codes of ethics internalized in the process of work socialization and through voluntary associations organized and operated by the work specialists themselves; and a system of rewards (monetary and honorary) that is primarily a set of symbols of work achievement and thus ends in themselves, not means to some end of individual self-interest. A profession consists of a group of people organized to serve a body of specialized knowledge in the interests of society.

Business Practices

The subject of ethics has been prevalent in the insurance industry since the early days of insurance. Those who specialize in business ethics know the drill. They open the newspaper to see details of an emerging corporate scandal, typically involving illegal activities. Soon a journalist is on the hunt seeking an expert opinion on the "ethics" of the firm at the heart of the scandal. If there are two or three such scandals in quick succession, the journalist may want an opinion on whether or why there is a general decline in business ethics. More often than not, the business-ethics expert has very little to add to such stories. The company or one of its managers broke the law. The law had been put in place precisely to serve as a disincentive to engage in activities with particular types of ethically negative consequences. The company or its agents knowingly or negligently went ahead with the dubious activities. There is often little of interest that an ethicist can contribute here, although journalists are obviously happy to be able to transmit some expert finger-wagging.

Bad News = Good Press

The tables would be turned if one were to open the paper and read a story about a difficult dilemma faced by a business, where it is not at all obvious what the most ethical solution is. Such stories are hardly ever seen, and bad news is good press. The net effect is that business-ethics news is almost always bad news. And one consequence of this is that it reinforces a perception of business and business leaders as fundamentally unethical, checked only by the countervailing power of state regulations, auditors, police, and investigative journalists.

For philosophical or practical reasons, skeptics have argued that business education should not be burdened with teaching ideology or values. Others say that education without embedded values is an illusion. When agency theory is taught, the view is perpetuated of managers as self-serving opportunists, not as enlightened professionals at the service of society.

The teaching of business ethics is almost inherently pluralistic, but little evidence of explicitly pluralistic approaches exists in teaching materials besides the available decision-making frameworks. Pluralism can be defined as the view that more than one basic principle operates equally in an area of human endeavor. Within moral philosophy, pluralism is considered a middle ground between monism (the view that one principle or good is basic) and relativism (the view that no principle or good is basic across individuals or societies). In moral pluralism, a certain finite number of principles or intrinsic goods are identified as basic. Two important objections often are made against pluralism. Some argue that pluralism is inconsistent because it privileges different principles in different situations. Defenders of pluralism say different principles should be used in different situations for good reasons, and in similar cases, people will come to similar judgments regarding the relative importance of principles within the specific context.

The Role of Business Ethics

It was only a few years ago that ethics officers were building ethics departments within their companies to manage integrated investigations, communications, and training. The role of business ethics as a distinct discipline is established in today's work environment. Today, with the focus on building ethical cultures, ethics officers are seeing the need to influence key business practices that go far beyond awareness of code standards and corporate values. "Ethics" must be the discipline of helping managers and leaders create the culture where raising issues is safe, as well as socially acceptable, and where frustrations stemming from today's business pressures can be safely vented.

Congress enacted the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") to restore public trust in the markets. Among its ways of achieving this, Sarbanes-Oxley attempts to improve organizational ethics by defining a code of ethics as including the promotion of "honest and ethical conduct," requiring disclosure on the codes that apply to senior financial officers, and including provisions to encourage whistle blowing. The Sarbanes-Oxley Act of 2002 § 406(a), 15 U.S.C. § 7264(a) (Supp. III 2003) (requiring corporations "to disclose whether or not, and if not, the reason therefore, such issuer has adopted a code of ethics for senior financial officers, applicable to its principal financial officer and comptroller or principal accounting officer, or persons performing similar functions"). Corporations are also required to disclose "any change in or waiver of the code of ethics for senior financial officers." The same section law requires audit committees to establish procedures for employees to submit concerns about questionable accounting practices (*id.* § 806 providing for protection of employee whistleblowers).

The Securities Exchange Commission's implementing rules expand the disclosure requirement on the code of ethics to include codes that apply to the chief executive officer and further develop the definition of a code of ethics (17 C.F.R. §§ 228.406, 229.406 (2003)). The final definition of a code of ethics requires written standards that are reasonably designed to deter wrongdoing and to promote:

- Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships
- Full, fair, accurate, timely, and understandable disclosure in reports and documents that a registrant files with, or submits to, the Commission and in other public communications made by the registrant
- Compliance with applicable governmental laws, rules and regulations
- The prompt internal reporting of violations of the code to an appropriate person or persons identified in the code
- Accountability for adherence to the code.

In addition, Sarbanes-Oxley mandated that the United States Sentencing Commission review the Organizational Sentencing Guidelines ("OSG"). As a result of this review, the Sentencing Commission modified the OSG to redefine an "effective" compliance program as one that includes efforts to "promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law."

Rise of Regulation

In America, the original pattern of expansion filled legitimate needs. The insurance industry, as well as of other forms of business, grew eventually into a relentless drive for more and more success. The results of this uncontrolled expansion and unethical practices brought on a demand for regulation. In the insurance business, state laws and licensing practices gradually developed to set required standards for companies and agents.

The Massachusetts legislature in 1858 was the first to pass a law making a version of the legal reserve principle a requirement for insurers. A state insurance department was created to enforce the new law and Elizur Wright became its head. As the western part of the country was settled, the insurance industry again expanded its horizons. New companies grew up to offer insurance in the growing western cities as transportation and manufacturing facilities followed the trails blazed by the pioneers.

People moved about more, and travel restrictions were removed from insurance policies. Prudential pioneered insurance for low-income groups and it became widely accepted. By the end of the 19th century, the total of insurance in force in the United States had risen to seven and a half billion dollars. Rapid growth again led to difficulties. Since insurance companies were the custodians of much of the nation's wealth, attention focused on them as a new "muckraking" phase of attacks on questionable business practices began shortly after the turn of the century. There was a renewed public demand for investigation of the insurance industry.

The Armstrong Investigating Committee in 1905, with Charles Evans Hughes as its chief counsel, turned its attention to insurance practices in New York. Its recommendations, backed by responsible insurance companies, resulted in the adoption of the New York Insurance Code in 1906. State supervision of insurance practices was tightened by this code, and eventually public confidence in the insurance industry was restored. Throughout the 20th century

insurance regulation has grown. The National Association of Insurance Commissioners (NAIC), a group made up of insurance officials from all states, has drafted model legislation which has been widely adopted by state legislatures.

The unfair trade practices act recommended by the NAIC defines unfair claims settlements, false advertising, defamation, and unfair discrimination and prohibits all these practices. This NAIC model has been adopted by nearly every state. The resulting laws give state insurance commissioners the power to investigate when such practices are suspected and to levy fines and suspend or revoke licenses when violations are found. Marketing and disclosure standards for life insurance agents also are recommended by the NAIC. These make deceptive practices designed to mislead clients not only unethical but also illegal.

Any statement misrepresenting the benefits or coverage offered by a policy is a deceptive practice which can lead to the loss of an agent's license. Implying that future dividends provided by a participating policy will be enough to take care of premium payments would be such a misrepresentation. So would an implication that future policy dividends are guaranteed.

Justice, Law and Ethics

The link between ethics and justice is difficult to define, and an exploration into its nature has occupied much time for philosophers. Ethics is the study of what is right and wrong, in the sense of obligations in action. Justice is a concept involving the fair, moral, and impartial treatment of all persons. In its most general sense, it means according individuals what they actually deserve or merit, or are in some sense entitled to. Justice is a particularly foundational concept within most systems of "law," and draws highly upon established and well-regarded social traditions and values. From the perspective of pragmatism, it is the name for a fair result.

In his book *The Law*, (1850) Frederic Bastiat concluded that "law is organized justice." The law is no guarantee of justice, and these terms are by no means synonymous. Justice is an ideal which good law continually strives to achieve. If the law is regarded as the sum total of the rules enforced and administered by courts and other agencies of government, the disparity between law and justice becomes apparent. As explained by Bastiat, law is inseparable from a politically organized society. In a government by a dictatorship, its laws might be oppressive, harsh, and calculated chiefly to maintain the control and domination of the dictator. A rule, regulation, edict or order is no less a law because it is harsh, unwise, or unjust. Law is ever changing and its change should be in the direction of fair, reasonable, equal and impartial treatment of the competing interests and desires of the individuals in the community to whom it applies. To the extent that it fails to do so, it fails to achieve justice.

On the portico of the Supreme Court Building in Washington, D. C. is inscribed in stone "Equal Justice under Law". These words express not only an ideal, but also the relative position of law and justice. Without law and order there can be no justice. The present and future welfare of mankind depends upon the administration of justice according to law. Here are six arguments for the administration of justice according to the law:

1. Law makes it possible to predict the course which the administration of justice will take.
2. Law secures against errors of individual judgment.
3. Law secures against improper motives on the part of those who administer justice.
4. Law provides the magistrate with standards on which the ethical ideas of the community are formulated.
5. Law gives the magistrate the benefit of all the experience of his predecessors.

6. Law prevents the sacrifice of ultimate interests, social and individual to the more obvious and immediately pressing but less weighty immediate interests."

Trust- The Basis of Insurance

A bedrock principle of the insurance industry is trust – particularly between an agent and his or her clients. It is important that an agent avoid anything that will erode that trust. A dynamic of the insurance industry is the remarkable growth of the industry and the change that has resulted from technology. Many of the regulatory issues that come about are largely a function of that growth and change. The future of the business lies in the trust customers and the public have in it;

- Honesty (full disclosure)
- Fairness (to all involved)
- Avoidance of conflicts of interest
- Promise keeping
- Responsibility

Acting in accordance with these values results in integrity and builds a reputation of trustworthiness. Obstructions to ethical decision making include the following;

- Pressure to make the numbers
- Time Pressure
- Misaligned priorities
- Short Term orientation (Failure to consider long term implications)
- Underestimating the risk of getting caught
- Rationalization

With insurance, the element of trust is critical. The purchase of a home, automobile, computer system, or even a washing machine is a big expense for a consumer. There is a great deal more at stake with a life insurance policy. The insured and his or her family members can suffer financially if the agent and his company fail to deliver on their promises. Unlike a house or auto, a life insurance policy is not a tangible product. Insureds cannot tour the home or kick the tires. When an agent delivers a policy to the insured, they should spend time going over premium, terms, and conditions of the policy. Afterwards, most people simply place the documents in a safe, a drawer, file cabinet, or safety deposit box until there's a problem. With an intangible product like a life insurance policy, clients are buying the trust and security that comes from a company's promise to "be there" if and when the need arises.

II Agency and Ethics

Agency is a three-legged stool with a relationship between the agent, client, and broker (insurer). There is great potential for cross talk, "he said-she said", and general miscommunication in such an arrangement. For their own protection, protocols must be established and adhered to whenever an insurance professional is in an agency system.

A relationship between two persons by which one of them is authorized to act on behalf of the other is called an agency. The person authorized to act is the agent. The person for whom he acts is the principal. Authorized acts of the agent bind the principal and create legal rights and duties for him with respect to third persons. In the legal sense the term "agency" applies to contractual or commercial dealings between two parties through the medium of another.

Changes in the legal position of the principal which may be produced by acts of an agent include the creation of contract rights and obligations, the existence of tort duties, and the transfer of title to property.

Without agency a business person could make transactions only by directly and personally participating in them or by closing contracts himself. Through the use of agents, he can enter into thousands of transactions in the time it would take him to make one in person. A corporation, which is a legal entity, could not do business at all without acting through its agents, officers, and employees. The agency concept is a necessity for modern business.

The basic principle of the law of agency is that the authorized act of the agent is the act of the principal. This is expressed in the Latin maxim "Qui facit per alium, facit per se," literally meaning that he who acts through another acts himself.

The most common method of creating an agency relationship is by contract or agreement, requiring a manifestation of consent by both the principal and the agent. Agency, however, may result from an order given by one person to another to act on his behalf with or without a promise of consideration. The element of consideration is not essential in the relationship of principal and agent. A statute may create an agency known as agency by operation of law. The non-resident motorist statute is such an agency. In most states the secretary of state is appointed as the agent of a non-resident motorist while on the highways of that state for service in case of an action arising out of that operation.

Agency by estoppel exists when a person, who by his conduct gives another person apparent authority to act on his behalf, and reasonably induces a third person to rely on dealing with that person as an agent.

Ratification can affirm the act of a purported agent or the unauthorized act of an agent, giving the commission of the act the same effect as if it were originally authorized.

Legality of Agency

In most cases whatever an individual may do personally he may do through an agent. There is an exception for acts so personal that their performance may not be delegated, such as personal services under contract.

Whatever a person may not legally do himself; he cannot legally authorize another to do for him. He cannot legally authorize another person to commit an illegal act or crime on his behalf. Any such agreement would be void. All parties planning or participating in the commission of a crime or unlawful act are held to be principals. Legally, war terminates commerce and trade between the belligerents. A citizen of a warring country cannot appoint or act through an agent in an enemy country.

Capacity

The capacity of an individual to act through an agent depends on the capacity of the principal to do the act himself. As contracts entered into by infants or insane persons are voidable, so appointments of agents by infants or insane persons are voidable. The incapacity of an agent to bind himself by contract as an agent does not disqualify him from making a contract that is binding on his principal. An infant or insane person as an agent may make a contract with a third

party who is valid between that party and the principal, even though the contract between the principal and agent may be voidable or void.

A person who has an interest adverse to that of the principal may not act as his agent. The Statute of Frauds prohibits a party to a contract from executing a note or memorandum as agent for the other party.

The relationship between master and servant is not one of agency. The servant does not have the right to enter contracts on behalf of the master unless there is a separate agency relationship. An independent contractor may or may not be an agent. The relationship depends on the nature of the work performed or services rendered and the extent of the control exercised over the contractor.

Kinds of Agents

An agent is one who has been given express or implied authority to act on behalf of the principal. An ostensible agent is one to whom the principal has given no authority but by conduct has induced others to reasonably believe that he has the authority for acting.

Another classification of agents is as general or special. A general agent is employed to transact all business of his principal or all business of a particular kind. A special agent is employed to act for his principal only in a specific transaction or for a particular purpose. A special agent does not have entire control over a particular business but only the authority to perform certain acts.

A subagent can be employed by an agent with the knowledge and consent of the principal. The subagent can assist the agent in transacting the affairs of the principal, not as a mere servant of the agent but with authority to bind the principal. He has a fiduciary relationship with the principal as does the agent.

Fiduciary Duties

A duty arising out of a position of trust and confidence is called a fiduciary duty. An agent has fiduciary obligations to his principal. Other examples of fiduciary obligations include the duty owed by a trustee to the beneficiary of the trust, by an officer or director of a corporation to that corporation and its shareholders, or by a lawyer to his client. A fiduciary duty exists in every relationship where one person is induced to put his trust and confidence in another. The fiduciary duty is one of good faith and utmost loyalty.

In the fiduciary relationship the agent must act solely in the interest of his principal. He must not act in his own interest or in the interest of a third party. He may not take a position in conflict with his principal's interest. He may not enter into any transaction in which he has a personal interest unless the principal consents and has full knowledge of all the facts. Full disclosure is required by the agent to his principal at all times. He cannot compete with his principal or act on behalf of a competitor. He cannot act for persons whose interest's conflict with those of the principal. He may not buy from himself. An agent employed to sell may not become the purchaser nor act as agent for the purchaser. His loyalty must be undivided.

An agent cannot use information obtained during the agency for his own benefit and contrary to the interest of his principal. If before the expiration of his employer's lease on a property he secretly obtains a lease for his own benefit, he may be forced to transfer it to his principal.

The agent is entitled to receive the agreed salary or commission, or if the amount was not fixed by agreement, a reasonable compensation. He is not allowed to make a secret profit out of the matter involved in the agency.

If a broker knows his principal will accept \$75,000 for a piece of property with an asking price of \$80,000, and the broker tells a prospective buyer he will try to get the seller to take \$75,000 on condition the buyer pays the broker a secret \$2,500, the fiduciary duty has been violated. The broker can be required to pay the secret \$2,500 to the seller and also forfeit his right to a legal commission.

Other Duties of Agent

An agent owes his principal other duties in addition to his fiduciary obligations. He is expected to act with reasonable care and skill in the performance of his work. He is to conduct himself with propriety in order not to bring disrepute on the principal or his business. He is to avoid conduct which would make friendly association with the principal impossible. He is to use reasonable efforts to give the principal information on the affairs entrusted to the agent that is relevant and which he knows the principal would wish to have. He must maintain and provide to the principal a true account of money or other items the agent has received or paid out on behalf of the principal.

There are times when the agent cannot communicate with the principal. Also, the principal has given no specific instructions. The agent must refrain from binding actions which are expensive, speculative in nature and uncertain in attaining the principal's objectives. All reasonable instructions and directions of the principal must be obeyed by the agent. He must follow the directions of the principal even though the terms of employment do not prescribe such directions. The agent does not have to follow directions that violate a privilege of the agent to protect his own or another's interest. The agent must refrain from acting as agent after termination of his authority.

Principal's Duties to Agent

In addition to whatever specific duties may be set out in a contract arrangement between principal and agent, the principal is under contractual duty to refrain from unreasonably interference of the agent's work. Simply by contracting to employ an agent, a principal does not promise to provide him with an opportunity to work, but such a promise may be implied by the nature of the employment or by the circumstances under which the agreement was made.

A principal who has reasonable knowledge of possible physical harm or monetary loss in the performance of the agent's duties is duty bound to inform the agent of such risks.

It is the principal's duty to maintain and render to the agent a true account of money or other things due the agent. He also has a duty to conduct himself in such a way as not to harm the reputation of the agent.

Reimbursement- Authorized payments made by the agent on behalf of the principal, and expenses incurred by or resulting from authorized acts of the agent, are to be reimbursed by the

principal. The principal is under a duty to pay the fair value for the agent's services rendered if the agency agreement does not specify a definite amount or rate of compensation.

Commission Advances- Courts have held that unless there is an express or implied agreement otherwise, a salesperson is not required to pay back any excess of advances over commissions. One decision called an arrangement with a salesperson "a joint enterprise in which the employee furnished his time and ability and the employer furnished the money necessary to enable the employee to devote himself thereto. Both expected the adventure to produce a fund (the earned commissions) from which each would be fully compensated.

The agent expects compensation for his time and labor, and the principal expects a return on his money. The advances are therefore not regarded as loans to the employee but as speculations in a common enterprise. Without a promise to repay contained in the agreement under which the advances were made, a promise to advance money for a particular purpose in the furtherance of the principal's business does not import an expectation of its return personally by the person to whom the money was advanced.

Liability to Third Persons

An agent can cause his principal to become bound to third persons. Since the principal can manifest his will through an agent, the acts or omissions of the agent impose liability on the principal. The agent has the power to subject his principal to either contract or tort liability. Power is defined as the ability of a person to produce a change in legal relations. Whether power is used rightly or wrongly it results in the creation of new rights and new duties. A principal is liable to third persons on contracts made by his agent when the agent is acting within the scope of his actual or apparent authority. The principal is not liable in contract for the unauthorized acts of an agent. To be binding on the principal, the actions of the agent must be strictly within the limits of the authority given to him by the principal.

Express and Implied Authority- Express authority is granted the agent in spoken or written words of the principal directing the agent to do something specific. Implied authority is based on the consent of the principal manifested to the agent. Implied authority is not given through expression or explicit words but is inferred from the principal's conduct and consent.

Implied authority includes authority to use all reasonable means to accomplish a particular task assigned to the agent. The agent employed to manage an apartment building for a commission has the implied authority to pay utilities, hire a porter, and pay for repairs. These acts may be reasonably inferred as necessary to proper management of the building.

An agent has apparent authority through manifestation by the principal to the third person with whom the agent is dealing. Smith writes Jones a letter authorizing Jones to sell Smith's car. Smith sends a copy of the letter to White, a prospective purchaser. Smith then writes a second letter to Jones revoking the agency agreement but does not send a copy of the second letter to White. Jones at this point has no actual authority to sell the car but as far as White is concerned, Jones continues to have apparent authority, since White has not been informed of the revocation of the agency.

Liability of Principal

If a principal authorizes his agent to commit a tort against the person or property of a third person, the principal is liable. Smith authorizes Jones as his agent to make certain representations about Smith's property that Jones is trying to sell. Smith knows the representations are false but Jones does not. Jones sells the property to White using the misrepresentations. Smith is liable to White for damages.

A principal may be liable for a tort committed by his agent. If the tort was committed during the agent's employment, whether unauthorized, or in flagrant disobedience of the principal's instructions to the agent, the principal could be found liable for the action.

This form of liability without fault is based on the doctrine of respondeat superior, "let the superior respond." A person who multiplies his business activities through the use of agents and employees is liable for those persons' negligence occurring during the time they are carrying out their duties. The wrongful act must be connected with the employment and within the scope of the employment in order for the principal to be held liable for injuries or damage to third persons.

The agents responsibilities are to the;
Policyholder
Insurer
Regulator
Public

Responsibility is a two-way street. The insurance agent has a responsibility to explain the policies but the insured also has the responsibility to take the time necessary to understand this explanation. If there is no responsibility placed on the insured, the agent is left in the position of protecting the consumer from his own bad choices (a trial attorney's dream land). In a market economy consumers must take responsibility for their choices (provided business is conducted legally and ethically), and the education necessary to make those choices.

III LICENSING

Insurers must be licensed by a state to issue policies there. A state's guarantee fund usually covers only insurers authorized to do business in that state. An agent representing an unauthorized company may be held personally liable for losses on a contract placed with an unauthorized insurer. The agent needs to be sure the company being represented is authorized to do business in that state.

It is also important for both the agent and the company office to be aware that laws can change. Actions of the state legislature and regulations issued by the state insurance commission both can vary with time and the pressure of public opinion.

Court decisions in insurance cases can make a change in liability affecting those in the industry. The legal system in this country is not static, but fluid. Company officials need to keep abreast of such developments and let their agents in the field know about them.

Unlicensed Insurers

One of the main problem areas involving unauthorized insurance has been health insurance. However, unauthorized insurance has more recently invaded other lines, too, including workers compensation insurance, auto, cruise/travel insurance, and viatical settlement. While the insurance market has always been cyclical (hard and soft), the hard cycles have more recently spawned more fraudulent activity than seen in the past. Making matters worse, the perpetrators have become more sophisticated and have created more complex schemes.

Problems with unauthorized health-insuring entities started in earnest in or about 1974 with the enactment of the ERISA. This federal law gave the United States Department of Labor responsibility for the enforcement of this body of statutory law. Within the Department of Labor, the Pension & Welfare Benefits Administration has direct involvement. ERISA deals with employee health and welfare benefit plans. Stated differently, it deals with matters relating to employer-sponsored health-insurance-type plans, and with retirement plans. Insurance regulators' concern is with the health insurance aspect.

State insurance departments and insurance organizations are on the lookout for unauthorized insurance because of-

- Ongoing, not isolated, instances of such activity;
- Potential for criminal activity within the business of insurance;
- Adverse economic impact upon authorized insurers and other insurance licensees;
- Potential for large quantity of unpaid claims due to dishonesty and actuarial unsoundness;
- Absence of state or federal guaranty fund to cover unpaid claims;
- Adverse impact on future insurability of participants under statutes mandating guaranteed-issue health coverage (i.e., creditable coverage issue);
- Adverse economic impact upon health-care providers from unpaid claims;
- Lack of comprehensive federal oversight, including licensing and regulation similar to that of state insurance codes;
- Public perception that it is the role of state insurance regulators to protect them from illicit insurance schemes, to ensure that benefits are paid as contracted, and that legitimate insurance is available and affordable.

One of the goals of ERISA was to encourage individual employers to establish employee health plans. It did so, in part, by allowing the employers to fully *self-insure* the arrangements. That is, it allowed a *single employer* to establish a health plan *for that employer's employees and dependents*.

A self-insured plan is one in which the employer would itself, from its own funds, bear the financial responsibility for the covered health claims of its own participating employees. By self-insuring, the employer could make the benefits more affordable. This is because the employer would not incur the insurer's costs of doing business, including its profits, which are otherwise incorporated into the premium that would be charged for insurance coverage. Other such costs include maintaining statutory reserve requirements, regulatory compliance expenses, etc. *Alternatively*, the employer could establish a *fully insured* health plan in which a *licensed insurer* would bear the financial risk for the payment of covered claims.

Suspicious Activity

Any agent that has concerns about a product they have been asked to market or sell, any individual that has concerns that a product being offered to them is a type of unauthorized

insurance, or any individual that has heard about such a product should contact their state's department of insurance or consumer protection agency by phone, fax or internet.

Insurance Agent Relationships

By its very nature, the insurance industry requires a robust network of agents to achieve growth, profitability, and competitive advantage. Agents need to find ready and able purchasers for their product; Agents also need carriers with products that meet the demands of the market. For the business model to work, agents must curry relationships with the insured and the insurer. To become attractive business partners, carriers must improve agents' ability to offer the right product to the right customer at the right time. That means getting the right information to the agents supporting the needs of the insured. Part of the process is for the agent to establish and maintain a reputation of honesty, integrity and fidelity.

Fiduciary Relationships

A Fiduciary is a person having a duty, created by his undertaking, to act primarily for the benefit of another in matters connected with his undertaking; one who holds a position of confidence. The State of Texas has stated that insurance companies owe "fiduciary-like" duties to their policyholders. The reasoning is that since insurance companies have such a superior bargaining position over the general insuring public, and issue policies on a take-it-or-leave-it basis (adhesion contracts), they should be held to act as a fiduciary when dealing with policyholders. However, many courts do not see it that way. Courts have different views of this most basic issue--the relationship between insurance company, agent and policyholder;

- The relationship of confidence and trust which exists between the insurance company and the policyholder is not a fiduciary one, and the insurance company has the right to protect its own interest along with that of the policyholder (State Farm Mut. Auto Insurance Co., v. Floyd, 366 S.E. 2d 93, 235 Va. 136 Va, 1988).
- The insurance company duty is analogous to that of fiduciary (James v. Aetna Life & Cas. Co., 326 N.W. 2d 114, 109 Wis 2d 363)
- The insurance agent owes a fiduciary duty to the insurance company, and acts not for the policyholder, but for the insurance company (Weinisch v. Sawyer & Allstate Insurance Co., 587 A. 2d 615 NJ, 1991).
- A fiduciary relationship exists between an automobile insurance company and its policyholders (Gibson v. Government Employees Insurance Co., 208 Cal. Rptr. 511, 162 CA 3d 441).
- Under Mississippi law there is no fiduciary relationship or duty between the insurance company and the policyholder (pertaining to property insurance), only a contractual relationship exists (Gorman v. Southeastern Fidelity Insurance Co., 621 F. Supp. 33, aff. 775 F. 2d 655).
- Louisiana law, an insurance broker has a fiduciary responsibility to the policyholder as well as to the insurance company (Offshore Production Contractors, Inc. v. Republic Underwriters Insurance Co., 910 F. 2d 224)
- The automobile policy created an obligation between the policyholder and the insurance company to deal with each other in good faith, but there was no trust or fiduciary relationship by either party (Miller v. Lumbermen's Mutual Cas. Co., 488 So. 2d 273, writ denied 493 So. 2d 637).

Insureds whose coverage does not apply to a particular loss will often sue their agent or broker for failure to obtain the coverages they needed.

To make their case, the insureds will invariably try to hold the agent or broker to a higher duty of care than he or she ordinarily has under the law. Specifically, they will attempt to prove that a fiduciary relationship exists between the parties. If they succeed, the case becomes easier for them to win.

A fiduciary duty is the highest standard of care imposed at either equity or law. A fiduciary is expected to be extremely loyal to the person to whom he or she owes the duty. The fiduciary must not put personal interests before the duty and must not profit from the relationship, unless the principal consents. The fiduciary relationship is characterized by good faith, loyalty and trust. Fiduciary relationships include those between a trustee and beneficiary, a director and company, a lawyer and client, and a doctor and patient.

To establish a fiduciary duty owed by an insurance agent or broker, the party claiming breach must show evidence of some special trust or confidence placed in the broker or agent by the insured and recognized by the agent, preferably in writing. The prudent agent or broker will make clear that the relationship with the insured is a business relationship.

The agent who successfully defended the following suit protected himself by clearly communicating with the insureds.

The lesson to be drawn from this discussion is to always communicate and document contacts with clients. The agent who maintains a paper trail and record of customer interactions avoids confusion, misunderstanding, and (possibly) litigation.

Commingling

The term commingling, when used in a legal context, is a breach of trust in which a fiduciary mixes funds that he holds in the care of a client with his or her own funds, making it difficult to determine which funds belong to the fiduciary and which belong to the client. This raises particular concerns where the funds are invested, and gains or losses from the investments must be allocated. In such circumstances, the law usually presumes that any gains run to the client and any losses run to the fiduciary that is guilty of commingling.

The problem of commingling is of particular concern in the legal profession. Attorneys are strictly prohibited from commingling their client's funds with their own, and such activity is grounds for disbarment in virtually every jurisdiction, because of the ease of embezzlement and the difficulty of detection. Similar rules apply for licensed real estate brokers handling earnest money and other professionals who hold deposits as agents for clients *in absentia*.

If insurance agents are not fiduciaries, it would seem acceptable for agents to be allowed to commingle their funds with client funds. Such is not the case. No matter what state you reside, commingling business funds and personal funds is against insurance law. Agents need a business account for the premiums that may be collected. Often, premiums are made payable to and forwarded to the insurer by the agent.

Client Relationships

With the insurance transaction, the arrangement with the customer not only includes the advantages, and benefits of the product, but also the agent's best efforts and assurance that the product meets the customer's needs. As they do with their doctor, lawyer, accountant, or any other licensed professional, policy holders depend on the agent's specialized knowledge and skills. Agents have a duty to the insureds he or she services. This duty, however broad, requires agents to exercise ordinary and reasonable care in the performance of their duties, exhibiting honesty and good faith in every transaction. Agents must at all time act in a manner which they believe to be in the best interests of the client.

Ethical trouble begins when an agent views insurance selling solely from the standpoint of personal gain or self-interest. Insurance professionals need to make sure they are providing a benefit to the client in return for a commission. The agent's main concern should always be to serve the customer's best interests. That service commitment often leads to long-standing business and a referral potential that works in favor of the agent. If a transaction would not serve the customer's best interests, it is not in the agent's best interest. That is part of the concept of placing the customer's best interests ahead of the agent's interests. It is an ethical standard that holds true for every business.

Referrals and repeat sales are the building blocks of the most successful agents (not necessarily the largest producers). These agents receive a benefit from establishing a relationship of trust and ethical behavior with their clients. Success in the insurance industry is made easier by the insurance professional remaining on an even ethical keel. Being ethical means sometimes being at risk of losing a sale to a competitor who is more attuned to filling an order book. It may be hard to do when a competing agent is not acting in the customer's best interest, but ethical behavior does have its reward.

Insurance professionals sell a product, but the insurance industry is a service oriented business. The primary benefit of an insurance policy is not immediate and there is nothing tangible to show for the money one spends on it. The tangible benefit comes in the form of a payment, making the insured whole again after a loss. Still, insurance is more than just a tangible benefit; it is a sense of security, given to the insured and his or her family in the knowledge that they are protected against loss- sometimes catastrophic loss. Part of an agent's obligation to service is to educate customers that the relatively-low expense of insurance premiums is worth it.

Once emotion is removed from the sale, the insurance business is unquestionably a business of service. It takes a great deal of both time and effort, to assure the client that the insurance agent truly has their best interest at heart. Insurance buyers often complain that, while they receive a great deal of attention from insurance agents who are trying to make a sale, they feel essentially abandoned after the sale is made. It is unfortunate that some agents forget about the service aspects of the relationship. Experienced agents follow up with the client during the policy period. Clients who allow their policy to lapse often do so because they feel abandoned or by getting 'picked off' by a lower price (and lower benefit). Client's needs should be reviewed on a regular basis. Life is an on-going process. Clients get married and divorced, have children, move, and change jobs. These changes generate needs for new or different products. An agent's job is to be mindful of these changes. That is a part of maintaining client relationships.

Skill and Competency

Simply stated, a skill is something you can do and competency is how well you do it. Agents are expected to have (or gain) the training, skill and competency to apply the modalities and tasks of the insurance to the mission of finding and servicing the needs of the insurance-buying public. Those characteristics are composed of the knowledge and skills needed to perform a job effectively. Competency can be described as an individual's actual performance in a particular situation. Competency describes how well that individual integrates knowledge, skill, attitudes and behavior in delivering work results according to expectations

Insurance agents are members of a profession dedicated to furnishing professional skills and service to the public. Whenever problems arise which might result in detriment to the agent or clients, the abilities of the agent can be called into question as part of a legal action. To avoid

unwanted results in such situations, agents must strive to maintain the highest standards of training, ability and capability.

Insurance is a big industry and an agent is but one person. By profiling competencies, agent's efforts can be channeled within a pre-defined framework that supports the organization's objectives. Also, management will be able to direct learning and knowledge acquisition in a targeted approach to overcome skill and competency gaps for a more productive workplace. Competencies will also help organizations to focus on the characteristics their agents must possess for their personal growth and success. With a set of competency goals in mind, this provides a clear roadmap to measure agent performance and to align performance with business strategies.

Market Conduct

Market conduct examinations, which are generally done on site, are a review of an insurer's marketplace practices. The examination is an opportunity to verify data provided to the department by the insurer and to confirm that companies' internal controls and operational processes result in compliance with state laws and regulations.

The fundamental objective of insurance company solvency monitoring is to ensure that companies meet regulatory standards and to alert regulators if actions need to be taken to protect policyholders. To accomplish this task, the state insurance regulators conduct financial analysis using regulatory financial reports, financial tools and other sources of information to detect problems that may jeopardize a company's long-term viability. These sources include SEC filings, corporate reports, external, independent certified public accountant (CPA) attestation reports, financial examination and market conduct reports, rate and policy form filings, consumer complaints, independent rating agency reports, correspondence from agents and insurers, and business media.

Insurers face increasingly intense market competition from other providers of financial service products both domestically and internationally. In this challenging environment, it is important that financial service providers follow high ethical standards to best protect and serve consumers and to make sure the marketplace remains strong.

Most insurers adhere to principles of ethical market conduct. The principles include requirements for the marketing, advertising, sales and customer service of insurance products. Companies are also encouraged to promote a "needs-based" selling standard and that the insurance buying public should receive clear and honest information before they purchase any type of insurance product.

The Changing Role of Market Conduct Regulation

Insurance regulation is intended to ensure a healthy, competitive marketplace, to protect consumers, and create and to maintain public trust and confidence in the insurance industry. An integral component of insurance regulation is the appropriate oversight of the ways insurance companies distribute their products in the marketplace, namely, market conduct regulation. The history of market conduct regulation goes back to the early 1970s when the NAIC developed its first handbook for market conduct examinations and did its first market conduct investigation. The system has come a long way -- by 2002, departments reported a total of 1,333 market conduct exams and 465 combined financial/market conduct exams. Under the federal form of

government, each state modifies or promulgates its own set of examination parameters. Each company writing business nationally must comply with the divergent state and federal standards regarding the replacement of policies. The logical reason for so many different standards is that moral, political, and local outlooks towards regulatory content vary from state to state.

Making Market Conduct Regulation More Efficient

The challenge for the future is to create a uniform system of market conduct oversight that creates greater efficiencies for insurance companies while maintaining appropriate consumer protections and protecting states rights.

The NAIC has explored ways that regulators and best practices organizations to work collaboratively to improve market conduct regulation and advance the interests of consumers. The NAIC studied so called “best practices” organizations. State insurance departments also encourage insurance companies to become members of such organizations in an effort to promote higher market conduct standards and to facilitate the regulatory examination process. For example, as part of the examination process carried out pursuant to Texas Insurance Code article 1.15, the Department examiners routinely inquire as to whether companies are members of best practice organizations. Such initiatives by state insurance regulators is a step towards pursuing a new market analysis approach to regulation that will hopefully reduce inefficiencies and better allocate resources to provide more comprehensive consumer protections.

The NAIC and NCOIL (National Council of Insurance Legislators) have developed a Model Law on market surveillance that promotes market analysis and greater use of insurer self-evaluative activities such as those required under best practices standards to introduce a more uniform and efficient regulatory scheme.

Establishing a system of market analysis in cooperation with best practices organizations allows regulators to focus on whether an insurer has a sound market conduct and compliance infrastructure in place to better protect consumer interests. Today's market conduct examinations tend to focus on technical instances of noncompliance rather than exploring whether a company has a comprehensive system of policies and procedures in place to address market conduct compliance issues.

When regulators conduct a market compliance exam, they look for specific metrics to evaluate an insurer. Here is a checklist for insurers to assess noncompliance risks;

- Failure to acknowledge, pay or deny claims within specified time frames.
- Failure to properly terminate a policy, including inadequate days' notice and omitted required language.
- Improper documentation of claim files.
- Using unapproved or unfiled rates and/or rating errors.
- Failure to provide required disclosures (such as the selection, rejection, or coverage notices in the underwriting process or notices such as statute of limitations, reasons for denials, and bill of rights in the claims process).
- Failure to provide notification of producer appointments or terminations.
- Improper documentation of underwriting and policy files.
- Failure to communicate a delay in the settlement of claims in writing.
- Using unapproved or unfiled forms.
- Failure to produce requested records for an examination.

Lost Market Capitalization

As a further example of the way market conduct can affect insurers, consider the *AIG, ACE, Marsh McClennan vs. New York Attorney General Elliot Spitzer* battle in 2004. The amount of market capitalization lost by the three is staggering. After Spitzer's initial press conference regarding Marsh, Ace and AIG-

In less than two hours on October 14, 2004, MMC, ACE and AIG lost \$25,176,390,000 in market value. This number is larger than the GDP of over 100 countries.

Enforcement Powers

State laws present a comprehensive framework of rules for agent conduct in connection with insurance sales. All of the states forbid premium rebating, churning, and twisting. The proscription of these three forms of misconduct provides the foundation of the several states regulation of unfair and deceptive trade practices. Also prohibited are misrepresentations in the sales process, fraudulent acts and forms of coercion. Outside of sales practices, insurance departments set general rules about handling the handling of business, premiums, commissions and claims. The states have enforcement powers to back up the regulations; the ability to impose cease and desist proceeding along with the ability to levy fines. The ultimate form of leverage for insurance departments is their ability to sanction or revoke licenses.

What the Agent Says

Insurance agents, like everyone else, run the spectrum of values; there are honest, dishonest, ignorant and informed agents. Ideally, agents would combine the two positive traits in the list. The problem from a consumer's point of view is finding this agent. The industry as a whole prefers to believe that very few agents are dishonest. There does seem to be, however, varying degrees of honesty (think moral relativism). For example, an agent may be well-versed in term insurance, but not so much in whole life; an agent may know about homeowners insurance, but not so much about auto policies. They may be honest but they are ignorant of the product at hand. If you ask them a specific question they may give you an answer (usually what their boss tells them to say) but it doesn't really answer your question.

Fairly and simply, a policy must do what the agent says it will do. Agents are trained by their insurance companies, but not to super-high levels of detail. They know enough to talk the policy up and make it sound like gold, but not necessarily a whole lot about the fine print. Not knowing particulars about a product is not a sin, but fabricating song-and-dance responses to a prospective purchaser's questions is certainly not right.

Investment Advice

Agent statements that are seen as 'investment advice' are a case in point. Variable annuities and equity indexed annuities fall outside of the state definition of a "security." In many states, the state regulators do not view this as an impediment to enforcing investor protection safeguards under state securities laws under certain circumstances. Specifically, a growing number of state securities regulators are taking the position that when a financial professional such as a registered insurance agent confers with a client about that client's overall financial picture, including the value of the securities in their portfolio, the state's investment adviser laws apply. The regulators argue that when an insurance agent recommends that any of the client's securities be sold in order to generate funds that are subsequently used to purchase an insurance product, the insurance agent's conduct comes within the definition of an "investment

adviser," since the agent provided advice regarding securities and was ultimately compensated from the annuity sale. Therefore, the state regulators reason that investment adviser registration and the fiduciary standards of conduct for an investment adviser – including investor suitability standards – apply to the transaction. So if an agent is not licensed to sell investments, he or she should think twice about advising a client to cash out a security in order to buy an indexed annuity or other insurance product.

Commission Driven

People who sell insurance product face the dilemma of putting customer needs ahead of their commission-driven business model. Where there is no sale, there is no revenue. The intricate nature of insurance products causes the public to be dependent on the knowledge and advice of the person selling the insurance product. The insurance professional's loyalty may be with the insurer, but there is an implicit duty owed to the customer as well.

Needs Selling

Needs selling is the focus on the needs of an individual purchaser, not on what the agent wants to sell. Traditionally agents are armed with a product and told to go sell it. Needs selling is based on the idea of putting the customer's needs first. The goal being to determine the client's needs and then to solve that need with an appropriate product. Common sense suggests that total needs selling is the way to go. In practice that is not the case. It is time-consuming, considered intrusive, and frequently takes the prospect's attention away from buying another policy to trying to deal with the myriad of issues that a "total needs" analysis tends to raise. Agents must not let the need to sell product override or replace the clients need for the insurance.

IV AGENT CONDUCT

As an insurance professional, the agent becomes part of the insurance industry's public relations arm. The agent meets the public every day, and the manner and conduct exhibited leaves a lasting impression with everyone with whom that agent had contact.

A big part of professionalism is the attitude toward competition; therefore, agents should avoid criticizing other agents. Such activity is detrimental to everyone in the business. Any criticism of another company's policies should be avoided. An incomplete comparison is not only misleading and harmful to the public; it can also result in license revocation for the guilty party. Respect for competitors helps to keep policy owners satisfied.

The agent is under an obligation to make accurate and complete disclosure of all information which policy owners or prospective purchasers should have, in order for them to make a decision in their best interest.

Representing the Insurance Product

The agent is called upon daily to make many statements and representations, oral and written, upon which policy owners and prospects are entitled to rely. Such statements and representations must not only be accurate, but must also be sufficiently complete to prevent any wrong or misleading conclusions from being made by policy owners or prospects. It is just as wrong for a life underwriter to omit giving essential information, such as, failing to correct a mistaken

impression which is known to exist, as it is to give inaccurate or misleading information. Representing insurance products as exclusively "retirement plans", "college education plans" or "savings plans", without noting that the life insurance is primary and the cash value features are secondary, can result in serious charges of misrepresentation of insurance products. Use of the word "deposit" versus "premium" can have a like effect.

Deceptive Practices

An outline of the law addressing misrepresentation can be found in Sec. 541 of the Texas Insurance Code. Other state laws are similar and agents are encouraged to examine their own state's insurance code.

It is an unfair method of competition or an unfair or deceptive act or practice in the business of insurance to:

- make, issue, or circulate or cause to be made, issued, or circulated an estimate, illustration, circular, or statement misrepresenting with respect to a policy issued or to be issued:
 - the terms of the policy;
 - the benefits or advantages promised by the policy; or
 - the dividends or share of surplus to be received on the policy;
- make a false or misleading statement regarding the dividends or share of surplus previously paid on a similar policy;
- make a misleading representation or misrepresentation regarding:
 - the financial condition of an insurer; or
 - the legal reserve system on which a life insurer operates;
- use a name or title of a policy or class of policies that misrepresents the true nature of the policy or class of policies; or
- make a misrepresentation to a policyholder insured by any insurer for the purpose of inducing or that tends to induce the policyholder to allow an existing policy to lapse or to forfeit or surrender the policy.

Here are some examples;

- Passing off the agent's own goods or services as someone else's.
- Misrepresenting the benefits, uses, or characteristics of the product.
- Making disparaging remarks pertaining to someone else's products, services, company, by making false or misleading representations.
- Advertising the product or rates while intending not to sell them as advertised.
- Misrepresenting the agent's authority as a sales person, representative, or agent to negotiate the final terms of the contract with the policy owner.
- Offering, in connection with an insurance purchase, participation in a "multi-level distributorship" under which payments are conditioned on the recruitment of additional sales people rather than the proceeds from the product sales.
- Using the terms "corporation" or "incorporated" or their abbreviations in the name of a non-incorporated business.
- Failing to disclose information during a transaction with the intent of inducing a prospect or policy owner to do something he or she would not do otherwise.
- The law allows courts to award an insured triple damages, court costs, and attorney fees, for deceptive insurance trade practices.
- Insurance is not only a complex product, it is an extremely complex industry. The insurance agent must be very careful not to mislead the consumer regarding any aspect of an insurance transaction.

- Misrepresentations can be in the form of an oral or written statement, advertisement in any media, use of a business logo or advertising slogan, or anything else that communicates a false or misleading idea. A few examples of misrepresentation include:
- False or misleading statements about a particular policy.
- False or misleading statements about the financial condition of a respective insurance company.
- Telling a prospect or policy owner that dividends or current assumption mortality charges are guaranteed.
- Identifying a term life policy by a name that implies cash value accumulation, or vice-versa.
- Indicating that premiums on a policy are payable for a shorter time period, when the premiums may be payable for life.
- Indicating that the agent represents several insurance companies, when in fact the agent represents only one.

A high degree of ethical representation is good solid business. The agent's insurance career can provide financial gain and personal growth. Practicing as an ethical professional will bring both. The agent's actions will gain the respect of the policy owners as well as that of the insurance carriers. The agent's reputation will be significantly enhanced, and people in the community will want to do business with that agent.

Agent Conduct- Waiver and Estoppel

Estoppel is defined as a restraint or a bar. It arises where a person has done some act that the policy of the law will not permit him to deny, or where circumstances are such that the law will not permit a certain argument because it would lead to an unjust result. Estoppel does not require any actual surrender of a known right. Rather, it implies some misleading act, conduct, or inaction on the part of the insurer upon which the insured detrimentally relies. Estoppel is an equitable principle imposed as a rule of law.

Waiver is an intentional and voluntary surrender of some known right, which generally may either result from an express agreement or can be inferred from circumstances. It is the relinquishment of a known right which may result from either the affirmative acts of the insurer or its authorized agents, or from the insurer's nonaction, with knowledge of the applicable facts

These two terms are similar in nature and need to be considered jointly. A clear difference between the two legal theories is confused for the following reasons. Over the years the courts have put forth an effort to counter the unilateral nature of insurance contracts. Insurers control the drafting of the policy language. It can be complex language unfamiliar to the layman. The courts refuse to allow the insurance companies to reap an unfair advantage in litigation with policyholders.

Assume that an agent fails to pass along information affecting the status of a policyholder to the insured. It is still generally held that the knowledge of the general agent of the insurer constitutes knowledge of the insurer. Similarly, an insurance broker is generally considered to be an agent of the insured. That person's knowledge is also attributed to the insurer. On the other hand, information or knowledge of someone acting in the capacity of soliciting agent is not treated in this manner. The knowledge of a person who only solicits and forwards applications does not constitute knowledge of the insurer.

A waiver of rights to contract can come about in two ways:

Express Waiver

The agent conveys to the insured that a situation contrary to the terms of the policy will not be relied upon by the policy issuer as a means of avoidance of its obligations under the policy. An example of this would be leaving a property vacant for an extended time.

Express waiver can also apply to the rights of the insurer. An example would be misrepresentation of information in the application by the insured. The same would apply to a breach of condition precedent to formation of the contract, such as the requirement of payment of the first premium upon delivery of the policy. The same applies to the breach of a condition or warranty during the term of the policy, such as a functioning alarm system.

Implied Waiver

The voluntary surrender of a known right will at times be implied by the courts. Examples of these circumstances include;

- Acceptance of a premium for future coverage by the agent with knowledge of an existing breach of condition or warranty.
- Receipt and retention of proof of loss without objection.
- The exercise of a right under the policy, such as the demand for an appraiser or arbitrator.

The results of silence on the part of the insurer depend on the circumstances. If an insurer learns of grounds for rescission or defense prior to a loss under the policy, it is not sufficient to constitute a waiver unless previous business practices require the insurer to give some affirmative notice to the insured. This situation commonly arises when the insured fails to pay a premium and prior waivers of late premium payments lead the insured to expect that the policy would continue in effect absent any notice to the contrary from the insurer. Some states require the insurer to notify the insured if they are to rely on nonpayment of premiums as a reason for forfeiture.

Estoppel

This generally applies to an insurance contract when an insurer is or should be aware of its right to rescission on the basis of a misrepresentation by the insured. With this condition extant, the insurer expressly or impliedly represents to the insured that the policy is enforceable. The insured is thus unaware of the grounds for policy rescission and relies on the representation of the insurer to his or her detriment. Under the doctrine of equitable estoppel, A makes a representation to B. This person B, having a right to do so, relies on the representation to their detriment. A is now estopped from denying the truth of the representation, or from taking a position inconsistent with the representation.

To illustrate further, consider that it is a general rule that the doctrine of estoppel does not apply to government or its agencies. This applies not only to true government functions but also when the government is performing functions that have a private counterpart. A farmer applied to the Federal Crop Insurance Corporation for crop insurance on reseeded wheat. The farmer made full disclosure to the agency, paid the premium and the policy was issued. A loss ensued. Payment was denied however, because the FCIC had adopted a regulation against insuring reseeded wheat. This particular regulation had been published in the Federal Register, but the

farmer had no knowledge of it. In the case *Federal Crop Insurance Corp. v. Merrill* (332 U.S. 380, 1947), the court acknowledged that a private insurer would be estopped from denying coverage under these circumstances. The principle does not extend to government agencies and coverage was denied.

How can the insured be unaware of the grounds for rescission? The terms and conditions are spelled out right there in the policy. The reality is that courts across the country are split as to whether or not an insured can claim an inculpable lack of knowledge of the grounds for rescission if it is a result of policyholder's failure to read the policy. The insured is not inclined to read the fine print of policies and is often unable to read or comprehend abstruse contractual verbiage. As a result, the courts impose no obligation on the insured. Estoppel is used to counter the insurance company's defense of misrepresentation or breach of condition by the insured. It cannot be used to extend coverage to losses not included or expressly excluded from coverage under the policy.

Promissory estoppel

A promise may be binding even though the promisor may have received nothing by way of an agreed upon exchange for it where made under circumstances which should lead the promisor reasonably to expect that the promisee will be induced thereby to take definite and substantial action in reliance thereon and the promisee does take such action. The basis of the promisor's liability is promissory estoppel, and consideration for the promise is not required. The promisor is estopped from pleading a lack of consideration for his promise where it has induced the promisee to make a substantial change of position in reliance thereon.

The rationale of promissory estoppel is similar to that underlying the principle of a true waiver. A person waives a condition upon which his liability depends when he tells a person who has the power and capacity to bring about the happening of the condition that it will be unnecessary to do so. A party waives the defense of the Statute of Limitations when he induces his creditor to forbear bringing an action by a promise of payment or a promise not to plead the statute as a defense. In these cases the condition or defense is waived because of the justifiable reliance upon the statement that induced forbearance to act or a change of position.

At the beginning of this chapter the concept of agency was reviewed. In some instances the law imposes an agency relationship even when there is no actual consent between the principal and agent. When statements and/or conduct of the principal cause a third party to reasonably believe that an agency condition exists, and the third party relies on the representation when dealing with the purported agent, the principal will be estopped from denying the agency. There is no actual authorization of the agent, only an apparent agency. The result is the same as actual agency. The principal is bound by the acts of the agent and is estopped from denying the relationship. The appearances of agency must be created by the principal and not by the agent to create an agency by estoppel. Mr. Jones produces business cards showing he is a representative of Zeta Co., owned by Ms. Tran. So long as Ms. Tran has no knowledge of the falsehood, she may deny agency. Persons relying on the ruse created by Mr. Jones are relying on appearances created by Jones, not Ms. Tran.

Parol Evidence Rule

The parol evidence rule emphasizes the importance of avoiding ambiguity in a contract. The rule provides that evidence is not admissible in court to change or modify the terms of a written contract. The contract must clearly reflect the intent of the parties. If a contract is disputed once

it's agreed on, usually evidence will not be accepted that will modify the meaning of the contract. The contract must be obvious in its intent.

An insurance agent writes a policy for a baking company. Before the policy is written he tells the baker that the policy does not include business interruption coverage. The baking company reviews the policy when the agent delivers it. The baker finds that the policy does include the business interruption coverage.

After an oven explodes at the bakery, the baker files a claim for property loss and business interruption. The insurer denied coverage. The insurer alleges a misunderstanding concerning the business interruption coverage. It appears that the bakery would prevail. The policy appears to have no contract ambiguity. The parole evidence rule prevents the insurer from denying coverage for the loss.

A contract reduced to writing and signed by the parties is frequently the culmination of numerous conversations, conferences, proposals, counter proposals, letters and memoranda, and sometimes the result of negotiations conducted, or partly conducted, by agents of the parties. At some stage in the negotiations tentative agreements may have been reached on a certain point or points which were superseded, or so regarded by one of the parties, by subsequent negotiations. Offers may have been made and withdrawn, either expressly or by implication, or lost sight of, in the give and take of negotiations that have continued for a period of time.

Ultimately a final written contract is prepared and signed by the parties. It may or may not include all of the points which have been discussed and agreed upon in the course of the negotiations. However, by signing the written agreement, the parties have solemnly declared it to be their contract, and the terms as contained therein represent the contract that they have made. As a rule of substantive law, neither party is permitted subsequently to show that the contract that they made is different from the terms and provisions as they appear in the written agreement.

The word "parol" means literally "speech," or "words." It is a term applied to contracts which are made either orally or in writing, not under seal, which are called parol contracts, in order to distinguish such contracts from those which are under seal and are known as deeds or specialties. The term "parol evidence" refers to any evidence, whether oral or in writing, which is extrinsic to the written contract.

The parties may differ as to the proper or intended meaning of language contained in the written agreement, where such language is ambiguous or susceptible to different interpretations. To ascertain the proper meaning requires a construction of the contract. "Construction" in this sense does not involve any change, alteration, modification, addition to, or elimination, of any of the words, figures, or punctuation, in the written agreement, but merely a construing of the language in order to ascertain its meaning. While the parol evidence rule precludes either party from introducing any evidence in any lawsuit involving the written agreement which would change, alter, or vary the language or provisions thereof, rules of interpretation or construction permit the introduction of evidence in order to resolve ambiguity and to show the meaning of the language employed and the sense in which both parties used it.

Reasoning Behind the Rule-The parol evidence rule applies only to an integrated agreement or contract, that is, one in which the parties have assented to a certain writing or writings as the statement of the agreement or contract between them. When there is such an integration of an

agreement or contract, no parol evidence of any other agreement will be permitted to vary, change, alter, or modify any of the terms or provisions of the written agreement.

The rule is recognized for a valid reason. The parties, by reducing their agreement to writing, are regarded as having intended the writing that they signed to include the whole of their agreement. The terms and provisions contained in the writing are there because the parties intended them to be in their contract. Any provision not in the writing is regarded as having been omitted because the parties intended that it should not be a part of their contract. The rule excluding evidence which would tend to change, alter, vary, or modify the terms of the written agreement is therefore a rule that safeguards the contract as made by the parties.

Some Cases Where the Rule Does Not Apply

The parol evidence rule, in spite of its name, is not an exclusionary rule of evidence, nor is it a rule of construction or interpretation. It is a rule of substantive law which defines the limits of a contract. Bearing this in mind, as well as the reason underlying the rule, it will be readily understood that the rule does not apply to any of the following:

- A contract that is partly written and partly oral. Where a written offer is accepted orally, there is no integration of the contract in a writing.
- A receipt for goods or merchandise. This is not a contract.
- A gross clerical or typographical error that obviously does not represent the agreement of the parties. Where a written contract for the services of a skilled actuary provides that his rate of compensation is to be \$1.50 per hour, a court of equity would permit reformation of the contract to correct the mistake upon a showing that both parties intended the rate to be \$150 per hour.
- The lack of contractual capacity of one of the parties, by proof of minority or insanity.
- A defense of fraud, duress, undue influence, or illegality. Evidence establishing any of these defenses would not purport to vary, change, or alter any of the terms of the written agreement, but merely to show such agreement to be voidable or unenforceable.
- A condition agreed upon orally at the time of the execution of the written agreement and to which the entire agreement was made subject.
- A subsequent oral mutual rescission or agreed modification of the written contract. Parol evidence of a later agreement does not tend to show that the integrated writing did not represent the contract between the parties at the time it was made. If the contract is one which the Statute of Frauds requires to be in writing, a subsequent mutual rescission or modification must also be in writing.
- Usage and custom- Parol evidence of usage and custom which is not inconsistent with the terms of the written agreement is admissible to define the meaning of the language in the agreement, where both parties knew or should have known of the existence of the usage or custom in the particular trade or locality.

This is a statutory requirement that certain kinds of contracts be in writing to be enforceable. Except as otherwise provided by statute, an oral contract, i.e., one made by word of mouth and not evidenced by any writing, is in every way as enforceable as a written contract. An oral agreement to pay \$750,000 to a writer for a new movie script to be written by him, the employment by oral agreement of a public relations firm for an indefinite period at a monthly rate of \$1,000, and an oral agreement to purchase a household appliance for \$80, are common examples of some commercial contracts that are completely valid and enforceable notwithstanding that they are not evidenced by a writing.

V Commissions, Rebating, and Sales

Commissions are the direct result of work performed by the agent with a new or existing policy owner. The agent's compensation is paid direct from the respective insurance company for the type of product and services recommended and are willing to provide. In addition to the initial commission, most insurance companies provide "renewal commissions", as an inducement to continue servicing the existing policy owners.

The Concept

This concept, initiated many decades ago, was intended to accomplish two primary objectives:

- Compensate the agent for future servicing needs the policy owner will require -- such as beneficiary changes, bank draft changes, endorsements, etc.
- Provide the agent with an opportunity to perform periodic reevaluations of the policy owners' needs, thereby resulting in additional sales opportunities.

The agent, as a licensed insurance person, shall not directly or indirectly rebate or attempt to rebate all or any part of a commission for insurance. Rebating is illegal in most states, and is strictly prohibited. It can be punishable by fine, cancellation of contract with insurance company, and loss of license, or a combination of all three. Rebating can be described as offering any type of inducement other than what is contained in the policy itself, in exchange for purchase of insurance. Examples include, but are not limited to the following:

- Any verbal or written agreement for the agent to pay any part of a policy owner's premium.
- Any payment, allowance, or gifts of any kind offered or given as an inducement to purchase insurance.
 - Any paid employment or contract for services.
 - Returning any part of the premium to the policy owner.
- Offering any special advantage regarding the dividend, interest, or other policy benefits to the policy owner which are not specified in the policy.
- Offering to buy, sell, or give any type of security (stocks, bonds, etc.) or property, or any dividends or income from securities or property, to the policy owners' benefit.
- Giving anything of value to the policy owner in return for buying an insurance product.

Borderline Situations

Rebating, or the attempt to rebate, is an offense not only under the Code of Ethics, but also under state insurance laws. There may be borderline situations in which it is difficult to determine whether rebating has taken place.

It is fairly common practice, as an example, for an insurance agent to entertain policy owners or prospective purchasers with a meal and perhaps give a nominal or token gift such as a policy wallet. Such things are considered to be normal business practice, and not in the nature of a rebate. However, should the agent contemplate anything more than such token gestures of appreciation, then the greatest caution and good judgment must be exercised. Excessive benefits or gifts conferred upon policy owners or prospective purchasers, will at the very least be considered in bad taste, and at the worst, depending on all the circumstances, may expose the licensee to a charge of rebating. In no circumstances should a gift of anything of value be given as an inducement to purchase insurance.

The rules for rebating do not apply to splitting of business with another licensed insurance agent. Joint case work is very common throughout the industry, and splitting of commissions is normal business practice. This practice does not apply to equity and variable life products, since they are sold under the rules and guidelines of the Securities Exchange Commission.

Insurance Sales to Military Personnel

In 2005, the federal government increased death benefits and life insurance coverage for servicemembers, providing survivors of deceased servicemembers with a \$100,000 death benefit and offering servicemembers up to \$400,000 in low-cost life insurance coverage through the government-sponsored Servicemembers Group Life Insurance (SGLI) program. Some servicemembers and their families also choose to purchase supplemental life insurance from private market insurance companies. However, a report by the Government Accountability Office (GAO) shows that servicemembers were being offered high-cost life insurance and securities products by some financial services companies engaging in abusive and misleading sales practices.

In the 2006 Military Personnel Financial Services Protection Act (the Act), Congress found that certain life insurance products were improperly marketed as investment products and provided minimal death benefits in exchange for excessive premiums that were front-loaded in the first few years, making the products inappropriate for most servicemembers. The Act provided for state insurance regulators, the National Association of Insurance Commissioners (NAIC), and the Department of Defense (DOD) to address concerns over unsuitable insurance products and inappropriate sales practices directed at servicemembers.

Congress, DOD, and state insurance regulators have long recognized that unique financial protections are warranted for servicemembers. Regulations implementing the consumer protection provisions of the John Warner National Defense Authorization Act for Fiscal Year 2007 cited financial concerns as a major source of stress among servicemembers and highlighted the importance of financial readiness to mission readiness. A state insurance regulatory official, who has worked on military issues for several years, mentioned that young servicemembers are a vulnerable sector of society, as many are often right out of high school and are generally a transient population.

In September 2006, Congress passed the Act to regulate the marketing and sale of life insurance products and securities on military installations and thereby protect servicemembers from sales of inappropriate financial products. The Act clarified that state insurance and securities laws generally apply to insurance and securities sales and related activities conducted on military installations worldwide. It also generally provided that if federal or state agencies or courts found that a person intentionally violated or willfully disregarded the Act's disclosures, that person could be banned from selling insurance on federal lands, including military installations.

Requirements and Action

With respect to life insurance products, the Act created requirements and encouraged DOD and state insurance regulators to take certain actions. The Act;

- Encouraged DOD and state regulators to work together to improve the quality and sale of life insurance products sold on military installations, including the development of product

standards designed to meet the needs of servicemembers whether or not the sale took place on military installations;

- Encouraged state insurance regulators to work with DOD to implement standards that would protect servicemembers from dishonest and predatory insurance sales practices while on military installations; and
- Required insurance agents, at the time of sale of a supplemental life insurance product to a servicemember on a military installation, to disclose, in writing, information about SGLI (including the amount of coverage and costs), the fact that the supplemental product is not endorsed by the federal government, the structure and features (such as side funds, savings features, and automatic premium payment features) of the supplemental product, and contact information for making complaints to the appropriate state insurance regulator.

In addition to action by Congress, DOD updated its instruction on Personal Commercial Solicitation on DOD Installations in March 2006, adding new prohibitions and requirements for on-installation solicitations for concerns that were not previously addressed. The services subsequently modified their regulations to implement the revised DOD instruction. Among other things, the revisions assign new responsibilities to certain DOD personnel, including installation commanders, to monitor sales practices of insurance agents, enforce compliance, and report certain information to DOD, state regulators, and appropriate federal personnel. The revisions also specifically forbid certain sales practices and impose requirements for insurance agents that, if violated, could result in the loss of privileges to solicit life insurance on military installations. The instruction does the following:

- It prohibits certain sales practices. For example, insurance agents soliciting on military installations are now prohibited from using promotional incentives, such as free items or contests, to facilitate transactions or to eliminate competition.
 - For example, the GAO obtained information about solicitation activities on one military installation where an insurance agency provided some funds to help sponsor an event on that installation. During the event, the agency apparently offered a prize drawing (e.g., for a flat screen television) as a means for collecting contact information from servicemembers for insurance product solicitations. State insurance regulators are currently reviewing whether such activities violate new state regulations.
- It specifies conditions for advertising and commercial sponsorship. Among other things, businesses may not use sponsorship of an activity on a military installation as a means of collecting personal contact information from individuals without getting their written permission.
- It requires installation commanders to monitor on-installation sales practices, enforce the DOD instructions, and ask that appropriate state officials determine whether a company or agent violated state law.
- It requires installation commanders to provide to, and request from, appropriate DOD, state regulators, and appropriate federal personnel certain types of information.
 - For example, installation commanders should verify an agent's licensing status and complaint history with appropriate regulators prior to granting permission to solicit on an installation; notify the appropriate regulators if an investigation determines that an agent or company does not have a valid license or fails to meet other state or federal regulatory requirements; report concerns on the quality or suitability of financial products or concerns or complaints involving marketing methods to appropriate regulators; and report to DOD, state regulators, and appropriate federal personnel concerning reinstated, suspended, or withdrawn privileges to solicit on installations.

Product Offerings

The federal government offers servicemembers life insurance as part of their total benefits package. Each member is eligible for the low-cost SGLI, which can provide up to \$400,000 of term life insurance coverage. Although many life insurance policies exclude coverage for death resulting from an act of war, SGLI does not contain this exclusion. In addition to the government-offered insurance, many servicemembers may be offered life insurance from private market insurers to supplement that offered through SGLI. Historically, a small number of insurance companies have targeted their marketing efforts at selling supplemental life insurance to servicemembers on and around military installations.

Sales of a product that couples life insurance with a side savings fund have been problematic, especially for junior enlisted servicemembers. Those product sales had unfavorable features that included a high-cost life insurance product that provided nominal supplemental coverage and a side fund that had an unfavorable interest-crediting method and high withdrawal penalties for the policyholder. The products used automatic deductions from side fund savings to pay premiums in the event of nonpayment, a feature that can exhaust all savings. According to information provided by state regulators with whom the GAO spoke for that report, those products have had high lapse rates, that is, a high percentage of the policies were terminated because of nonpayment by the policyholder.

As defined in NAIC's Model Regulation, "side fund" means a fund or reserve that is part of or otherwise attached to a life insurance policy (excluding individually issued annuities) by rider, endorsement, or other mechanism that accumulates premium or deposits with interest or by other means. The term does not include (1) accumulated value or cash value or secondary guarantees provided by a universal life policy; (2) cash values provided by a whole life policy that are subject to standard nonforfeiture law for life insurance; or (3) a premium deposit fund that (a) contains only premiums paid in advance that accumulate at interest; (b) imposes no penalty for withdrawal; (c) does not permit funding beyond future required premiums; (d) is not marketed or intended as an investment; and (e) does not carry a commission, either paid or calculated.

In the United States, states are the primary regulators of insurance companies, products, and agents. The state insurance regulators oversee the insurance companies that do business in their jurisdictions in several ways, including reviewing and approving products for sale and examining the operations of companies to help ensure the companies' financial soundness and proper market conduct. Each state has its own insurance regulator and insurance laws. Additionally, NAIC provides a national forum for addressing and resolving major insurance issues. Such issues include efforts to develop consistent policies on the regulation of insurance among states, when consistency is deemed appropriate. It also serves as a clearinghouse for exchanging information and provides a structure for interstate cooperation for examinations of multistate insurers. NAIC coordinates the development of model insurance laws and regulations for consideration by states.

Subject to State Law

Insurance sales to servicemembers are subject to state laws and regulations, as well as regulations established by DOD, the services, and individual installations. DOD's primary policy governing the solicitation of most products and services on military installations is set out in the DOD instruction on Personal Commercial Solicitation on DOD Installations. Among other things, the instruction identifies prohibited practices on DOD installations for agents offering life

insurance to servicemembers and the procedures agents are to use to gain access to an installation for the purpose of commercial solicitation of insurance and other types of products and most services.

Within DOD, the Office of the Under Secretary of Defense for Personnel and Readiness is responsible for developing the policies and procedures governing personal commercial solicitation for life insurance and other products. Further, the heads of DOD components, or their designees, are responsible for ensuring implementation of the regulations and compliance with their provisions. Each service provides additional regulations regarding commercial solicitations, and some installations further specify how these DOD and service policies and practices are to be implemented locally. The Defense Finance and Accounting Service (DFAS) oversees the financial management regulations and the payroll computer systems and databases. DOD can provide some oversight of activities off installations through Armed Forces Disciplinary Control Boards (AFDCB), which can declare a business off-limits to servicemembers if a board determines the business to be causing harm to servicemembers.

Public Perception of Insurance Industry

A problem for the insurance industry is guilt by association; all big business is dumped into the same category, particularly businesses entrusted with the public's money. Insurers are tarred with the real and perceived sins of others. The public is also bombarded with media information about situations that refuse to go away. The mold issue in Texas and the claims controversies that follow every hurricane. New issues are heaped atop past problems that refuse to die. Advocates of a cure-all government are on a mission to prove that the government can cure all forms of risk.

This demonstrates the prevalence of the dangerous but widespread social assumption that all risk can be avoided by insurance. Indeed at a domestic level there is a belief that consumers are entitled to insurance, albeit at a price. Increasingly insurance is viewed not as a commercial transaction, but as a form of middle class welfarism under which a more than minimally wealthy lifestyle can be protected by insurances. This approach to insurance may lead to booming sales of highly profitable products in the short to medium term. However, in the long term there are real dangers in a widespread view that insurance is a panacea for risk.

As the industry grapples with image issues, it will also have to deal with negative public perceptions about its job performance. The public receives conflicting messages about the industry and its work force in bad economic times as in good. It all comes down to the agent and the impression he or she makes on the public. There is no substitute for the consumer's confidence. Agents must focus on the customer and present credible, valuable information about product. That way, the public sees firsthand that honest agents are the keepers of the flame for the industry.