

California Code & Ethics 12-Hour

3rd Edition

Class Notes



At press time, this edition contains the most complete and accurate information currently available. Owing to the nature of license examinations, however, information may have been added recently to the actual test that does not appear in this edition. Please contact the publisher to verify that you have the most current edition.

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CALIFORNIA CODE & ETHICS 12-HOUR, 3RD EDITION
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Course Overview

In addition to this book, the CA Department of Insurance provides you with useful information on applying for your insurance license. The following topics that may be of interest to you can be found on the state's website at www.insurance.ca.gov/.

- How to Apply for a California License
- California Accident & Health Educational Objectives
- California 12-Hour Ethics and California Insurance Code Educational Objectives
- California Life Only Educational Objectives
- California Property Educational Objectives
- California Casualty Educational Objectives

How to Use this Book

This 12-hour Code and Ethics book prepares you to take your California agent license exam. Please review the pre-requisite educational hours you need in order to take your state licensing exam.

Prelicensing Education Hour Requirements

- Ethics and California Insurance Code—12 hours
- Life—20 hours
- Accident and Health—20 hours
- Life / Accident & Health—40 hours
- Property—20 hours
- Casualty—20 hours
- Property and Casualty—40 hours

Examples

In order to sit for the Life, Accident/Health, and Ethics state exam, each student must complete 52 hours of approved prelicensing education—40 hours of “product” training (life and health course) and 12 hours of California Code & Ethics training.

In order to sit for the Life and Ethics state exam, each student must complete 32 hours of approved prelicensing education—20 hours of “product” training (life insurance course) and 12 hours of California Code & Ethics training.

In order to sit for the Accident/Health and Ethics state exam, each student must complete 32 hours of approved prelicensing education—20 hours of “product” training (accident and health course) and 12 hours of California Code & Ethics training.

In order to sit for the Property/Casualty and Ethics state exam, each student must complete 52 hours of approved prelicensing education—40 hours of “product” training (property and casualty course) and 12 hours of California Code & Ethics training.

If you are a nonresident producer who has moved to California and desires a resident license, all you need to do is complete the 12 hours of Code & Ethics training.

Help Desk & Instructor Support

If you have questions about the material you have studied, send an email to kaplanlearn.com/education and a qualified subject matter expert will respond to you within one business day.

Study Techniques

You may have a lot of experience taking training courses and their examinations or it may have been years since you've taken a course. Here are a few tips we recommend to make your study most effective.

Read the Entire Book

Study the text of each unit until you understand the material. A firm grasp of the material in this book is the best preparation for passing the exam.

Look for Question Areas as You Read Each Assignment

You can prepare for the exam by attending to the questions throughout the book. They point to important areas you should master. More importantly, study with the exam in mind. What questions would you put in the exam if you were creating it to test a student's knowledge of the material? This exercise will help you master the important material in the book and pass the exam.

KEY POINTS

- Study the entire book
- Look for questions as you read
- Answer the questions scattered throughout the book
- Reread the material until you understand it

I. CALIFORNIA INSURANCE REGULATION

A. THE INSURANCE DEPARTMENT, THE INSURANCE COMMISSIONER, AND INSURANCE COMPANIES

1. Protecting the Public

- a. Insurance is a highly regulated business because it is an activity that directly affects the public interest. Insurance has played a major role in economic development and stability.
- b. The financial security of individuals and businesses depends heavily on insurance. Insurance companies are major financial institutions that accumulate funds to back up commitments made to policyholders, and most of these funds are reinvested in the economy. As a result of the importance of insurance, nearly every aspect of the insurance business is regulated to protect the general public and to promote the public interest.

B. THE CALIFORNIA INSURANCE CODE

1. The California Insurance Code provides for the formation of a Department of Insurance, which has broad regulatory powers to enforce the insurance laws. The Code regulates capitalization and reserve requirements for insurers, rate-making practices, minimum requirements for some types of coverage, and limits of insurance that must be offered to the public. General business practices and claims practices are also regulated.

C. LICENSING REQUIREMENTS

1. To ensure that insurance producers are knowledgeable and professional, agents, brokers, and solicitors are subject to licensing requirements. In addition to the other qualifications that must be met, most candidates for insurance licenses are required to pass state licensing examinations, which test their level of knowledge and competency to act as insurance producers.

D. THE INSURANCE COMMISSIONER [CIC 12900; 12921]

1. The public official in charge of the Insurance Department is the Commissioner of Insurance, who supervises and regulates insurance affairs in California.
2. The Commissioner is elected to office by the people in the same time, place, and manner as the Governor. The Commissioner's term of office is four years, but an individual may not hold the position for more than two four-year terms. Should a vacancy occur during the term of office, the Governor may appoint a replacement and legislative confirmation will be required.
3. The Commissioner is empowered to create rules and regulations, after public notice and hearings, to help carry out the intent of the Code, and to conduct hearings and investigations when it appears that any provision of the Code may have been violated. The Commissioner will perform all duties imposed on him by the provisions of the Code and other laws regulating the business of insurance in this state, and will enforce the execution of such provisions and laws.
4. The Insurance Commissioner is elected to a four-year term.

5. The Commissioner has the power to institute rules and regulations to administer the Insurance Code.
6. Other powers:
 - Perform all duties imposed by the Code
 - Investigate complaints
 - Cooperate with other agencies to enforce insurance laws
 - Provide consumer education
 - Establish fees for services
 - Adopt emergency regulations if necessary
 - Report annually to the government

E. THE INSURANCE CODE

1. The **California Insurance Code (CIC)** was established by the state legislature. It is a body of laws that apply to the insurance business in this state. New insurance laws may be enacted, or existing statutes may be changed, only by the legislature. The Insurance Code is organized into major regulatory sections, including General Provisions, General Rules Governing Insurance, Classes of Insurance, and the Insurance Commissioner's Powers and Duties.
2. The **California Code of Regulations (CCR)** Title 10, Chapter 5 comprises the regulations issued by the California Insurance Commissioner. Regulations include:
 - standards for approval and disapproval of names of insurance agents;
 - continuing education requirements;
 - various requirements for recordkeeping;
 - standards for claim settlement practices; and
 - specific requirements for different types of insurance (such as motor vehicle insurance, surplus lines, health insurance, and insurance in connection with sales and loans).
3. Regulations also address many procedural issues related to agent and insurance company practices, filing of various documents, and the conduct of hearings and investigations. All these regulations have been issued by the Insurance Commissioner, under the authority granted by the Insurance Code.
4. **Use of Shall and May [CIC 16]** As used in the Insurance Code, the word shall is mandatory and the word may is permissive, unless otherwise apparent from the context.
5. **Definition of Person [CIC 19]** Under the Insurance Code, the term person means any person, association, organization, partnership, business trust, limited liability company, or corporation. In other words, any reference to person applies to a natural person as well as any other legal entity.
6. **Mailing as Proof of Notice [CIC 38]** Except as otherwise provided, any notice required to be given to any person by any provision of the Code may be given by mailing notice, postage prepaid, addressed to the person to be notified, at his residence or principal place of business in this state. The affidavit of the person who mails the notice, stating the facts of such mailing, is prima facie evidence that the notice was thus mailed.

F. INSURANCE REGULATIONS

1. The California Code of Regulations (CCR) Title 10, Chapter 5 comprises the regulations issued by the California Insurance Commissioner. Regulations include standards for approval and disapproval of names of insurance producers, continuing education requirements, various requirements for recordkeeping, standards for claim settlement practices, and specific requirements for different types of insurance (such as motor vehicle insurance, surplus lines, health insurance, and insurance in connection with sales and loans). Regulations also address many procedural issues related to agent and insurance company practices, filing of various documents, and the conduct of hearings and investigations.
2. All of these regulations have been issued by the Insurance Commissioner, under the authority granted by the Insurance Code.

G. ADMINISTRATIVE PROCEDURES ACT (RULEMAKING PROCESS)

1. Regulations are proposed, written, amended, and repealed by the Department of Insurance (DOI).
2. Proposed changes are published in the California Regulatory Notice Register at least 45 days before hearing or adoption.
3. The public provides written comments during the rulemaking process.
4. A hearing is optional but it can be requested by an interested party by filing a request at least 15 days before the close of the written comment period.
5. The regulation is formally adopted.
6. The regulation is submitted to the **Office of Administrative Law (OAL)** for review/approval (30 days).
7. If approved, the secretary of state files and publishes the regulation in the **California Code of Regulations (CCR)**.
8. If disapproved, the file is returned to the **California Department of Insurance (CDI)** for correction of deficiencies (120 days).

H. EMERGENCY REGULATIONS

1. The rulemaking process can be avoided if the CDI can demonstrate a change is necessary for the immediate preservation of the public peace, health and safety, or general welfare.
2. The OAL has 10 days to review the proposed change.

I. REGULATING INSURANCE COMPANIES

Insurance is provided by both private and government insurers. A private insurer may be a person, association, organization, partnership, corporation, business trust, or limited liability company.

- 1. Stock insurers** A stock insurance company consists of stockholders, also known as shareholders, who own shares in the company. Stockholders select the board of directors, and the board elects the officers who conduct the daily operations of the business. A stock company is referred to as a non-participating company because policyholders do not participate in dividends resulting from stock ownership.
- 2. Mutual insurers** In a mutual company, there are no stockholders; ownership rests with the policyholders, also known as policyowners. They vote for a board of directors that in turn elects or appoints the officers to operate the company. Funds not paid out after paying claims and other operating costs are returned to the policyowners in the form of policy dividends. As such, mutual companies are sometimes referred to as participating companies because the policyowners participate in dividends.
- 3. Demutualization [CIC 11535]** A domestic incorporated mutual life insurer issuing non-assessable policies on a reserve basis may be converted into an incorporated stock life insurer, in a process known as demutualization.
- 4. Reciprocal insurers** Reciprocal insurers are unincorporated groups of people providing insurance for one another through individual indemnity agreements. Each individual who is a member of the reciprocal is known as a subscriber. Each subscriber is allocated a separate account wherein his premiums paid and interest earned are tracked. If any subscriber should suffer a loss provided for by the reciprocal insurance then each subscriber account would be assessed an equal amount to pay the claim. Administration, underwriting, sales promotion, and claims handling for reciprocal insurance is handled by an attorney-in-fact. The attorney-in-fact is often controlled and overseen by an advisory committee of subscribers.
- 5. Fraternal insurers** Fraternal benefit societies are primarily life insurance carriers that exist as social organizations and usually engage in charitable and benevolent activities. Their membership is usually drawn from those who are also members of a lodge or fraternal organization.
- 6. Lloyd's of London** Lloyd's of London is not an insurance company, but provides a meeting place and clerical services to its members who actually transact the business of insurance. Members are individually liable and responsible for the contracts of insurance into which they enter.
- 7. Risk Retention Groups (RRGs)** Risk retention groups are composed of members who are engaged in similar businesses or activities. The group's primary activity consists of assuming and spreading all, or a portion of the liability exposure of its members. These groups may only provide liability insurance, not workers' compensation or personal lines insurance. RRGs are regulated by the state where they are domiciled but can transact insurance in any other state without further regulation or the requirement to participate in the state guaranty fund.
- 8. Domestic insurers [CIC 26]** A company incorporated, chartered, organized, and formed under the laws of California is called a **domestic company**.

- 9. Foreign insurers [CIC 27]** A **foreign insurance company** is a company incorporated, chartered, organized, or formed under the laws of another state but licensed and permitted to conduct the business of insurance in the State of California.
- 10. Alien insurers [CIC 1580]** An **alien insurance company** is a company incorporated or organized in a nation outside the United States.

J. INSURANCE LICENSE [CIC 700; 1633]

- 1.** No one may transact insurance in California without a license. Persons must be licensed and insurance companies must have a certificate of authority. The Commissioner shall either issue or deny an application for a certificate of authority within 180 calendar days after the date of the application.
- 2.** A person or insurer who willfully transacts insurance business in California without a license or certificate of authority commits a public offense.
- 3.** Penalties for transacting insurance business in California without a license:
 - imprisonment in state prison or county jail for up to one year;
 - fine of up to \$50,000; or
 - both imprisonment and fine.
- 4.** Penalties for transacting insurance business in California without a certificate of authority:
 - imprisonment in state prison or county jail for up to one year;
 - fine of up to \$100,000; or
 - both imprisonment and fine.
- 5.** In deciding whether to grant a certificate of authority, the Commissioner considers:
 - a.** capital and surplus;
 - b.** lawfulness and quality of investments;
 - c.** financial stability;
 - d.** reinsurance arrangements;
 - e.** competency, character, and integrity of management;
 - f.** ownership and control of issued and outstanding shares (for a capital stock insurer);
 - g.** whether claims under policies are promptly and fairly adjusted and are promptly and fully paid in accordance with law and the terms of policies;
 - h.** fairness and honesty of methods of doing business;

- i. method by which said applicant was promoted if any of its promoters remain as stockholders or in management; and
 - j. hazard to policyholders or creditors [CIC 717].
- 6. Change in Organization License [CIC 1656.1.b]** Every licensed corporation must file a written notice with the Commissioner of all changes, except address changes, of its stockholders who own 10% or more of the corporation stock and of all officers and directors of the corporation.

TAKE NOTE

A partnership whose membership has changed since its formation does not need to return its license to the Commissioner with the signatures of the original partners.

The partnership may continue operation under the license while an application is pending with the Commissioner, so long as the application is filed within 30 days, is signed by a remaining general partner, and at least one person who exercised agency or broker powers under the previous license continues to do so under the new license [CIC Sec. 1711].

K. REGULATION OF ADMITTED AND NONADMITTED INSURERS [CIC 24; 25; 1760–1780]

1. **Admitted**, in relation to a person, means entitled to transact insurance business in this state, having complied with the laws imposing conditions on those transacting insurance business in California.
2. **Nonadmitted**, in relation to a person, means not entitled to transact insurance business in this state, because of a failure or inability to comply with the requirements for transacting such business.
3. Every nonadmitted insurer and surplus line broker must ensure that, at the time of accepting an application for any insurance policy, the signature of the applicant on a disclosure statement is obtained.
 - a. The surplus line broker must maintain a copy of the signed disclosure statement in his records for a period of at least five years. These records must be made available to the Commissioner and the insured upon request.
 - b. Because of the special nature of the surplus lines market, surplus lines brokers do not have binding authority.
4. **Potential consequences for consumers**
 - a. Nonadmitted insurers are not subject to the financial solvency regulations and enforcements that apply to California licensed insurers. They do not participate in any of the insurance guarantee funds created by California law, therefore guarantee funds will not pay claims or protect assets if an insurer becomes insolvent and is unable to make payments as promised.

L. MARKETING AND DISTRIBUTION SYSTEMS [CIC 730; 1170-1182]

Insurance is made available to the public through a number of distribution systems. Most insurers sell their product through insurance producers, or agents. Independent agents represent the insurer, not the insured. Brokers, on the other hand, represent the insured. The following are descriptions of the four different types of agents.

- 1. Independent insurance agents** sell insurance products for several companies and work for themselves or other agents. The independent agent owns the expirations of the policies he sells, meaning the agent may place that business with another insurer upon renewal if in the best interest of the client. Agents are paid commissions by the companies based on the business they sell.
- 2. Captive agents** (also known as exclusive agents) represent only one company. These agents are sometimes independent contractors and not employees of the insurer. Independent agents are paid a commission by the insurer and generally own the renewals of the policies they sell.
- 3. General agents or managing general agents [MGAs]** hire, train, and supervise other career agents within a specific geographical area. The MGA is compensated by commissions earned on business sold by herself as well as an overriding commission on the business produced by the other agents managed by the general agent. An MGA has field underwriting and binding authority only in property and casualty insurance.
- 4. Direct writers** usually pay salaries to employees whose job function is to sell the company's insurance products. This type of producer is compensated by a salary, commission, or both. The insurance company owns the renewals of the policies sold on their behalf.
- 5.** One of the primary responsibilities of the Commissioner is to ensure the financial stability of the insurance companies doing business in California so they can pay claims and meet policyholder obligations.
 - a.** Companies doing business in California are subject to financial examination by the insurance department; by law, domestic companies must be examined at least once every 5 years.
 - b.** The Insurance Code specifies the types of investments that may be made by domestic incorporated insurers. The Commissioner regulates the investment activities of insurers and determines the amount of capital, surplus, and reserves an insurer must maintain.
 - c.** Companies must file quarterly financial statements and submit to annual audit by a CPA. Insurers are required to file annual statements with the Commissioner showing financial conditions and affairs of the company during the prior calendar year. They must also pay federal income tax and state premium taxes.

 TAKE NOTE**Rating Services**

Agents have the responsibility to place coverage with financially sound carriers.

Several organizations rate the financial strength of insurance carriers on the basis of an analysis of company claims experience, investment performance, management, and other factors.

Organizations include AM Best, Standard & Poor's, Moody's, Duff & Phelps Credit Rating Company, and Weiss Ratings. These ratings are one of the most widely used indicators of financial health in the insurance industry.

M. SOLVENCY ISSUES [CIC 36; 985; 985(A); 1013]

Insolvency is defined as any impairment of minimum paid-in capital required by law for the class(es) of insurance that it transacts, or an inability of the insurer to meet its financial obligations when they are due.

- 1.** An **insolvent insurer** is an insurer that was a member of the Guaranty Association either at the time the policy was issued or when the insured event occurred, and against which an order of liquidation or receivership with a finding of insolvency has been entered by a court of law.
- 2.** If a policy's premiums are fully earned at inception, or if a policy does not provide for a return premium to the insured if canceled prior to expiration, the insurer is required to reinsure the outstanding risk to protect its solvency. This does not apply to life, title, mortgage, or mortgage guaranty insurers
- 3.** **Insurer insolvency** means impairment of insurer's capital, financial stability, and financial strength to the point where policyholders and the public may be harmed.
- 4.** **Paid-in capital** or "**capital paid-in**" means the value of an insurer's assets in excess of the sum of its liabilities for losses reported, expenses, taxes, and all other indebtedness and reinsurance of outstanding risks. An insurer must have additional assets equivalent to the aggregate "paid-in capital" or "capital paid in" after making provisions for all its liabilities and for reinsurance of all outstanding risks.
- 5.** **Impairment** means that the necessary paid-in capital of the insurer has been compromised; for domestic insurers, paid-in capital is the value of its assets over the sum of its liabilities for losses, expenses, taxes, and other debts, or the aggregate par value of its issued shares of stock, including treasury shares, whichever is lower. (Shares of stock are not treated as liabilities for the purpose of computing paid-in capital.)
- 6.** Foreign mutual insurers without outstanding capital stock must have paid-in capital of available cash assets of at least \$200,000.
- 7.** It is a misdemeanor to refuse to deliver books, records, or assets to the Commissioner after a seize order has been issued in an insolvency proceeding.

N. CONSERVATION [CIC 1011]

1. This section applies to all persons subject to examination by the Commissioner, purporting to do insurance business, organizing with intent to do insurance business, that need a Certificate of Authority to do business, or whose Certificate of Authority is revoked or suspended. The Commissioner may file an application with the superior court, and the court may issue an order for the Commissioner to become conservator of such a person, and be vested with their assets, books, records, property, and conduct their business, if the person or entity has:
 - refused to submit books, papers, accounts, or affairs for examination;
 - neglected or refused to observe an order to make good any deficiency in its capital or reserve;
 - transferred its entire property or business, or entered into a merger or consolidation without first obtaining the Commissioner's consent in writing;
 - found, after an examination, to be in hazardous financial condition;
 - violated its charter or state law;
 - refuses to be examined under oath regarding its affairs;
 - embezzled, sequestered, or wrongfully diverted any assets;
 - not complied with the requirements for a certificate of authority or its certificate of authority has been revoke; or
 - shown at last examination to be insolvent.

O. SUMMARY SEIZURE [CIC 1013]

1. If conditions for conservation exist or irreparable loss and injury to the property and business of any person engaged in the insurance business has occurred or may occur unless the Commissioner acts immediately, the Commissioner must take possession of the property, business, books, records, and accounts of such person, and of the offices and premises occupied by it for the transaction of its business, and retain possession subject to the order of the court.
 - a. Any person having possession of and refusing to deliver any of the books, records, or assets of a person against whom a seizure order has been issued by the Commissioner is guilty of a misdemeanor and will be punishable by a fine up to \$1,000, or by imprisonment for up to one year, or both such fine and imprisonment.

P. LIQUIDATION [CIC 1016]

1. If the Commissioner determines it is futile to proceed as conservator, he may apply to the court to liquidate and wind up the business of the insurer. Upon full hearing, the court may order the winding up and liquidation with the Commissioner as liquidator.

Q. SUMMARY SEIZURE [1013]

1. If the Commissioner determines that any of the conditions for conservation exist or an irreparable loss and injury to the property and business of any person engaged in the insurance business has occurred or may occur, the Commissioner may take the following immediate actions without notice and before applying to the court for any order:
 - a. take possession of the property, business, books, records, and accounts;

- b. take possession of the offices and premises occupied by it for the transaction of its business; and
 - c. retain possession subject to the order of the court.
2. Any person having possession of and refusing to deliver any of the books, records, or assets of a person against whom a seizure order has been issued by the Commissioner, shall be guilty of a misdemeanor and shall be punishable by a fine up to \$1,000, or by imprisonment for up to one year, or both such fine and imprisonment.

R. LIQUIDATION [CIC 1016]

1. If the Commissioner determines it is futile to proceed as conservator, he may apply to the court to liquidate and wind up the business of the insurer. Upon full hearing, the court may order the winding up and liquidation with the Commissioner as liquidator.

Activity 1.A

Match the term in the left-hand column with the correct description in the right-hand column.

The Insurance Commissioner	An insurer organized under the laws of California, whether or not admitted
The California Code of Regulations	Entitled to transact insurance business in this state, having complied with the laws imposing conditions on those transacting insurance business in California
Domestic insurer	Imprisonment in state prison or county jail for up to one year; fine of up to \$100,000; or both imprisonment and fine
The California Insurance Code	Regulates capitalization and reserve requirements for insurers, rate-making practices, minimum requirements for some types of coverage, and limits of insurance which must be offered to the public
Penalties for transacting insurance business in California without certificate of authority	Standards for approval and disapproval of names of insurance producers, continuing education requirements, various requirements for record keeping, standards for claim settlement practices, and specific requirements for different types of insurance
Admitted	In charge of the California Insurance Department

Answers can be found at the end of Unit 1.

S. PRIVACY RULES

1. The **Gramm-Leach-Bliley Act**, also referred to as the Financial Services Modernization Act of 1999, places restrictions on financial institutions’ information management and sharing practices.
2. All financial institutions must disclose detailed privacy policies to their customers at the time the customer relationship is established and on an annual basis. Information to be disclosed includes:
- categories of the types of information being collected;
 - categories of institutions and persons with whom information is being shared;
 - institution practices regarding sharing of information of former customers; and
 - practices for sharing information within a corporate family.

3. Before certain information is shared, consumers must be offered the opportunity to direct their financial institution not to share information with most third parties, or opt out. Institutions also must provide customers with instructions for exercising their right to opt out.
4. Financial institutions cannot provide account numbers to nonaffiliated third parties for use in direct marketing campaigns. Third parties that accept customer financial information are bound by the same limitations on disclosure of the information received from a financial institution as apply to the financial institution itself.
5. Pretext calling, the practice of obtaining customer information from financial institutions through false representations, was criminalized and is punishable by up to five years in prison.
6. The act empowers consumers to prohibit their financial institutions from sharing information with most outside parties. It does so in a manner complementary to the limits and procedures already in place in the Fair Credit Reporting Act.

T. CALIFORNIA INSURANCE INFORMATION AND PRIVACY PROTECTION ACT

1. Insurers who engage in, or collect, receive, or maintain information about insurance transactions involving California residents are subject to privacy protection laws.
 - a. The purpose of these provisions is to establish standards for the collection, use, and disclosure of information gathered in connection with insurance transactions, and to maintain a balance between the need for information and the public's need for fairness and privacy.
 - b. Individuals have the right to know what information has been collected about them, to have access in order to verify or dispute its accuracy, to limit the disclosure of information to other parties, and to enable insureds or applicants to obtain reasons for any adverse underwriting decisions.
2. **Consumer Reports** Consumer reports include written, oral, and other communications regarding a consumer's credit, character, reputation, or habits that are used in connection with an insurance transaction.
3. **Investigative Consumer Reports** An investigative consumer report includes information on a consumer's character, general reputation, personal habits, and mode of living that is obtained through interviews with the person's associates, friends, acquaintances, and neighbors.
4. **Consumer Reporting Agencies** Consumer reporting agencies collect information on individuals, prepare reports, and make the reports available to persons or organizations having a legitimate reason to receive such information.
5. A notice of insurance information practices must be provided to all applicants or policyholders upon written application, policy renewal, and policy reinstatement or change in benefits.

6. Applicants for insurance must be given advance notice of the insurer's practices regarding collection and use of personal information.
 - a. Notice must be given promptly and in writing. Notice should be given in the following cases and in the following manner:
 - If a third party is interviewed, the applicant must be given notice when the collection of information has begun.
 - If only the applicant is interviewed, the applicant must be given notice when the policy is delivered.
 - If a policy is being renewed, the insured must be given notice by the renewal date.
 - If a policy is being reinstated, the applicant-insured must be given notice at the time the request is received.
 - If an insured is requesting a change in benefits, the insured must receive notice at the time the request is received.

7. For reinstatement or changes in benefits, no notice is required if information is only collected from the policyholder, an insured, or from public records, or if a similar notice was provided within the past 24 months.

8. Those questions designed to obtain information for marketing or research purposes must be specified.
 - a. The notice shall state whether personal information will be collected from persons other than the individual proposed for coverage, the types of information to be collected, and the types of disclosures that may be made. The individual has the right to information concerning himself, the right to correct inaccurate information, the right to know the reasons for being turned down for insurance, or any other adverse underwriting decision.

9. A disclosure authorization form must be furnished to each applicant providing the following kinds of information:
 - The people with access to personal information
 - The kind of information to be collected
 - The kind of information the insurer can receive without the applicant's prior approval
 - The sources of information
 - The persons to whom information may be disclosed without the applicant's prior authorization

The disclosure form must be written in plain language and dated.

10. Disclosure forms state the types of people authorized to disclose private and personal information (e.g., neighbors, employers, and previous or other insurers); the kind of information which may be disclosed (e.g., personal habits, work habits, and health habits such as smoking and drinking).

11. The form must also state the reason information is collected, and how it will be used. For instance, the reason personal information is gathered is because the applicant requested a life insurance policy; the information will be used by the underwriting department for the purpose of determining the applicant's risk category.

12. The applicant's signature on the disclosure form authorizes the insurer to collect and disseminate information in the manner described in the notice.
13. The authorization is only good for a certain period of time.
 - a. For example, if an insurer is collecting information with regard to an application, the authorization is good for 30 months for life or health insurance, but only 12 months for property or casualty insurance.
 - b. If the authorization is to collect information with regard to a claim, the authorization is valid for the policy term for health insurance, for the duration of the claim for insurance other than health, and for the duration of claims processing activity if a nonprofit hospital service contract.
 - 1.) At the end of this period another authorization must be obtained. The applicant or insured may request, and receive, a copy of the authorization form.
14. Personal information may be disclosed to persons other than the requesting parties under certain conditions.
 - a. Among those to whom an insurer may disclose information are agents, other insurers, insurance departments, and insurance organizations (such as the Medical Information Bureau, or MIB, a nonprofit organization which serves as a clearinghouse for confidential medical information on applicants for life insurance).
 - b. This type of third-party disclosure may require authorization, but in some instances authorization is not required, just as long as the applicant or insured has received proper notification of the insurer's information practices. In some cases information is passed on to those conducting scientific research, audits, or marketing approaches.
15. **Penalties [CIC 791 through 791.26]** The Commissioner of Insurance has the authority to investigate any insurer or any agency used by the insurer to collect information, to determine if the company is in compliance with this Act.
 - a. If the Commissioner believes that a violation of the Act has taken place, he can conduct a hearing to determine the facts.
 - b. If a violation is found, the Commissioner can issue a cease and desist order.
 - c. Any person who violates a cease and desist order may be subject to one or more of the following penalties:
 - A fine not to exceed \$10,000 for each violation
 - A fine not to exceed \$50,000, if the Commissioner finds that violations have occurred with such frequency as to constitute a general business practice
 - Suspension or revocation of an insurance company's certificate of authority or agent's license if the insurance company or agent knew or reasonably should have known it was in violation of this article

- d. The penalty for anyone who willfully obtains insurance-related information under false pretenses is a fine of up to \$10,000, or imprisonment for up to one year, or both fine and imprisonment.
- e. If the violator continues to violate the Act, the Commissioner can institute a fine of up to \$10,000 for each violation.
- f. If the violation is one that happens with such frequency that it appears to be a general business practice, the fine for each violation can be up to \$50,000.
- g. The Commissioner may also revoke or suspend the insurer's Certificate of Authority and/or the agent's license if they knew or should have known they were in violation of the privacy protection laws.

U. CALIFORNIA FINANCIAL INFORMATION PRIVACY ACT [CAL GLBA] [SECTION 4050-4060 CALIFORNIA FINANCIAL CODE]

1. This Act provides additional protections for consumer nonpublic personal information. Instead of the opt out provisions of Gramm-Leach-Bliley, California requires an opt in. Financial institutions that want to share information with third parties and unrelated companies must seek and acquire the affirmative consent of California consumers prior to sharing the information.
2. California consumers must be able to prevent the sharing of financial information among affiliated companies through a simple opt-out mechanism via a clear and understandable notice provided to them.
 - a. A financial institution shall not disclose to or share a consumer's nonpublic personal information with any nonaffiliated third party unless the institution has obtained a consent acknowledgment from the consumer.
 - b. A financial institution shall not discriminate against or deny an otherwise qualified consumer a financial product or service because the consumer has not provided consent.
 - c. The law also requires annual disclosure of the financial institution intent to share nonpublic personal information with an affiliate.
3. California's rules regarding privacy of nonpublic personal information also provide that:
 - licensees must provide consumers with a notice describing the licensee's privacy practices at the time of policy application and annually thereafter;
 - all notices must clearly and conspicuously describe the categories of personal information collected about individuals, the categories of personal information disclosed about individuals, and the categories of third parties who may receive that information;
 - if a licensee wishes to disclose personal financial information to nonaffiliated third parties, the licensee must provide a clear and conspicuous opt-out notice and a cost-free method for the consumer to reply;
 - insurance producers are responsible for providing notices only if they collect or disclose information in ways other than as set forth in the insurer's notice;

- nonpublic personal medical record information may not be disclosed without prior written consent;
- standards are required for the safeguarding of nonpublic personal information; and
- licensees not in compliance with all applicable provisions may be subject to enforcement action. [CCR Title 10, Subchapter 5.9, Section 2689]

V. HIPAA DISCLOSURES

1. The Health Insurance Portability and Accountability Act (HIPAA) imposes specific requirements on health care providers with respect to the disclosure of insureds' health and medical information, or protected health information.
2. Health care providers must preserve patient confidentiality and protect this information. If this information is inadvertently disclosed, providers must mitigate the harm to their patients. Insurers and producers are under similar requirements when dealing with the protected health information of applicants and insureds.

W. INSURANCE CONTRACTS

1. Transacting Insurance [CIC 22; 35]

- a. **Insurance** is a contract whereby one undertakes to indemnify another against loss, damage, or liability arising from a contingent or unknown event.
- b. The term **transact**, as applied to insurance, includes any of the following:
 - Solicitation
 - Negotiations preliminary to execution
 - Execution of a contract of insurance
 - Transaction of matters subsequent to execution of the contract and arising out of it

2. Classes of Insurance

- a. Insurance in California is divided into the following 20 classes:
 - Life
 - Fire
 - Marine
 - Title
 - Surety
 - Disability (includes health, accidental death and dismemberment, Medicare supplement, long-term care, and disability income)
 - Plate glass
 - Liability
 - Workers' compensation
 - Common carrier liability
 - Boiler and machinery

- Burglary
- Credit
- Sprinkler
- Team and vehicle
- Automobile
- Mortgage
- Aircraft
- Mortgage guaranty (includes insolvency insurance and legal insurance)
- Miscellaneous

b. All can be sold by a properly licensed California agent or broker.

3. Insurable Events [CIC 250] Any contingent or unknown event, whether past or future, which may damnify a person having an insurable interest or create a liability against him, may be insured against, except for lotteries or gambling.

4. Insurable Interest [CIC 280; 283; 286; 10110]

- **Insurable interest** means the policyowner has a legitimate financial interest in the life or property that is the subject of the insurance.
- In property and casualty insurance, an insurable interest often exists on the basis of a person's own interests, or the person's interest in family members and business associates, or interests that exist because of contractual relationships.
- In life and disability insurance, every individual has an insurable interest in his own life and health, and may have an interest in the life and health of any person upon whom the individual depends for education or support, or any person under a legal obligation to provide the person with money, property or services, or any person upon whose life any estate or vested interest depends.

- a. For insurance to be legal, the policyowner must have an insurable interest in the event or person insured. If the policyowner has no insurable interest, the contract is void.
- b. In property and casualty insurance, insurable interest must exist when the insurance takes effect, and at the time the loss occurs, but not necessarily in the meantime.
- c. In life and health insurance, insurable interest must exist at the time the policy takes effect, but not necessarily at the time of the loss.
- d. A mere contingent or expectant interest in anything, not founded on an actual right to the thing, nor upon any valid contract for it, is not insurable.

5. The Contract

- a. An **insurance policy [CIC 380]** is the written instrument in which a contract of insurance is set forth.

- b. Six Requirements for All Insurance Contracts [CIC 381]** All insurance contracts must specify each of the following:
- The parties between whom the contract is made
 - The property or life insured
 - The interest of the insured in property insured, if he is not the absolute owner thereof
 - The risks insured against
 - The period during which the insurance is to continue
 - Either a statement of the premium or, if the insurance is of a character where the exact premium is only determinable upon the termination of the contract, a statement of the basis and rates upon which the final premium is to be determined and paid.

TAKE NOTE

The financial rating of the insurer is not required to be specified in the insurance policy [CIC 381].

- 6. Parties Subject to Contract [CIC 150]** Any person capable of making a contract may be an insurer subject to the restrictions of the Insurance Code. These restrictions, however, are stringent. Insurers must obtain approval from the Insurance Department and must qualify for a Certificate of Authority to transact business. To be approved, they must adhere to rigorous capital and surplus requirements.

The other party to the contract, the insured, must not be any of the following:

- A minor
- Intoxicated at the time of making the contract
- Mentally incompetent

X. CONCEALMENT AND REPRESENTATION

- 1. Concealment [CIC 330; 331; 333; 334; 338; 339]** Concealment is neglecting to communicate that which a party knows and ought to communicate. Concealment, whether intentional or not, entitles the injured party to rescind insurance.
- 2. Rescind** means the contract is terminated, or voided, from the beginning, and treated as if it had never existed.
- 3.** Each party to an insurance contract must communicate to the other, in good faith, all facts within his knowledge that are (or he believes are) material to the contract. Each party makes no warranty in communicating these facts, which the other has no means of ascertaining.
 - a.** The following information that does not need to be communicated in a contract
 - Known information
 - Information that should be known
 - Information that the other party waives
 - Information that is not material to the risk

- b. Whether a matter is material is determined not by the event, but by the probable and reasonable influence of the facts on the party to whom communication is due, in forming his estimate of the disadvantages of the proposed contract, or in making his inquiries.
- c. Each party to a contract is bound to know all the general causes open to inquiry that may affect either the political or material perils contemplated and all the general usages of trade. This means whenever you enter into a contract, you have an obligation to understand and be aware of the matters that are material to the contract.
- d. The right to information of material facts may be waived either by the terms of insurance or by neglect to make inquiries as to the facts when they are distinctly implied in other facts which are communicated. Information about the nature or amount of one insured's interest need not be communicated unless in answer to an inquiry.
- e. An intentional and fraudulent omission on the part of an insured to communicate information that would prove a warranty false entitles the insurer to rescind. Neither party is bound to communicate information of their own judgment (opinion) upon the matters in question.

Y. REPRESENTATION [CIC 354; 355; 358; 359; 361]

- 1. A **representation** may be oral or written and may be made at the time of or before issuance of the policy.
- 2. The language of a representation will be interpreted by the same rules as contracts in general.
- 3. A representation as to the future is a promise, unless merely a statement of belief or expectation.
- 4. A representation cannot qualify an express contract provision but may qualify an implied warranty.
- 5. A representation may be altered or withdrawn before the insurance is effected, but not afterwards.
- 6. The completion of the contract of insurance is the time to which a representation is presumed to refer.
- 7. A representation is false when the facts fail to correspond with its assertions or stipulations.
- 8. If a representation is false in a material point, whether affirmative or promissory, the injured party is entitled to rescind the policy from the time the representation becomes false.
- 9. The materiality of a representation is determined on the same basis as the materiality of a concealment. These provisions apply to a modification of an insurance contract as well as its original issue.
 - a. Suppose a person who has just found out he is terminally ill applies for life insurance and neglects to reveal his condition on the life insurance application. This would constitute

concealment of a material fact (intentional and fraudulent omission) and would entitle the insurer to rescind the insurance policy.

- b.** If the applicant lies on the application and indicates that he is in excellent health, this would be a representation that is false in a material point, and again the insurer would be entitled to rescind the policy.
- 10.** When an insured has no personal knowledge of a fact, he may nevertheless repeat information about the subject that he believes to be true (hearsay), with the understanding that he does so on the basis of the information of others; or he may submit the information in its whole extent to the insurer. In neither case is he responsible for the truth, unless it proceeds from an agent of the insured whose duty it is to give the information.

Z. WARRANTIES [CIC 440-444; 445; 447]

- 1.** Under California law, a warranty may be either expressed or implied.
- 2.** A statement in an insurance policy of a matter relating to the person or thing insured, or to the risk, as a fact, is an express warranty thereof.
- 3.** A particular form of words is not necessary to create a warranty.
- 4.** Every express warranty made at or before the execution of a policy must be contained in the policy itself, or in another instrument signed by the insured and referred to in the policy, as making a part of it.
- 5.** A warranty may relate to the past, the present, the future, or to any or all of these.
- 6.** A statement in a policy, which asserts that there is an intention to do or not to do a thing which materially affects the risk, is a warranty that such act or omission will take place.
- 7.** The violation of a material warranty or other material provision of a policy, on the part of either party thereto, entitles the other to rescind the contract.

Activity 1.B

Match the term in the left-hand column with the correct description in the right-hand column.

Insurance	A contract whereby one undertakes to indemnify another against loss, damage, or liability arising from a contingent or unknown event
Insurable interest	A statement in an insurance policy of a matter relating to the person or thing insured, or to the risk, as a fact
Rescind	The policy owner has a legitimate financial interest in the life or property that is the subject of the insurance
Express warranty	The contract is terminated, or voided, from the beginning, and treated as if it had never existed

Answers can be found at the end of Unit 1.

AA. UNFAIR TRADE PRACTICES

- 1. Purpose and Scope [CIC 790; 790.01]** The purpose of the California unfair trade practices article is to regulate insurance trade practices by defining all practices that constitute unfair methods of competition, practices, or unfair or deceptive acts, and by prohibiting the trade practices so defined or determined.

These provisions apply to all types of insurers and insurance producers, including reciprocal and inter-insurance exchanges, Lloyd's insurers, fraternal benefit societies, fraternal fire insurers, annuities societies, motor clubs, nonprofit hospital associations, agents, brokers, solicitors, surplus line brokers, special lines surplus line brokers, and all other persons engaged in the business of insurance.

- 2. General Prohibition [CIC 790.02]** No person shall engage in California in any trade practice that is prohibited by statute, or which is defined or determined to be an unfair method of competition, or an unfair or deceptive act or practice, in the business of insurance.

- 3. Unfair methods of competition and unfair or deceptive acts or practices [CIC 790.03]** The following are defined as unfair methods of competition and unfair or deceptive acts or practices in the business of insurance.

- **False or Deceptive Advertising [CIC 790.03(b); 790.036]** It is unlawful for any person to place before the public in any newspaper, other publication, advertising device, public proclamation, or in any other manner, any statement about the insurance business or any person engaged in the insurance business which is untrue, deceptive, or misleading, and which is known or reasonably should be known to be untrue, deceptive, or misleading.

It is an unfair and deceptive practice in the business of insurance for an insurer to advertise insurance that it will not sell. An intentional violation of this section is a misdemeanor punishable by a fine of up to \$10,000. However, this does not apply to an insurer that refuses to sell a policy on the basis of its underwriting guidelines, and does not prevent an insurer from advertising insurance products for which it is licensed to sell where the product is not available for sale, as long as the unavailability is disclosed in the advertisement.

- **Boycott, Coercion, or Intimidation [CIC 790.03(c)]** It is unlawful for any person to commit, or to enter into an agreement to commit, any act of boycott, coercion, or intimidation resulting in or tending to result in any unreasonable restraint of, or monopoly in, the business of insurance.
- **False Financial Statements [CIC 790.03(d) (e)]** It is unlawful to knowingly file with any public official, or to knowingly make, issue, publish, circulate, or deliver to any person, or place before the public, any false statement of the financial condition of an insurer with the intent to deceive. It is unlawful to knowingly make a false entry, or omit to make a true entry, of a material fact regarding the financial condition of an insurer in any book, report, or statement of the insurer with the intent to deceive any person lawfully appointed to examine the insurer's condition or affairs, or any public official to whom the insurer is required by law to report.
- **Unfair Discrimination-General [CIC 790.03(f)]** It is illegal to engage in or to permit any unfair discrimination between individuals of the same class and equal expectation of life in the rates charged for any contract of life insurance or life annuity, or in the dividends or other benefits payable thereon, or in any other terms and conditions of the contract. However, differentials in the rates, dividends, benefits, or any combination

thereof, based on the sex of the insured or annuitant may be required for contracts of ordinary life insurance and individual life annuities. This requirement is satisfied if such differentials are substantially supported by valid pertinent data segregated by sex, including, but not necessarily limited to, mortality data segregated by sex.

- **Advertising of Guaranty Association Prohibited [CIC 790.03(g)]** It is unlawful for any person to place before the public in any newspaper, other publication, advertising device, public proclamation, or in any other manner, any statement to the effect that a named insurer or specified insurers are members of the California Insurance Guaranty Association, or are otherwise insured against insolvency. Although the association exists to protect members of the general public, not all claims are fully covered. All insurers offering coverages protected by the association are required to be members, and no insurer is permitted to use the existence of the association in its advertising claims.

- a. **Penalties for Violations [CIC 790.035]** Any person who engages in an unfair method of competition or an unfair or deceptive act or practice, which is prohibited by the Code shall be liable for a civil penalty to be fixed by the Commissioner. This fine may be any amount up to \$5,000 for each act, or, if the act or practice was willful, up to \$10,000 for each act.

4. **Misrepresentations [CIC 780]** An insurer, officer, agent, broker, or solicitor shall not cause or allow misrepresentation of:

- policy terms;
- policy benefits or privileges; or
- future dividends payable under the policy.

5. **Twisting [CIC 781]** A person shall not make any misrepresentation to any other person to induce the person to take out an insurance policy, refuse to accept a policy, or to lapse, forfeit, or surrender a policy. A person shall not make any misleading representation or comparison of insurers or policies to an insured to induce him to lapse, forfeit, change, or surrender his insurance, whether on a temporary or permanent plan. This practice is known as *twisting*.

- a. **Penalties for Misrepresentation and Twisting [CIC 782-784]** Penalties for a producer include the following:

- \$25,000 (or up to three times the amount of loss if the loss is more than \$10,000)
- Imprisonment for up to one year in county jail
- License suspension up to three years
- Any combination of the above penalties

A plea of *nolo contendere* (no contest) is treated as a guilty plea by the courts.

If insurers knowingly violate or permit employees, officers, or agents to violate rules, the penalty is certificate of authority suspension.

6. **Examinations, Investigations, and Hearings [CIC 790.04-05]** The Commissioner has the power to examine and investigate the affairs of every person engaged in the insurance business in California to determine whether any such person has been or is engaged in any unfair method of competition, or any unfair or deceptive act or practice, which is defined by and prohibited by the Code.

Whenever the Commissioner has reason to believe that a person has been engaging, or is engaged, in an unfair method of competition or unfair or deceptive act or practice, and that a

proceeding into the matter would be in the public interest, the Commissioner shall issue and serve upon the person:

- notice of a hearing concerning the matter;
- a statement of the charges;
- a statement of the person's potential liability for civil penalties; and
- an order to show cause why a cease and desist order should not be issued.

Notice of the hearing will contain the time and place for the hearing, which shall not be held less than 30 days from the date notice is served.

If any of the charges is found to be justified, the Commissioner shall issue and cause to be served upon the person an order requiring the person to pay civil penalties up to \$5,000 for each act, or, if the act or practice was willful, up to \$10,000 for each act, and to cease and desist from engaging in the prohibited method of competition, or unfair or deceptive act or practice. A person served with such an order is entitled to judicial review of the Commissioner's decision.

- 7. Procedure for Undefined Violations [CIC 790.06]** The Commissioner also has authority to take action against methods of competition, or acts or practices, that are not specifically defined and prohibited by the Code, but which nonetheless appear to be unfair or deceptive.

Whenever the Commissioner has reason to believe that a person engaged in the insurance business has been engaging, or is engaged, in an unfair method of competition or unfair or deceptive act or practice which is not specifically defined by the Code, and that a proceeding into the matter would be in the public interest, the Commissioner may call a hearing for the purpose of determining whether the alleged method, act, or practice should be declared to be unfair or deceptive. Notice will be given at least 30 days in advance, along with a statement of the charges and an order to show cause why action should not be taken.

If any of the alleged methods, acts, or practices are found to be unfair or deceptive within the meaning of the Insurance Code, the Commissioner shall issue a written report so declaring. If the report charges that the person's conduct is a violation and it has not been discontinued, the Commissioner may, within 30 days after service of the report, through the Attorney General, cause a petition to be filed in superior court to enjoin and restrain the person from engaging in the method, act, or practice. The court will have jurisdiction and have the power to enter appropriate orders which in its judgment are necessary to prevent injury to the public.

8. Penalties for Violating Orders [CIC 790.07-10]

Whenever the Commissioner believes that a person has violated a cease and desist order, or an order of the court, after it has become final and while it remains in effect, the Commissioner may call a hearing to determine whether such violation has occurred.

After the hearing, if it is determined that a violation of the order was committed, the Commissioner may order the person to pay one of the following penalties:

- A fine up to \$5,000, if the violation is not found to be willful, plus the amount of any outstanding penalty for violating the Code.
- A fine of up to \$55,000, if the violation is found to be willful, plus the amount of any outstanding penalty for violating the Code.

For the purposes of this section, the failure to pay any penalty imposed for violating the unfair insurance practices laws, after the order to pay has become final, shall be treated the same as a violation of a cease and desist order.

For any subsequent violation of a cease and desist order, court order, or order to pay a penalty, while it remains in effect, the Commissioner may, after a hearing, suspend or revoke the person's license or certificate of authority for a period of up to one year. All fines and penalties under this section shall be in addition to any other fines and penalties that may be imposed under the law, and shall not relieve or absolve any person from any other administrative action against the person's license or certificate, or from any civil liability or criminal penalty under the law. The Commissioner has the authority to make any rules and regulations which are necessary to administer these provisions.

BB. DISCRIMINATORY PRACTICES [CIC 679.70]

Scope of Provisions

The following rules apply to insurance policies other than automobile and workers' compensation, covering risks in California. Generally, this includes insurance against loss or damage to residential real and personal property and coverage for the legal liability of natural persons. However, most of the following provisions also apply to life and disability insurance.

- 1. Failure or Refusal to Accept Application [CIC 679.71; 10140]** No admitted insurer shall fail or refuse to accept an application for, or to issue a policy to an applicant for, or cancel insurance, under conditions less favorable to the insured than in other comparable cases, except for reasons applicable to persons of every marital status, sex, race, color, religion, national origin, ancestry, or sexual orientation. Sex, race, color, religion, national origin, ancestry, or sexual orientation do not constitute a condition or risk for which a higher rate, premium, or charge may be required.
- 2. Application or Report Carrying Identification [CIC 679.72]** No application for insurance or insurance investigation report furnished to agents or employees to help determine applicant insurability shall carry any identification or requirement for the applicant's race, color, religion, national origin, or ancestry.
- 3. Birthplace of Applicant [CIC 679.73; 10142]** Applications may contain questions asking for the birthplace of an applicant as long as the question is used only to identify, and not to discriminate against, the applicant.
- 4. Sexual Orientation and Civil Penalties [CIC 10140]** No insurer may consider sexual orientation in its underwriting criteria, or utilize marital status, living arrangements, occupation, gender, beneficiary designation, zip codes, or other territorial classification, in order to establish sexual orientation, or determine whether to test for HIV antibodies. Effective January 1, 2002, insurers knowingly violating this section shall be subject to a civil penalty of \$1,000 to \$5,000 as determined by the court.
- 5. Identification of Applicant Race [CIC 10141]** No application or investigative report may require the identification of the applicant's race, color, religion, ancestry, or national origin.
- 6. Administrative Penalties for Discrimination [CIC 10140.5]** In addition to any other remedy permitted by law, the Commissioner has the administrative authority to assess penalties against life or disability insurers that discriminate against applicants or insureds on

the basis of sex, race, color, religion, national origin, ancestry, sexual orientation, or marital status. The following penalties may be imposed:

- An administrative penalty of up to \$2,500 for the first violation, and up to \$5,000 for each subsequent violation.
- If it appears that such violations are knowing violations or occur with a frequency that indicates a general business practice, an administrative penalty of not less than \$15,000 and not more than \$100,000 for each violation.
- An act or omission that is inadvertent and that results in incorrect premium rates being charged to more than one subscriber shall be a single violation for the purpose of this section.

- 7. Genetic Disability Traits [CIC 10143]** Insurers may not refuse to issue, sell, or renew a life or disability insurance policy because the person to be insured carries a gene that may be associated with a disability in that person's offspring but that causes no adverse effects on the carrier. Such genes include Tay-Sachs, sickle cell, or thalassemia trait, and X-linked hemophilia A.

Policies issued to an association, corporation, firm, fund, individual, group, order, organization, society, or trust may not demand or require a higher premium rate than required of other insureds, or require any rebate, discrimination, or reduction on the amount of coverage because of these traits.

No insurer may insert a stipulation in a policy that the person insured is bound to accept any sum less than the full value of the policy in case of claim. Insurers may not set a lower commission fee for agents or brokers writing or renewing policies on applicants with these traits.

- 8. Disclosure of Genetic Test Results [CIC 10140.1]** It is illegal to disclose the results of a test for a genetic characteristic to any third party, in a manner that identifies or provides identifying characteristics of the person to whom the test results apply, except under a written authorization. The penalties for violating this section are:
- for a negligent disclosure, a civil penalty up to \$1,000 plus court costs (the penalty and costs shall be paid to the subject of the test);
 - for a willful disclosure, a civil penalty not less than \$1,000 and not more than \$5,000 plus court costs (the penalty and costs shall be paid to the subject of the test); and
 - for a willful or negligent disclosure that results in economic, bodily, or emotional harm to the subject of the test, the person shall be guilty of a misdemeanor punishable by a fine of up to \$10,000.
- 9. Physically or Mentally Impaired [CIC 10144]** Individual or group life, annuity, or disability insurers may not refuse to insure, refuse to continue to insure, or limit the amount, extent, or kind of coverage available, or charge a different rate for the same coverage of a physically or mentally impaired person, except when based on sound actuarial principles or related to actual and reasonable anticipated experience. **Physical or mental impairment** means physical, sensory, or mental impairment that substantially limits one or more of that person's major life activities.
- 10. Denial of Coverage for Experimental Treatment [CIC 10144.1]** A disability insurer that denies coverage for an experimental medical procedure or plan of treatment for a claimant with a terminal illness, which for the purposes of this section refers to an incurable or irreversible condition that has a high probability of causing death within one year or less,

under a disability insurance policy that includes hospital, medical, or surgical coverage issued in this state shall provide written notification directly to the claimant or representative, which shall include all of the following:

- The specific medical and scientific reasons for the denial and specific references to pertinent policy provisions upon which the denial is based.
- A description of the alternative medical procedures or treatments covered by the policy, if any.
- A description of the process by which the claimant or representative may exercise her right to appeal the denial.

11. Victims of Domestic Violence [CIC 10144.2] No disability insurer covering hospital, medical, or surgical expenses shall deny, refuse to insure, refuse to renew, cancel, restrict, or otherwise terminate, exclude, or limit coverage or charge a different rate for the same coverage, on the basis that the applicant or insured person is, has been, or may be a victim of domestic violence.

12. Blindness or Partial Blindness [CIC 10145] Individual or group life, annuity, or disability insurers may not refuse to insure, refuse to continue to insure, or limit the amount, extent, or kind of coverage available, or charge a different rate for the same coverage, on the basis of the applicant's blindness or partial blindness.

CC. UNFAIR CLAIMS PRACTICES [CIC 790.03(H)]

1. Any of the following acts are considered to be an unfair claims practice if committed with a frequency to indicate that it is a general business practice:
 - Misrepresenting pertinent facts or policy or contract provisions relating to coverages at issue
 - Failing to acknowledge and to act reasonably promptly upon communications with respect to claims arising under insurance policies
 - Failing to adopt and implement reasonable standards for the prompt investigation and processing of claims arising under insurance policies
 - Failing to affirm or deny coverage of claims within a reasonable time after proof of loss statements have been completed and submitted by the insured
 - Not attempting in good faith to effectuate prompt, fair, and equitable settlements of claims in which the company's liability is reasonably clear
 - Compelling persons to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by such insureds, when the insureds have made claims for amounts reasonably similar to the amounts ultimately recovered
 - Attempting to settle a claim for less than the amount to which a reasonable person would have believed she was entitled by reference to written or printed advertising material accompanying or made part of the application
 - Attempting to settle claims on the basis of an application which was altered without notice to, or knowledge or consent of the insured, or the insured's representative, agent, or broker
 - Failing, after payment of a claim, to inform insureds or beneficiaries, upon request by them, of the coverage under which payment has been made

- Making known to insureds or claimants a policy of appealing from arbitration awards in favor of insureds or claimants for the purpose of compelling them to accept settlements or compromises less than the amount awarded in arbitration
- Delaying the investigation or payment of claims by requiring the insured, claimant, or the physician of either, to submit a preliminary claim report and then requiring the subsequent submission of formal proof of loss forms, both of which submissions contain substantially the same information
- Failing to promptly settle claims, where liability has become reasonably clear, under one portion of the insurance policy coverage, in order to influence settlements under other portions of the insurance policy coverage
- Failing to promptly provide a reasonable explanation of the basis relied on in the insurance policy, in relation to the facts or applicable law, for the denial of a claim or the offer of a compromise settlement
- Directly advising a claimant not to obtain the services of an attorney
- Misleading a claimant as to the applicable statute of limitations
- Delaying the payment or provision of hospital, medical, or surgical benefits for services provided with respect to acquired immune deficiency syndrome (AIDS) or AIDS-related complex (ARC) for more than 60 days after the insurer has received a claim, when the delay in claim payment is for the purpose of investigating whether the condition preexisted the coverage.

2. Definitions

- a. **Claimant [CCR 2695.2(c)]** means a first- or third-party claimant as defined in these regulations, any person who asserts a right of recovery under a surety bond, an attorney, any person authorized by operation of law to represent the claimant, or any of the following persons properly designated by the claimant: an insurance adjuster, a public adjuster, or any member of the claimant's family.
- b. **Notice of legal action [CCR 2695.2(o)]** means notice of an action commenced against the insurer with respect to a claim, or notice of action against the insured received by the insurer, or notice of action against the principal under a bond, and includes any arbitration proceeding.
- c. **Proof of claim [CCR 2695.2(s)]** means any documentation in the claimant's possession submitted to the insurer, which provides any evidence of the claim and that supports the magnitude or the amount of the claimed loss.
- d. **Claim Files and Record Documentation [CCR 2695.3]**
 - 1.) Claim files are subject to examination by the Commissioner and his staff.
 - 2.) Claim data must be accessible, legible, and retrievable.
 - 3.) Claim files must show claim number, line of coverage, date of loss, and date of payment of the claim, and date of acceptance, denial, or date closed without payment.
 - 4.) Claim files must be available for all open and closed files for the current year and the four preceding years.

e. Duties Upon Receipt of Communications [CCR 2695.5]

- 1.) Upon receiving any written or oral inquiry from the Department of Insurance concerning a claim, every licensee must immediately (at least within 21 days) furnish a complete written response based on the facts, addressing all issues raised by the Department of Insurance in its inquiry and including copies of any documentation and claim files requested

f. Standards for Prompt, Fair, and Equitable Settlements [CCR 2695.7(a)(b)(c)(g)(h)] Insurers may not discriminate in claims settlement practices on the basis of the claimant's age, race, gender, income, religion, language, sexual orientation, ancestry, national origin, or physical disability or upon the territory of the property or person insured.

- 1.) Upon receiving proof of claim, insurers must accept or deny the claim, in whole or in part, within 40 days; the amounts accepted or denied must be clearly documented in the claim file unless the claim has been denied in its entirety.
- 2.) If more time is needed, the insurer must provide the claimant with written notice; continuing notices are required every 30 calendar days for as long as the claim remains unresolved.
- 3.) Insurers may not attempt to settle a claim by making a settlement offer that is unreasonably low.
- 4.) Insurers must pay claims within 30 days of acceptance.

Activity 1.C

Match the term in the left-hand column with the correct description in the right-hand column.

Proof of claim	Action resulting in any unreasonable restraint of, or monopoly in, the business of insurance
Twisting	Failing to adopt and implement reasonable standards for the prompt investigation and processing of claims arising under insurance policies
Boycott, Coercion, or Intimidation	Any misrepresentation to any other person to induce the person to take out an insurance policy, refuse to accept a policy, or to lapse, forfeit, or surrender a policy
Unfair claims practice	Any documentation in the claimant's possession submitted to the insurer which provides any evidence of the claim and that supports the magnitude or amount of the claimed loss

Answers can be found at the end of Unit 1.

DD. THE INSURANCE FRAUDS PREVENTION ACT

1. **False and Fraudulent Claims [CIC 1871]** The legislature has found that the business of insurance involves many transactions that have the potential for abuse and illegal activities related to fraudulent claims, particularly in the areas of automobile insurance, workers' compensation insurance, and health insurance.

Insurance fraud is a particular problem for automobile policyholders; fraudulent activities account for 15 to 20 percent of all auto insurance payments. Automobile insurance fraud is the biggest and fastest growing segment of insurance fraud and contributes substantially to the high cost of automobile insurance with particular significance in urban areas.

- 2. Purpose; Access to Records [CIC 1871.1]** Insurers and their agents, while they are investigating suspected fraudulent claims, must have access to all relevant public records that are required to be open for inspection.
- 3. Notice and Penalties for Violations [CIC 1871.2; 1871.3]** Any insurer that provides notice of claim forms must include on the form this statement:
 For your protection, California law requires the following statement to appear on this form: *“Any person who knowingly presents false or fraudulent claim for the payment of a loss is guilty of a crime and may be subject to fines and confinement in state prison.”*
 Before the settlement of a claim for insured vehicle theft, the insurer shall secure from the insured a claim form including a warning that false representations on the form subject the insured to a penalty of perjury, a detailed description of the insured vehicle, the purchase location of the insured vehicle, purchase date, and name of seller, a detailed statement of the circumstances surrounding the theft, and the insured’s current driver’s license number.
 The insured must sign the claim form in the presence of the insurance agent, broker, or adjuster, or other claims representative, who must verify the insured’s driver’s license number, or submit a notarized claim form, and the claim form shall be signed under penalty of **perjury**. The insurer must retain for three years all settlement checks in settling an auto theft, the original claim form, and a legible copy of the police report.
- 4. Notice and Penalties for Violations [CIC 1871.4]** For all types of insurance coverages, it is unlawful to make false or fraudulent statements related to a claim. It is specifically unlawful to knowingly:
- make a false or fraudulent statement or material representation to obtain or deny compensation;
 - present any false or fraudulent written or oral material statement supporting or opposing a claim for compensation for the purpose of obtaining or denying compensation;
 - assist, a bet, solicit, or conspire with a person engaging in an unlawful act under this section; and
 - make a false or fraudulent statement with regard to entitlement to benefits with the intent to discourage an injured worker from claiming benefits or pursuing a claim.

Violators may be subject to one or more of the following punishments:

- Imprisonment in county jail for up to one year, or in the state prison for two, three, or five years
- A fine of up to \$150,000 or double the value of the fraud, whichever is greater
- Both imprisonment and a fine

If the violator has a prior felony conviction of the same offense, there shall be an additional two-year sentence for each prior conviction. These penalties do not preclude additional criminal charges.

- 5. Civil Liability [CIC 1872.5]** Insurers, employees, and agents are not subject to civil liability for libel, slander, or other tort for providing (without malice):
- information about suspected fraudulent insurance transactions furnished to law enforcement or licensing officials;
 - information relating to suspected fraudulent insurance transactions furnished to other persons subject to the California Insurance Code; and
 - information required by the Commissioner.

- 6. Bureau of Fraudulent Claims [CIC 1872; 1874.6]** There is created within the Insurance Department a Bureau of Fraudulent Claims to enforce the provisions prohibiting fraudulent claims and to enforce related sections of the Penal Code.
- a. Reports to National Automobile Theft Bureau** Every insurer must report covered private passenger automobiles involved in theft and salvage total losses, including the vehicle identification number and any other information as may be required, to the National Automobile Theft Bureau, or a similar central organization engaged in automobile loss prevention approved by the Commissioner. Prior to the payment of total theft losses, insurers shall comply with verification procedures in accordance with regulations adopted by the Commissioner.
- No insurer, the National Automobile Theft Bureau, or a similar central organization, engaged in automobile loss prevention approved by the Commissioner, or their employees or agents, shall be liable for damages in a civil action when the insurer or person acts under this section in good faith, without malice, and in reasonable belief that the action taken is warranted by the known facts after a reasonable effort to obtain the facts.
- As used in this section, **private passenger automobile** means a motor vehicle of the private passenger or station wagon type, any other four-wheel vehicle with a load capacity of 1,500 pounds or less, or a motorcycle.
- b. Arson Information Reporting System [CIC 1875.8; 1875.14; 1875.20]** There is hereby created the Arson Information Reporting System to permit insurers, law enforcement agencies, fire investigative agencies, and district attorneys to deposit arson case information in a common data base within the Department of Justice. The State Fire Marshal shall oversee the establishment, operation, and maintenance of the Arson Information Reporting System. The Department of Justice shall implement the Arson Information Reporting System in consultation with the State Fire Marshal.
- The purpose of the database is to identify utilization patterns by individual claimants and the methods of operation of individuals, groups, or businesses engaged in the commission of arson, and to prevent the commission of insurance fraud by arson.
- The use of the information deposited under this article shall be made available to law enforcement agencies, fire investigative agencies, district attorneys, and insurers, via modem, for the purpose of investigating and prosecuting arson and arson-related insurance fraud, or evaluating the validity and payment of fire-related insurance claims. The State Fire Marshal shall establish rules governing the access to, and use of, information and the circumstances under which information may be accessed and corrected.
- Any information acquired under this section shall not be a part of any public record.
- Any authorized governmental agency, insurer, or agent that receives any information furnished under this section shall not release that information to public inspection until the time that its release is required in connection with a criminal or civil proceeding. Information submitted to the State Fire Marshal under this section concerning active cases shall be confidential.
- Nothing in this section shall prohibit the accumulation and public distribution by the Bureau of Statistical Data if those data do not reveal the identity of specific claimants, injured parties, attorneys, physicians, or other service providers.
- 7. Gathering information [CIC 1875.1]** An authorized agency may, when there is evidence or suspicion that the crime of arson has been committed, request an insurer to release all information in its possession that the authorized agency determines to be relevant to the crime.

- 8. Insurance claims analysis bureau [CIC 1875.14]** The insurance claims analysis bureau's primary purpose is to further the prevention and prosecution of insurance fraud. To that end, the bureau performs the following functions:
- Collects and compiles information and data from members or subscribers concerning insurance claims
 - Disseminates information to members or subscribers relating to insurance claims for the purpose of preventing and suppressing insurance fraud
 - Promotes training and education to further insurer investigation, suppression, and prosecution of insurance fraud
 - Provides the Commissioner with all California data and information contained in the records of the bureau at no additional cost
- 9. Fraud unit requirement [CIC 1875.20]** Every insurer admitted to do business in this state shall maintain a unit or division to investigate possible fraudulent claims by insureds or by persons making claims for services or repairs against policies held by insureds.
- 10. Reporting required for fraudulent workers' compensation claims [CIC 1877.3(b)(1)]** When an insurer knows or reasonably believes it knows the identity of a person or entity whom it has reason to believe committed a fraudulent act relating to a workers' compensation insurance claim, insurance policy, or application, then the insurer must notify the local district attorney's office and the Bureau of Fraudulent Claims of the Department of Insurance. The insurer must state in its notice the basis of the suspected fraud.

U N I T 1 Q U I Z

1. All of the following statements about the California Commissioner of Insurance are correct EXCEPT
 - A. the Commissioner can serve no more than four 4-year terms
 - B. the Commissioner can institute insurance rules and regulations
 - C. the Commissioner can investigate complaints
 - D. the Commissioner can adopt emergency regulations
2. Which of the following statements is CORRECT?
 - A. "Shall" is permissive.
 - B. "May" is mandatory.
 - C. "Shall" is mandatory.
 - D. "Person" is permissive.
3. Penalties for transacting insurance business in California without a license include all of the following EXCEPT
 - A. imprisonment for up to 1 year
 - B. prohibition from state licensure
 - C. both imprisonment and a fine
 - D. a fine of up to \$100,000
4. Any impairment of minimum paid-in capital required in the aggregate of an insurer for the class of insurance it transacts is the definition of
 - A. unwarranted
 - B. conservation
 - C. insolvency
 - D. endangered contracts
5. The penalty for anyone who willfully obtains insurance-related information under false pretenses includes all of the following EXCEPT
 - A. a fine up to \$50,000
 - B. a fine up to \$10,000
 - C. imprisonment for up to 1 year
 - D. both a fine and imprisonment
6. Upon receiving any written or oral inquiry from the Department of Insurance concerning a claim, licensees must respond at least within
 - A. 10 days
 - B. 15 days
 - C. 21 days
 - D. 45 days
7. Anyone who makes false or fraudulent statements relating to a claim is subject to all of the following penalties EXCEPT
 - A. a fine of up to \$150,000 or double the value of the fraud, whichever is greater
 - B. a fine of up to \$150,000 or double the value of the fraud, whichever is smaller
 - C. imprisonment in a county jail for up to 1 year or in a state prison for 2, 3, or 5 years
 - D. both imprisonment and a fine
8. A person who willfully engages in an unfair method of competition or an unfair or deceptive may be fined up to
 - A. \$5,000 for each act
 - B. \$7,500 for each act
 - C. \$12,000 for each act
 - D. \$10,000 for each act
9. Which of the following statements does NOT allow a party to rescind a contract?
 - A. Violation of a material warranty
 - B. A representation that is false in a material point
 - C. Neglecting to communicate that which a party knows and ought to communicate
 - D. Communicating information which is an opinion on the matters in question
10. An insurer that advertises insurance that it will not sell is committing the unfair and deceptive practice known as
 - A. coercion
 - B. false advertising
 - C. unfair discrimination
 - D. false financial statements

UNIT 1 ACTIVITY ANSWERS

Activity 1.A

The Insurance Commissioner	In charge of the California Insurance Department
The California Code of Regulations	Standards for approval and disapproval of names of insurance producers, continuing education requirements, various requirements for record keeping, standards for claim settlement practices, and specific requirements for different types of insurance
Domestic insurer	An insurer organized under the laws of California, whether or not admitted
The California Insurance Code	Regulates capitalization and reserve requirements for insurers, rate-making practices, minimum requirements for some types of coverage, and limits of insurance which must be offered to the public
Penalties for transacting insurance business in California without certificate of authority	Imprisonment in state prison or county jail for up to one year; fine of up to \$100,000; or both imprisonment and fine
Admitted	Entitled to transact insurance business in this state, having complied with the laws imposing conditions on those transacting insurance business in California

Activity 1.B

Insurance	A contract whereby one undertakes to indemnify another against loss, damage, or liability arising from a contingent or unknown event
Insurable interest	The policy owner has a legitimate financial interest in the life or property that is the subject of the insurance
Rescind	The contract is terminated, or voided, from the beginning, and treated as if it had never existed
Express warranty	A statement in an insurance policy of a matter relating to the person or thing insured, or to the risk, as a fact

Activity 1.C

Proof of claim	Any documentation in the claimant's possession submitted to the insurer which provides any evidence of the claim and that supports the magnitude or amount of the claimed loss
Twisting	Any misrepresentation to any other person to induce the person to take out an insurance policy, refuse to accept a policy, or to lapse, forfeit, or surrender a policy
Boycott, Coercion, or Intimidation	Action resulting in any unreasonable restraint of, or monopoly in, the business of insurance
Unfair claims practice	Failing to adopt and implement reasonable standards for the prompt investigation and processing of claims arising under insurance policies

U N I T 1 Q U I Z A N S W E R S

1. **A.** The Commissioner's term of office is four years, but an individual may not hold the position for more than two 4-year terms.
2. **C.** The word shall is mandatory and the word may is permissive.
3. **D.** The penalty for transacting insurance business without a license is a fine up to \$50,000 and/or imprisonment for up to 1 year.
4. **C.** The inability of the insurer to meet its financial obligations when they are due is also a definition of insolvency.
5. **A.** The penalty for anyone who willfully obtains insurance-related information under false pretenses is a fine of up to \$10,000, or imprisonment for up to 1 year, or both fine and imprisonment.
6. **C.** Licensees must furnish a complete written response based on the facts at least within 21 days.
7. **B.** For all types of insurance coverages, it is unlawful to make false or fraudulent statements related to a claim. One of the penalties is a fine of up to \$150,000 or double the value of the fraud, whichever is greater.
8. **A.** Any person who engages in an unfair method of competition or an unfair or deceptive act or practice shall be liable for a civil penalty of up to \$5,000 for each act, or if the act was willful, up to \$10,000 for each act.
9. **D.** An intentional and fraudulent omission on the part of an insured to communicate information that would prove a warranty false entitles the insurer to rescind. Neither party is bound to communicate information of their own judgment (opinion) upon the matters in question.
10. **B.** It is an unfair and deceptive practice in the business of insurance for an insurer to advertise insurance that it will not sell. An intentional violation of this section is a misdemeanor punishable by a fine of up to \$10,000.

II. ETHICAL BEHAVIOR

INTRODUCTION

This unit addresses some major concepts you'll need to understand for the ethics portion of your examination. Some of the topics have been covered in the Insurance Code provisions you reviewed earlier. However, it is important to understand that although the California Insurance Code and Code of Regulations identify many unethical and illegal practices, they are not a complete guide to ethical behavior.

A. CODES OF ETHICS

1. Professional Organizations

- a. Many professional insurance organizations have codes of ethics that they impose upon their members. These organizations include the following:
 - Chartered Life Underwriters (CLU)
 - Chartered Property and Casualty Underwriters (CPCU)
 - Professional Insurance Agents (PIA)
 - Certified Insurance Counselors (CIC)
 - National Association of Insurance and Financial Advisors (NAIFA)
 - Insurance Brokers and Agents of the West (IBA West)
- b. Codes of ethics increase the stature of insurance professionals among their peers and the public. These codes usually include the following:
 - Placing the consumers' interests first
 - Continuing education
 - Strict adherence to laws and regulations
 - Educating the public about insurance

Ethics go beyond the letter of law, and involve more than just strict adherence to the Insurance Code and California Regulations. Ethics define what insurers and producers *should* do; law defines what insurers and producers *must* do.

Personal and professional behavior should be based on principles that enhance dignity and self-esteem as well as respect for others.

Code of Ethics
Independent Insurance Agents & Brokers of America, Inc.
<p>I believe in the value and importance of the insurance business and its future, and that the Independent Insurance Agent plays a critical role in serving consumers throughout the insurance process.</p> <p>I support the Independent Agency System, which has developed insurance to be a fundamental component in the economic fabric of our nation, and I pledge to support right principles and oppose bad practices in the insurance business.</p> <p>I respect the importance of the relationship between Independent Insurance Agents and the public, insurance companies, and other Independent Insurance Agents, and believe that the rights of the client are paramount.</p>
To the Public
<p>I believe that serving the public as an Independent Insurance Agent is an honorable occupation, affording me a special opportunity to serve society and offer valuable insurance products and services to the public.</p> <p>I believe that as an Independent Insurance Agent, I am serving the interests of my clients by responding to their expressed insurance needs.</p> <p>I will strive to further the public's understanding of insurance, endeavor to promote safety and loss control in my community, and strive to participate in civic and philanthropic activities that contribute to my community.</p>
To the Insurance Companies I Represent
<p>I will respect the authority vested in me by the insurance companies I represent, and work to maintain open lines of communication with them.</p>
To Other Independent Insurance Agents
<p>I will strive to maintain positive relations with other insurance agencies in my community, competing with them on an honorable and fair basis.</p> <p>I will follow all insurance laws relative to the conduct of my business.</p> <p>I will work with other Independent Insurance Agents for the betterment of the insurance business, and endeavor to elevate the standards of my occupation by following this Code of Ethics and encouraging other Independent Insurance Agents to do likewise.</p> <p style="text-align: center;"><i>(Reprinted with permission from the Independent Insurance Agents of America.)</i></p>

2. Ethical Issues in Selling Insurance to Senior Citizens

Special consideration must be given to the needs of senior citizens, who are often vulnerable to the approaches of individuals who represent themselves as humanitarians but who exploit senior's fears and sell unnecessary or overpriced insurance policies to them.

As a general statement, all insurers, brokers, agents, and others engaged in the transaction of insurance owe a prospective insured who is 60 years of age or older a duty of honesty, good faith, and fair dealing. This duty is in addition to any other duty, whether express or implied, that may exist.

3. Pretext Interviews [CIC 791.03]

One type of illegal encounter is the pretext interview. A pretext interview occurs when the party gathering information refuses to reveal their true identity, pretends to be someone else, or misrepresents the true purpose of the interview, which, in this case, may be to sell insurance.

Pretext interviews may be legally conducted only when an insurer is conducting an investigation for suspected criminal activity, fraud, material misrepresentation, or material nondisclosure in connection with a claim. Otherwise, it is prohibited for any insurance institution,

agent, or insurance support organization to use or authorize the use of pretext interviews to obtain information in connection with an insurance transaction.

B. AGENT RESPONSIBILITIES

1. Responsibilities of Agents

The insurance agent is a key person in the process of marketing, underwriting, and delivering insurance policies. As a marketing representative of the insurance company, an agent has a responsibility to represent and market the insurer's products in an ethical and professional manner. This requires a thorough knowledge of various insurance products, being aware of a prospect's insurance needs, and being able to recommend the proper insurance products to satisfy those needs.

Agents need to be familiar with a number of requirements that protect consumers. For example, agents must furnish various notices and disclosure statements concerning information practices, replacement transactions, and specific insurance coverages. They must obtain signatures on applications and other documents when required, and they must keep records required by the insurance company or the insurance department.

Each agent also has a responsibility to be aware of insurance laws, which pertain to the marketing of insurance products. These include being familiar with required standards that apply to advertising and sales literature. As a rule, all advertising, sales presentations, and illustrations must be truthful, and they may not misrepresent or omit material information.

2. The Agent as Fiduciary

- a. A **fiduciary** is a person or organization holding the funds or property of another in trust.
- b. All funds received by any person acting as an insurance agent, broker or solicitor, life agent, life analyst, surplus line broker, special lines surplus line broker, motor club agent, bail agent, permitted, or solicitor as premium or return premium on or under any insurance policy or undertaking of bail are received and held by that person in a fiduciary capacity.
 - 1.) Any person who diverts or appropriates such fiduciary funds to personal use is guilty of theft and may be punished for theft as provided by law.
- c. Any premium that a premium financer agrees to advance under the terms of a premium finance agreement shall be fiduciary funds only if actually received by a person holding a license.

3. Fiduciary Funds [CIC 1733 to 1734.5; 1735.5]

- a. If fiduciary funds are received by any licensed person in the course of transacting an insurance business, the licensee shall:
 - remit the premiums and return premiums, less commissions, received or held to the insurer or person entitled thereto;
 - maintain such fiduciary funds on California business at all times in a trustee bank account or depository in this state, separate from any other account or depository (not **commingled** with any other funds), in an amount at least equal to the premi-

ums and return premiums, net of commission, received and remaining unpaid to the persons entitled thereto; or

- maintain such fiduciary funds under a written agreement in the form of U.S. government bonds, treasury certificates or other obligations of the United States, or certificates of deposit of banks or savings and loan associations, or in repurchase agreements collateralized by securities issued by the U.S. government, or in bonds or other obligations of the state of California or any local agency or district of the state.

- b. In the case of any alternative method of maintaining fiduciary funds under a written agreement, such written agreements must be obtained from every insurer or person entitled to the funds authorizing the maintenance and retention of any earnings accruing on those funds.
- c. An insurance agent, insurance broker, or surplus line broker may offset funds due an insured for return premiums against any amounts due from the same insured for unpaid premiums on the same or any other insurance policy. Any insurer may pay return premiums to an agent or broker for such purpose.

4. Commissions

In most cases, only licensed insurance representatives with current agency contracts can receive commissions. However, heirs of a licensed representative may also receive commissions after the death of the licensed representative. An agent may continue to service policies and receive renewal commissions for auto policies for up to two years after termination of the agent's contract with an insurer.

5. Prepaid Commissions

Agents commonly receive commissions based on advance payments of annual premiums. This could cause problems when an agent receives advance commissions on an unusually large account or for an unusually large amount of business written during a specific period, because the commissions are not earned until the premium is earned. If a policy is canceled during midterm, the unearned premium will be returned to the policyholder and the agent will have to return the unearned commission. An agent who does not anticipate this possibility could be faced with a cash flow problem.

6. Policy Fees

In addition to the premium, an insurer may charge a policy fee to cover the onetime administrative expense involved in issuing the policy. Only an insurer, not the agent or broker, can charge a policy fee.

- Fees are any charge the policyholder pays over and above the premium.
- Brokers must disclose basis for fees and must have provided service that goes beyond ordinary placing of policy.
- Agents must include policy fees and other fees in all price quotations.

Return Premium Offsets (for Fire and Casualty Agents)
Premium financing
Financing premium through a loan is usually done for large amounts of coverage in fire and casualty policies or for business uses of life insurance policies.
The amount of an agent's compensation as a result of premium financing must always be disclosed to the insured.
A fire-casualty broker may offset funds due to an insured for return premiums by amounts due from the same insured for unpaid premiums on that or another policy.
An insurer may pay return premiums to the fire-casualty broker agent for that purpose. [CIC Sect 1735]

7. Sales Presentations

When making sales presentations, agents must act in the best interest of their clients and should identify and meet client needs. In addition, agents are often required by law and regulation to disclose facts about insurance and the products they are proposing for sale. Frequently, agents are required to provide applicants with the following documents at the time of application.

- **Policy summary**—A document that summarizes the coverages, benefits, limitations, exclusions, and terms of the policy proposed for sale
- **Buyers guide**—A consumer publication that describes the type of coverage being offered and provides general information to help the applicant compare different policies and reach an informed decision about whether the proposed coverage is appropriate

8. Field Underwriting by Agent

Because an agent has personal contact with an applicant, the agent is usually in a position to play an important part in the risk selection process by engaging in field underwriting. Frequently, it is the agent who asks the questions contained in the application and records the answers.

Completing the application is one of the most important functions of an agent. Much of the information reported on the application becomes the basis upon which to accept or reject the proposed insured. Answers to questions must be recorded accurately and completely by the agent. Honest reporting is required.

The agent may not omit pertinent information or report it inaccurately in order to get the policy issued. The ethical conduct of the agent with regard to the underwriting process must be above reproach. A signed and witnessed copy of the application becomes part of the policy, which is the legal contract between the insured and the insurer.

The agent can help expedite the underwriting process by submitting the application promptly, and, if necessary, promptly schedule the applicant for a physical examination. In some cases, the agent may be required to verify that the applicant is still in good health at the time of policy delivery, and, if the applicant is no longer in good health, to withhold the policy.

If the proposed insured is rated as a substandard risk or declined for the insurance, it is the agent's role as a field underwriter to explain the reasons for the underwriting decision.

In addition, there may be some underwriting forms (amendments or revisions) that must be signed by the applicant when the policy is delivered, and it is the agent's responsibility to obtain the signatures and return the signed forms to the home office.

In health insurance, field underwriting by the agent is much more important than it is in life insurance because of the possibility of malingering on disability claims. If the agent has suspicions, she should probe when completing the application. Any suspicions should be communicated to the underwriting department in the space provided on most applications for

agent comments. The goals of the agent are to get complete and accurate information from the applicant and to detect possible moral hazard.

Insurance laws and regulations may require the agent and the applicant to certify in writing that the applicant has read, or had read to him, the completed application and that the applicant understands that any false statement or misrepresentation may result in loss of coverage or denial of a claim. Failure to complete an application accurately and honestly could subject the agent to disciplinary action.

9. **Disclosure of the Effective Date of Coverage [CIC 1730.5]** A life agent and a fire and casualty broker/agent must provide to all insureds or applicants at the time of application or receipt of premium monies the effective date of coverage, if known, or the circumstances under which coverage will be effective if there exist conditions precedent to coverage. This section applies only to coverage for personal lines of insurance, such as private passenger automobile, homeowner and renter insurance, personal liability, and individual disability and health insurance.
10. **Misrepresentations [CIC 780]** An insurer, officer, agent, broker, or solicitor shall not cause or allow misrepresentation of:
 - policy terms;
 - policy benefits or privileges; and
 - future dividends payable under the policy.
11. **Twisting [CIC 781]** A person shall not make any misrepresentation to any other person to induce the person to take out an insurance policy, refuse to accept a policy, or to lapse, forfeit, or surrender a policy. A person shall not make any misleading representation or comparison of insurers or policies to an insured to induce him to lapse, forfeit, change, or surrender his insurance, whether on a temporary or permanent plan. This practice is known as *twisting*.
12. **Penalties for Misrepresentation and Twisting [CIC 782; 783.5; 784]** The penalties for a producer are:
 - \$25,000 (or up to 3 times the amount of loss if the loss is more than \$10,000);
 - imprisonment for up to one year in county jail;
 - license suspension for up to three years; or
 - any combination of the above penalties.
 - a. A plea of *nolo contendere* (no contest) is treated as a guilty plea by the courts.
 - b. The Commissioner may suspend the Certificate of Authority for the class of insurance of any insurer that knowingly violates these provisions or allows an officer, agent, or employee to do so.

C. RECORDKEEPING REQUIREMENTS

1. **Records [CIC 1727; 1727.5; 1730.5]** The Commissioner shall specify the manner and type of records to be maintained by licensees acting as agents and brokers, and the location where records must be kept. Every licensee employing an insurance solicitor shall keep the records for insurance transacted by the solicitor as the licensee's employee.

Life agents and fire and casualty broker/agents must also maintain records of the written disclosure required concerning the effective date of personal lines coverages. Agents must provide applicants with the effective date of coverage at the time of application or when the premium is first received.

All recordkeeping systems must provide an audit trail so that details may be identified and made available on request.

2. Fire and Casualty Agents and Brokers-Recordkeeping Requirements [10 CCR 2190-2190.8] Fire and casualty agents and brokers must maintain the following records with respect to every insurance transaction:

- Name of insured
- Name of insurer
- Policy number
- Effective date, termination date, and mid-term cancellation date of coverage
- Amount of gross premium
- Amount of net premium
- Amount of commission and basis on which computed
- Names of persons who receive, or are promised, commission or other valuable consideration related to the transaction
- Amount of premium received, including itemization of any partial payments or additional premium
- Date premium received by agent or broker
- Date deposited in trustee account
- Name and address of bank and number of trustee account
- Date premium paid by agent or broker to person entitled (principal) and means of transmittal
- Amount of net and gross return premium
- Date return premium received from insurer
- Date gross return premium is remitted to person entitled

Agents and brokers must also maintain records on the identity of each person who transacted the insurance, renewals, and changes in coverage; records of binders showing names of insured and insurer, nature of coverage, effective and termination dates, and premium for binder or policy to be issued; copy of application or memoranda of request for insurance; and correspondence received or sent, or other records describing the transaction. These records must be kept for 18 months.

Detailed bank records (account statements, deposit records, canceled checks, and withdrawal records) must also be kept. Records must be kept at the principal office in California (once a policy has expired or been canceled, records may be stored off premises). Records must be maintained for at least five years from policy expiration or cancellation.

3. Insurer Records: Life or Disability Insurance [CIC 10508; 10508.5] Insurers transacting life or disability insurance must maintain the following records, which the Commissioner may request for examination:

- Original application for each insurance policy or contract sold in California
- Premiums received by the insurer for each policy or contract issued

- Production records showing all policies or contracts sold by each agent for each of the preceding five calendar years
- Records identifying any agent other than the agent appearing on the application, who handled any part of an insurance transaction for which the other agent was not compensated
- Correspondence, solicitations, or proposals sent to a prospect, applicant, or insured
- Any written comparison of benefits, limitations, exclusions, costs of existing accident, sickness, or long-term care coverage, and proposed coverage
- A copy of the outline of coverage or other required disclosure statement
- Copies of correspondence between the policyholder, the proposed policyholder, or anyone acting on behalf of this person and the agent or insurer

Records must be kept for at least two years following actual policy delivery, or two years from the date of application if no policy was issued.

Life and disability insurance agents must maintain the records described above in their place of business for at least five years, and the records must be open to inspection or examination by the Commissioner at all times.

Recordkeeping Responsibilities
Life agents must keep transaction records for 5 years. [CIC 10508.5]
Agents (all classes other than life) must keep all client, policy, and transaction records for minimum of 2 years Commissioner has right to specify kinds of records to be kept and where they should be kept. [CCR 2190-2190.8]
If the agent has not kept the required records, the Commissioner may order the agent to establish the records within 60 days; failure to comply is grounds for license suspension or revocation. [CIC Sect 1747]

- 4. File and record documentation [CCR 2695.3]** Agent or broker records must be kept for different lengths of time, based on the type of file or record:
- Informational records about transactions conducted under the agent/broker license must be kept for 18 months.
 - Written agreements of fees charged for services of a life/disability analyst must be kept for three years.
 - Detailed bank records (account statements and deposit records from policy-canceled checks and withdrawal records) must be kept for at least five years at the cancellation/principal office in California.
 - Once a policy has expired or expiration been canceled, records may be stored off premises.
 - Applications, premium and production records, coverage and correspondence from date of policy delivery, or application must be kept for two years.
 - Any materials used in a life insurance policy replacement must be kept for three years.
 - Claim files must be available for all open and closed files for the current year and the four preceding years.
 - Advertisements used to solicit long-term care insurance must be kept for three years.
 - Claim files must be available for all open and closed files for the current year and the four preceding years.

5. Recordkeeping Requirements

- Automobile dealers licensed as insurance agents must keep separate records of all insurance business transacted.
- Long-term care insurers must keep records of all policy rescissions and report them to the Commissioner annually.
- Fire/casualty broker/agents must keep records of the written disclosure required on the effective date of coverage.

6. Internet Advertising [CIC 1726] A person who is licensed in this state as an insurance agent or broker, advertises insurance on the internet, and transacts insurance in this state, must identify all of the following information on the internet, whether the insurance agent or broker maintains his internet presence or whether the presence is maintained on his behalf:

- His **name**, as it appears on his insurance license, and any fictitious name approved by the Commissioner
- The **state** of his domicile and principal place of business
- His **license number**

A person will be deemed to be transacting insurance in this state when the person advertises on the internet, whether or not the insurance agent or broker maintains her internet presence or if it is maintained on her behalf, and does any of the following:

- Provides an insurance premium quote to a California resident
- Accepts an application for coverage from a California resident
- Communicates with a California resident regarding one or more terms of an agreement to provide insurance or an insurance policy

7. Change of Address [CIC 1729] Every licensee and every applicant for a license must immediately notify the Commissioner in writing of any change in email address, residence address, principal business address, or mailing address.

8. Reporting of Administrative Actions and Criminal Convictions [CIC

1729.2] All licensees and applicants are required to report any administrative actions or criminal convictions to CDI within 30 days of the final disposition of the matter. This requirement applies to both California resident and non-resident licensees and applicants.

Background information that must be reported includes any of the following:

- A misdemeanor or felony conviction
- A filing of felony criminal charges in state or federal court
- An administrative action regarding a professional or occupational license
- A licensee's discharge or attempt to discharge in a personal or organizational bankruptcy proceeding an obligation regarding any insurance premiums or fiduciary funds owed to any company, including a premium finance company, or managing general agent
- Any admission, or judicial finding or determination, of fraud, misappropriation or conversion of funds, misrepresentation, or breach of fiduciary duty

a. Documents to Provide

Supporting documents, such as a statement regarding the background change; certified court documents; administrative or disciplinary documents; or any other information relative to the change must be submitted.

b. Reporting

To report information to CDI in writing, you may use the background change disclosure form available at www.insurance.ca.gov by selecting “Producer Background Information” under “Agents & Brokers.” Additional information regarding this requirement and the form can be found by typing “background change” in the search box on CDI’s homepage.

You may also submit background changes electronically to the National Insurance Producer Registry (NIPR) Attachment Warehouse Reporting of Actions (ROA) at <http://www.nipr.com/> by selecting “Reporting of Actions” under “Attachments Warehouse.” The documents submitted through the ROA service fully satisfy the Background Reporting requirements of Section 1729.2 of the California Insurance Code.

- 9. Use of Corporation or Association Name [CIC 1729.5]** A fire and casualty broker/agent or life agent who has a service contract with a licensed corporation, or is a stockholder or member of any incorporated association or corporation that provides services to agents, may use the name of the association or corporation on stationery, advertisements, or other printed matter provided the agent’s name is clearly identified according to the relationship.

For example:

Representing _____

A stockholder of _____

Placing business through _____

Using services of _____

- 10. Aiding a Nonadmitted Insurer [CIC 703]** The following acts are misdemeanors except when performed by surplus lines brokers:

- Acting as an agent for a nonadmitted insurer in the transaction of insurance business in California
- Advertising a nonadmitted insurer in California
- Aiding a nonadmitted insurer in any other way to transact insurance in California
- Acting as an agent or broker for, or aiding an insurer without a certificate of authority in California

The penalty, in addition to any penalty for misdemeanors for the above actions is a fine of up to \$500 plus \$100 for each month or portion of a month during which the violation continues.

- 11. Free Insurance [CIC 777.1; 777.2]** No insurer, agent, or broker shall participate in any plan to offer insurance or annuities as an inducement to the purchase or rental by the public of any real or personal property, or services, without any separate charge for the insurance. Willful violators may have their license suspended or revoked for up to one year.

This does not apply to insurance written in connection with newspaper subscriptions, the purchase of shares in a credit union, insurance offered as a guarantee on the performance of goods, or title insurance. Nor does this apply to life or disability insurance written in connection with an indebtedness, where the insurance is provided for the purpose of paying the balance of the indebtedness in the event of death or disability of the insured person.

D. RELATIONSHIPS AND CONFLICTS OF INTEREST

- 1.** Agents have responsibilities toward their customers. It is important that an agent always conduct herself with the highest ethical standards. Regardless of personal interest, the agent’s first

obligation is to serve the client and provide the best coverage and service. Steps an agent can take to ensure a professional image include the following:

- Place the customer's interest first.
- Know your job—increase your level of competence.
- Identify customer needs and meet those needs.
- Accurately represent products and services.
- Use layman's language when possible.
- Stay in touch with customers and conduct periodic coverage reviews.
- Protect confidential relationships with clients.
- Know and obey all insurance laws and regulations.
- Provide exemplary service to clients.
- Avoid unfair or inaccurate remarks about the competition.

E. USING ERRORS AND OMISSIONS COVERAGE FOR PROTECTION

1. The Danger

Because insurance agents have professional and fiduciary responsibilities to both insureds and insurers, they can be held legally liable for the consequences of any negligence or errors or omissions committed during the course of conducting their business.

An agent has a duty to evaluate a client's insurance needs and to make proper insurance recommendations. A failure to address an insurance need, or a recommendation that leaves a serious gap in coverage, could leave an insurer with a loss that is not covered but should have been covered. In such cases, the insured may have a valid legal claim against the agent for damages.

Insurance agents may purchase an individual E&O policy, a policy through the agency, or through the insurance company.

Except for obvious exclusions (e.g., intentional acts, criminal acts, liability assumed under contract, and bodily and personal injury), E&O policies have few other exclusions. However, some E&O coverages are beginning to exclude such things as coverage for placing business with insurers who become insolvent.

2. Basic Characteristics of E&O

Although there are no standard insurance agency E&O policies, they do have certain basic characteristics in common. E&O policies usually have a high deductible, such as \$1,000 or more, which may be tied to the number of agency employees. The coverage is usually written with a limit per claim, but aggregate limits for all claims during the policy period are also available. Common limits range from \$100,000 to \$2 million or more.

3. Typical E&O Insurance Agreement

A sample E&O insurance agreement could look like this:

Coverage is provided for an act, error, or omission in rendering or failing to render professional services in the conduct of the named insured's profession as a licensed agent for life and health insurance.

4. E&O Insurance

a. Types of Coverage

- Legal defense
- Settlement costs—Up to stipulated maximum
- Unlicensed employees—Covered as long as they do not have agent’s or broker’s license and do not produce new business

b. Covered Losses

- Sale of insurance and employee benefit plans
- Administrative activities

c. Exclusions

- Actions committed through fraud, criminal intent, or illegal activities
- Covered under another contract or agreement
- Misuse of client funds

Activity 2.A

Match the term in the left-hand column with the correct description in the right-hand column.

Twisting	Making a misrepresentation to an insured person to induce that person to take out an insurance policy
Code of ethics	Increase the stature of insurance professionals to the public
Buyers guide	Exchanging an insured’s current policy with a new policy
Replacement	An attempt by an existing insurer to dissuade a policy owner from replacing existing life insurance or an annuity
Conservation	A person who hold the funds of another in trust
Fiduciary	A publication that helps consumers compare different policies and reach an informed decision concerning the appropriateness of proposed coverage

Answers can be found at the end of Unit 2.

Case Studies in Ethics

Case 1

John has a securities and insurance license. He tells his client that variable universal life is a good way to fund a retirement plan, especially because you can borrow cash value from the policy and you never have to pay it back.

Is there a legal or ethical problem with John’s presentation?

Write your response in the space provided below.

Case 2

Sheila has her real estate license and her insurance license. Whenever she sells a home, she provides six months of free homeowners insurance to the purchaser.

Is there a legal or ethical problem with Sheila's practice? If so, what might be the potential penalties?

Write your response in the space provided below.

Case 3

Ellen's client asks about the financial rating of the insurance company writing her term life insurance policy, as they were recently in the news because of impaired capital. Ellen tells her client not to worry, because the insurer is a member of the California Life and Health Guarantee Association, which is like the FDIC for insurance policies.

Has Ellen done something illegal?

Write your response in the space provided below.

Case 4

Carl moves to a new agency across town. He calls all his former clients and convinces them to replace their existing coverage with a new insurer, telling them the coverage they have is inferior and the carrier may be in financial trouble. He forgets to tell them that there will be new waiting periods, and that he will earn a new first-year commission. He recommends they do not bother reading the Notice Regarding Replacement, since the new coverage is clearly a better deal.

Are Carl's actions legal? Ethical? What are the potential penalties? How might that change if more than one of his clients is affected by his actions?

Write your response in the space provided below.

Case 5

Kate takes an application for health insurance from Everett, who indicates he is in excellent health and does not pay the initial premium up front. One month later when Kate delivers the policy, Everett is clearly in poor health.

What are Kate's legal and ethical responsibilities?

Write your response in the space provided below.

Case 6

Bob likes selling insurance but he does not like the paperwork that is required. On occasion, he neglects to keep detailed records of his transactions for his clients.

Is this unethical? Is it illegal? What kinds of problems could Bob encounter without complete and accurate records?

Write your response in the space provided below.

Answers can be found at the end of Unit 2.

U N I T 2 Q U I Z

1. The codes of ethics of professional insurance organizations usually address all of the following subjects EXCEPT
 - A. strict adherence to laws and regulations
 - B. educating the public about insurance
 - C. placing a client's interest first
 - D. the need for agents to have a college degree
2. A person who holds the funds or property of another in trust is known as
 - A. a broker
 - B. a fiduciary
 - C. a solicitor
 - D. an insurance agent
3. All of the following statements regarding policy fees are true EXCEPT
 - A. a policy fee may be charged in addition to the premium to cover administrative expenses involved in issuing a policy
 - B. an agent or broker can charge an additional policy fee
 - C. brokers must disclose the basis for fees
 - D. agents must include policy fees and other fees in all price quotations
4. What is the minimum number of years from policy expiration or cancellation date that account statements, deposit records, canceled checks, and withdrawal records must be maintained?
 - A. 3 years
 - B. 5 years
 - C. 7 years
 - D. 10 years
5. A document that summarizes the coverage, benefits, limitations, exclusions, and terms of an insurance policy proposed for sale is called
 - A. a field underwriter guide
 - B. a policy summary
 - C. a summary statement
 - D. a DOI critique
6. When an agent uses misrepresentation to convince a policyowner to drop a policy solely for the purpose of selling the policyowner another policy without regard to any possible disadvantage to the policyowner, the agent is guilty of
 - A. restraint of trade
 - B. rebating
 - C. defamation
 - D. twisting
7. Life or disability insurers must keep transaction records for
 - A. 1 year
 - B. 2 years
 - C. 3 years
 - D. 5 years
8. Within how many days must all licensees and applicants report any administrative actions or criminal convictions to the California Dept. of Insurance?
 - A. 15 days
 - B. 21 days
 - C. 30 days
 - D. 45 days
9. All of the following acts are misdemeanors EXCEPT
 - A. acting as an agent for a nonadmitted insurer in the transaction of insurance business in California
 - B. advertising a nonadmitted insurer in California
 - C. acting as an agent or broker for, or aiding an insurer without a certificate of authority in California
 - D. acting as a surplus lines broker for a nonadmitted insurer in the transaction of insurance business in California

10. George and Donna Smith are considering whether to purchase a town house from their real estate agent, Barbara White. She also works part-time for an insurance agency, so Barbara tells the Smiths she will pay their homeowners insurance for the first year if they agree to purchase the town house. Barbara
- A. may not offer free insurance under any circumstances
 - B. may offer free insurance as a way to sell more real estate
 - C. may offer only homeowners, but not personal automobile insurance
 - D. may not offer insurance coverage for more than 6 months

UNIT 2 ACTIVITY ANSWERS

Activity 2.A

Twisting	Making a misrepresentation to an insured person to induce that person to take out an insurance policy
Code of ethics	Increase the stature of insurance professionals to the public
Buyers guide	A publication that helps consumers compare different policies and reach an informed decision concerning the appropriateness of proposed coverage
Replacement	Exchanging an insured's current policy with a new policy
Conservation	An attempt by an existing insurer to dissuade a policy owner from replacing existing life insurance or an annuity
Fiduciary	A person who hold the funds of another in trust

U N I T 2 C A S E S T U D Y A N S W E R S

Case 1*Question*

John has a securities and insurance license. He tells his client that variable universal life is a good way to fund a retirement plan, especially because you can borrow cash value from the policy and you never have to pay it back.

Is there a legal or ethical problem with John's presentation?

Correct Responses

John could be guilty of misrepresentation, because he has inaccurately described the policy. With any variable product, the policy owner bears the investment risk, so variable products are a risky method for funding retirement.

John needs to explain that policy loans are available only to the extent that a policy has cash value, that interest is charged, and that the loan amount will ultimately be deducted from the proceeds at death.

John also needs to tell his client that premiums can fluctuate, there is no guaranteed rate of return, and the product does not have a guaranteed death benefit.

Case 2*Question*

Sheila has her real estate license and her insurance license. Whenever she sells a home, she provides six months of free homeowners insurance to the purchaser.

Is there a legal or ethical problem with Sheila's practice? If so, what might be the potential penalties?

Correct Responses

Offering free insurance is an illegal act in California and could be construed as an inducement to buy or rent any property or service (i.e., to purchase a home). The Commissioner may suspend or revoke Sheila's license for up to one year if she is guilty of willfully violating this rule.

The exceptions to this rule are:

- Insurance written in connection with newspaper subscriptions
- Insurance written in connection with purchase of shares in a credit union
- Insurance that guarantees performance of goods
- Title insurance or credit life or disability in connection with the loan
- Motor club insurance
- Incidental insurance when the cost is \$1 or less per year

Case 3*Question*

Ellen's client asks about the financial rating of the insurance company writing her term life insurance policy, as they were recently in the news because of impaired capital. Ellen tells her client not to worry because the insurer is a member of the California Life and Health Guarantee Association, which is like the FDIC for insurance policies.

Has Ellen done something illegal?

Correct Responses

It is an unfair trade practice to imply that by being a member of the California Life and Health Guarantee Association, an insurer is protected or insured in any way against insolvency.

The California Life and Health Guarantee Association (CLHGA) protects insureds from insurer insolvency; however, benefit amounts are subject to limits. The existence of the CLHGA cannot be used by insurers and their agents to imply that the insurer is protected against insolvency.

Case 4

Question

Carl moves to a new agency across town. He calls all his former clients and convinces them to replace their existing coverage with a new insurer, telling them the coverage they have is inferior and the carrier may be in financial trouble. He forgets to tell them that there will be new waiting periods, and that he will earn a new first-year commission. He recommends they do not bother reading the Notice Regarding Replacement, since the new coverage is clearly a better deal.

Are Carl's actions legal? Ethical? What are the potential penalties? How might that change if more than one of his clients is affected by his actions?

Correct Responses

Carl's actions are both illegal and unethical. It is an unfair practice to cause a policyholder to unnecessarily replace any policy. Replacement transactions should only occur when in the best interest of the policyholder.

Replacement policies may result in higher premiums, reduced benefits, may require the applicant to prove insurability, and may institute new waiting periods for incontestability, suicide exclusions, and preexisting conditions limitations. Also, newly placed life policies generally will not have any current cash values.

Implying that the current carrier may be in financial trouble is an illegal practice known as defamation.

Carl could be fined \$250 for the first violation; fines for subsequent violations are no less than \$1,000 to a maximum of \$25,000.

Case 5

Question

Kate takes an application for health insurance from Everett, who indicates he is in excellent health and does not pay the initial premium up front. One month later when Kate delivers the policy, Everett is clearly in poor health.

What are Kate's legal and ethical responsibilities?

Correct Responses

Kate's legal and ethical duties lie with the insurance company. She should send the policy back to the insurance company and explain to Everett why she cannot deliver the policy.

This is an excellent example of why an agent should always collect the initial premium with the application. When an applicant who has not paid the initial premium suffers a decline in health between the time of application and the time of policy delivery, the insurer has no contractual or legal obligation to honor the application and complete delivery of the policy.

Case 6

Question

Bob likes selling insurance but he does not like the paperwork that is required. On occasion, he neglects to keep detailed records of his transactions for his clients.

Is this unethical? Is it illegal? What kinds of problems could Bob encounter without complete and accurate records?

Correct Responses

Failing to maintain complete and accurate transaction records is both illegal and unethical. If Bob is unable to produce records upon request from the CDI, he will be subject to disciplinary action. Also, without accurate records, Bob is less able to defend himself if he is ever accused of wrongdoing or negligence regarding an insurance transaction.

Life agents must maintain records of all client and policy transactions at the principal place of business for at least 5 years. Records must be orderly and readily available for inspection or examination by the Commissioner at all times. If the Commissioner requests that an agent produce records, the agent must comply within 30 days.

UNIT 2 QUIZ ANSWERS

1. **D.** Evidence of a college degree is not included in the code of ethics of professional insurance organizations.
2. **B.** A person who holds the funds or property of another in trust is known as a fiduciary. Any person who appropriates fiduciary funds for personal use is guilty of theft.
3. **B.** Agents and brokers may not charge policy fees. Only an insurer can charge a fee.
4. **B.** Records must be maintained for at least 5 years after the expiration or cancellation date of the policy.
5. **B.** When making a sales presentation, agents are often required by law to provide a policy summary.
6. **D.** Twisting is an illegal high-pressure sales tactic.
7. **B.** Records must be kept for at least 2 years following actual policy delivery, or 2 years from the date of application if no policy was issued.
8. **C.** Any administrative actions or criminal convictions must be reported within 30 days of the final disposition of the matter.
9. **D.** Only surplus lines brokers may act as an agent for a nonadmitted insurer transacting insurance business in California.
10. **A.** Agents, brokers, or insurers may not offer insurance as an inducement to purchase or rent by the public any real or personal property or services without any separate charge for the insurance. Violators may have their license suspended or revoked for up to 1 year.

III. PRODUCER LICENSING

A. DEFINITIONS [CIC 31; 1621; 1749.02]

1. Agents, Brokers, and Solicitors

- a. **Insurance agent [CIC 31]** means a person authorized, by and on behalf of an insurer to transact all classes of insurance other than life, disability, or health insurance, on behalf of an admitted insurance company. (Note: A property/casualty broker-agent can no longer transact 24-hour care coverage. The California Insurance Code defines 24-hour coverage as “the joint issuance of a workers’ compensation policy with a disability policy, health care service plan or other medical insurance coverage for nonoccupational injuries and illnesses.”)
- b. **Life only [CIC 32; 1622; 1626]** entitles the licensee to transact insurance coverage on human lives, including endowments and annuities, and may include benefits in the event of death or dismemberment by accident and benefits for disability income.
- c. **Accident and Health [CIC 32, 1622, 1626]** entitles the licensee to transact insurance coverage for sickness, bodily injury, or accidental death, and may include benefits for disability income. An accident and health agent licensee also is authorized to transact 24-hour care coverage.
- d. **An insurance broker [CIC 33; 1623]** is a person who, for compensation and on behalf of another person, transacts insurance other than life, disability, or health with, but not on behalf of, an insurer. There is no license issued in California for a life broker or a health broker.
- e. **Life settlement broker [CIC 10113.1(b); 10113.29(b)(1)(B)]** means a person who, on behalf of an owner, and for a fee, commission, or other valuable consideration, offers or attempts to negotiate life settlement contracts between an owner and providers. A life settlement broker represents only the owner and owes a fiduciary duty to the owner to act according to the owner’s instructions, and in the best interest of the owner, notwithstanding the manner in which the broker is compensated.
 - A life insurance producer who has been licensed as a life agent (or a licensed nonresident producer) in this state for one year or longer may act as a life settlement broker by notifying the Commissioner and paying the life settlement broker license fee.
 - A life insurance producer who has not held life agent license for one year must first complete at least 15 hours of education on life settlement transactions and must complete an application and pay the life settlement broker license fee.
 - A licensee licensed to act as a viatical settlement broker or provider as of December 31, 2009 is considered to have met the requirements for licensure as a life settlement broker or provider.
- f. A life settlement broker license is not required for a licensed attorney, certified public accountant, or accredited financial planner who represents the policy owner and whose compensation is not paid directly or indirectly by the life settlement provider.

- g.** An **insurance solicitor** [CIC 34; 1624] is a natural person employed to aid an insurance agent or insurance broker in transacting insurance other than life, disability, or health insurance.
- h.** A **third-party administrator** is a firm that provides administrative services for employers and other associations having group insurance policies. The third-party administrator acts as a liaison between the insurer and the employer in matters such as certifying eligibility, preparing reports required by the state, and processing claims. The use of third-party administrators has become common as a result of employers self-funding health benefits.

Activity 3.A

Match the term in the left-hand column with the correct description in the right-hand column.

Insurance broker	A natural person employed to aid an insurance agent or broker in transacting insurance other than life insurance
Insurance solicitor	A person authorized, by and on behalf of an insurance company, to transact all classes of insurance other than life insurance
Life agent	Acts as a liaison between the insurer and the employer in matters such as certifying eligibility, preparing reports required by the state, and processing claims
Insurance agent	A person who, for compensation and on behalf of another person, transacts insurance other than life insurance with, but not on behalf of, an insurer
Third-party administrator	A person authorized, by and on behalf of a life, disability, or life and disability insurer, to transact life or disability insurance, or both

Answers can be found at the end of Unit 3.

B. LICENSING

- 1. Application Investigation [CIC 1666]** Upon filing an application for license, the Commissioner may make an investigation and may require the filing of supplementary documents, affidavits, and statements as may be necessary to obtain the full disclosure of information needed to determine whether the prerequisites for the license have been met. If the applicant shows to the satisfaction of the Commissioner that all prerequisites have been met, and if the applicant is otherwise eligible, the Commissioner may issue a permanent license.
- 2. Causes for Denial of Application [CIC 1668]** After providing an opportunity for a hearing, the Commissioner may deny an application for a license in any of the following cases:
 - The applicant is not properly qualified to perform the duties of a person holding the license applied for.
 - The granting of the license would be against the public interest.
 - The applicant does not intend actively and in good faith to conduct as a business with the general public the transactions which would be permitted by issuance of the license applied for.
 - The applicant is not of good business reputation.
 - The applicant is lacking in integrity.
 - The applicant has been refused a professional, occupational, or vocational license, or has had such a license suspended or revoked, for reasons that should preclude the granting of the license applied for.

- The applicant seeks the license for the purpose of avoiding or preventing the operation or enforcement of the insurance laws of this state.
- The applicant has knowingly or willfully made a misstatement in an application to the Commissioner for a license, or in a document filed in support of such application, or has made a false statement in testimony given under oath before the Commissioner or any other person authorized by the Commissioner.
- The applicant has previously engaged in a fraudulent practice or act, or has conducted any business in a dishonest manner.
- The applicant has shown incompetency or untrustworthiness in the conduct of any business, or has by commission of a wrongful act or practice in the course of any business exposed the public to the danger of loss.
- The applicant has knowingly misrepresented the terms or effect of an insurance policy or contract.
- The applicant has failed to perform a duty expressly imposed by a provision of the Code, or has committed an act expressly forbidden by the Code.
- The applicant has been convicted of a felony, or a misdemeanor denounced by any laws regulating insurance, or a public offense having as one of its necessary elements a fraudulent act or an act of dishonesty in acceptance, custody, or payment of money or property.
- The applicant has aided or abetted any person in an act or omission which would constitute grounds for suspension, revocation, or refusal of any license or certificate issued to such other person.
- The applicant has permitted any person in his employ to violate any provision of the Code.
- The applicant has violated any provision of law relating to conduct of business that could lawfully be done only under the authority conferred by the license applied for.
- The applicant has submitted to the Commissioner a false or fraudulent certificate regarding educational courses completed.

3. Denial of Application Without a Hearing [CIC 1669; 1738] The Commissioner may, without hearing, deny an application if the applicant has done one or more of the following:

- Been convicted of a felony
- Been convicted of a misdemeanor denounced by this code or by other laws regulating insurance
- A judgment, plea, or verdict of guilty or a conviction following a plea of nolo contendere is deemed to be a conviction
- Had a previous application for a professional, occupational, or vocational license denied for cause by any licensing authority, within five years of the date of the filing of the application
- Had a previously issued professional, occupational, or vocational license suspended or revoked for cause by any licensing authority, within five years of the date of the filing of the application

In the event the Commissioner issues an order based on a plea that does not at any time result in a judgment of conviction, the Commissioner shall vacate the order upon petition by the applicant.

The Commissioner may suspend or revoke any permanent license on the same grounds for which an application may be denied.

C. TRANSACTING WITHOUT A LICENSE [CIC 1631]

- 1. Acting Without a License [CIC 1631; 1633]** A person cannot transact business in any class of insurance in California without first being admitted to transact insurance as an agent for that class. Doing so is a misdemeanor and is punishable by:
 - imprisonment in state prison or county jail for up to one year;
 - fine of up to \$50,000; or
 - both imprisonment and fine.

- 2. Prelicensing Education Requirements [CIC 1749; 1749.01]** Prelicensing education is a prerequisite to obtaining a life-only agent, accident and health agent, or fire/casualty broker/agent license in California.
 - a.** Individuals must complete a minimum of:
 - 40 hours of prelicensing instruction in the area of fire/casualty for a fire/casualty broker-agent license;
 - 20 hours of prelicensing instruction in the area of life insurance for a life-only license; and
 - 20 hours of prelicensing instruction in the area of accident and health insurance for an accident and health license.

 - b.** In addition, all students must complete 12 hours of instruction on Ethics and the California Insurance Code. Individuals who are licensed in another state and have completed an equivalent 40-hour study course in that state are required to complete only a 12-hour course on the California Insurance Code and Ethics.

 - c.** Prelicensing certificates of completion expire three years from the completion date of the course, whether or not a license is issued.

 - d.** The prelicensing education requirement does not apply to life agents limited by contract to selling funeral and burial expense policies (or annuities) with face amounts of \$10,000 or less.

- 3. Continuing Education Requirements [CIC 1749.3]** Once licensed, agents are subject to continuing education (CE) requirements in order to renew their licenses.
 - a.** All agents, including life-only agents or accident and health agents also licensed as property and/or casualty broker-agents, must complete 24 hours of continuing education each two-year license renewal period.

 - b.** Three of those hours must be in Ethics.

 - c.** Failure to complete continuing education requirements results in license expiration.

 - d.** The individual experiences a break in licensure, and in order to reactivate the license must complete the CE requirement, pay late penalties and fees, and reestablish all endorsements and appointments.

4. Exemptions [CIC 1749.3(c)] Licensees do not need to complete continuing education requirements if they submit satisfactory proof to the Commissioner that their California license has been in good standing for 30 continuous years and are 70 years of age or older. This exemption does not apply to individuals licensed for the first time on or after January 1, 2010.

5. Long-Term Care Insurance [CIC 10234.93(a)(4)(A)]

a. Individuals authorized to sell long-term care (LTC) insurance must complete an eight-hour LTC course prior to soliciting individual consumers for the sale of LTC insurance.

1.) In addition, new licensed agents must complete eight hours of LTC training every year for the first four years that they are licensed.

2.) Beginning in the fifth year that they are licensed, licensees are required to complete just eight hours of LTC training every two-year license term.

Licensees must complete the initial training requirements prior to being authorized to solicit individual consumers for the sale of long-term care insurance.

b. The training must consist of required topics related to long-term care services and long-term care insurance, including, but not limited to:

- California regulations and requirements;
- available long-term care services and facilities;
- changes or improvements in services or facilities;
- alternatives to the purchase of private long-term care insurance;
- differences in eligibility for benefits and tax treatment between policies intended to be federally qualified and those not intended to be federally qualified;
- the effect of inflation in eroding the value of benefits;
- the importance of inflation protection; and
- NAIC consumer suitability standards and guidelines.

c. Completion of these topics may result in more than the minimum number of hours required to satisfy the continuing education requirements.

6. California Partnership for Long-Term Care is a program in which the State of California and the Department of Health Care Services work in cooperation with a select number of private insurance companies. Every agent writing California Partnership coverage must complete:

- eight hours of general long-term care continuing education;
- eight hours of classroom-only continuing education specifically on the California Partnership for Long-Term Care; and
- eight hours of classroom training on the partnership each two-year licensing period.

This educational requirement is in addition to the eight-hour training program for long-term care insurance.

For licensees issued a license after January 1, 1992, the Partnership education requirement must be met by completing four hours of such education in each licensure year.

7. Agent Appointment [CIC 1704-1704.5; 1705;] Licensees must be **appointed** by an insurer in order to transact insurance business on behalf of that insurer.

- The authority to transact insurance under an appointment by an insurer, agent, or broker becomes effective as of the date the notice of appointment is signed.
- Notice of appointment must be filed with the Commissioner within 15 days of appointment. Additional notices of appointment may be filed by other insurers as long as the license remains in force.

The fire and casualty broker/agent appointing an insurance solicitor must hold a permanent license to act as a fire and casualty broker/agent, or hold a certificate of convenience to act as a fire and casualty broker/agent.

8. Agent Notice of Termination [CIC 1704(a)(1)(b); 1707] Each notice of termination of an appointment must be filed with the Commissioner within 15 days of termination.

- a. Upon the termination of all appointments, or all endorsements naming the licensee on the license of an organization license, and cancellation of the bond required if acting as a broker, the permanent license shall not be canceled, but become **inactive**.
- b. It may be renewed or reactivated at any time before its expiration by the filing of a new appointment or new bond.
- c. An inactive license does not permit its holder to transact any insurance for which an active license is required.

9. Solicitation Before Life Agent Appointment [CIC 1704.5] Except as otherwise provided below, a licensed life agent may present a proposal for insurance to a prospective policyholder on behalf of a life insurer for which the life agent is not specifically appointed, and may also transmit an application for insurance to that insurer.

If a policy of insurance is issued in response to that application, the insurer is considered to have authorized the agent to act on its behalf, and the insurer is responsible for all actions of the agent that relate to the application and policy as if the agent had been duly appointed for the insurer.

Not more than 14 days after the life agent submits an application for insurance to the insurer for which the insurer issues a policy, the insurer must forward to the Commissioner a notice of appointment of the life agent as the insurer's agent. Nothing in this section obliges an insurer to accept an application for underwriting from a life agent.

Any payments made by the prospective policyholder prior to issuance of the policy shall be made only in the form of a draft, check, cashier's check, traveler's check, money order, or similar instrument made payable to the insurer to which the application is transmitted.

A licensed life agent who is not specifically appointed for a particular life insurer may not present a proposal to a prospective policyholder for insurance with that insurer, or transmit an application for insurance to that insurer, if the insurer requires all its life agents to represent only that insurer or a group of affiliated insurers of which that insurer is a member or to submit risks to that insurer or group of affiliated insurers prior to submitting them to other insurers.

10. Implied Declarations [CIC 1705] An insurer, or employing fire and casualty broker/agent, by filing a notice of appointment for an original license for an applicant, has declared that:

- the applicant is of good reputation; and
- the applicant is worthy of the license sought.

Should the applicant be a co-partnership, corporation, or association, the insurer shall be deemed to have made the above assumptions about the business organization and each person in the application who will exercise agency powers. When additional people are added to the license, the business organization is deemed to have made the appropriate declarations regarding the person.

11. Cancellation of License [CIC 1708; 1710; 1711; 1712.5; 1718] A licensee may at any time surrender any license under which he or she is permitted to act for cancellation. The licensee may make that surrender by written notice to the Commissioner. All licenses issued to natural persons shall automatically terminate upon the death of such person.

An organization ceases to exist as an entity eligible to hold a license:

- upon dissolution of a co-partnership or upon any change in membership of a co-partnership;
- upon termination of an association; or
- upon dissolution of a corporation.

The surviving or continuing co-partnership may continue to transact under the license issued provided:

- it files an application within 30 days for registering the change in membership;
- is signed by a general partner; pays the required fee;
- furnishes any required bond; and
- at least one person continues to exercise the agency or brokership powers of the surviving co-partnership.

The termination of the existence of the licensed entity automatically terminates its right to transact insurance, except that a natural person, co-partnership, association, or corporation may continue to transact insurance under an existing license in either a different capacity or as a different organization if a natural person is named to exercise the agency or brokerage powers, and remains eligible to be so named, provided no substantial change in ownership or control has taken place and within 30 days an application is filed and fees paid for an appropriate license.

The license of an organization licensed as a property broker-agent, casualty broker-agent, or life agent shall become inoperative upon the removal or termination of the last named natural person.

The license will not be renewed unless it is reactivated by the correction of all deficiencies, including, if necessary, adding of a natural person to transact insurance under the authority of the organization's license.

At least 60 days before a permanent license is due to expire, the Commissioner will mail an application to renew the license to the licensee.

The application to renew an expired license may be filed up to one year from the expiration date.

The fee will be the renewal fee plus a delinquent fee.

Grounds for Suspension/Revocation of an Agent or Broker License

- Issuing a binder from an insurer for whom the agent is not authorized to bind coverage
- Knowingly violating the law against twisting (up to three years)
- Misrepresenting a material fact regarding insurance coverage, or facts regarding rules of submission or rates, to any surplus lines broker
- Conspiring to procure nonadmitted insurance in violation of the law
- Violating the right to voluntary selection of insurance connected to sales and loans
- Subsequent violation of a cease and desist order, court order, or order to pay a penalty (up to one year)
- Violating long-term care insurance requirements
- For any of the same grounds for which a license application may be denied
- Willful violation of rules against offering free insurance as an inducement to purchase real or personal property or services

12. Agency Names [CIC 1724.5] Every individual and organization licensee, and every applicant for a license, must file in writing with the Commissioner the true name of the individual or organization, and also all fictitious names under which the licensee conducts or intends to conduct business. After licensing, any change in the names filed or discontinuance of any such name must also be filed with the Commissioner.

The Commissioner may disapprove in writing the use of any true name (other than the bona fide natural name of an individual) or any fictitious name by any licensee on any of the following grounds.

- The name is an interference with, or is too similar to, a name already filed and in use by another licensee.
- The use of the name may mislead the public in any respect.
- The name states, infers, or implies that the licensee is an insurer, motor club, hospital service plan, or is entitled to engage in insurance activities not permitted under the license.
- The name states or implies that the licensee is an underwriter (this does not prevent a natural person from using the designations Chartered Life Underwriter or Chartered Property and Casualty Underwriter when entitled thereto, nor does it prevent a producers' trade association whose members are separately licensed from using a name that includes the word underwriter).
- The licensee has already filed and has not discontinued the use of more than two names, including the true name (a licensee who lawfully purchases or acquires the business of another licensee may use up to two additional names that were used by the predecessors for each such business).

A licensee may not use a true or fictitious name after being notified by the Commissioner that the use is contrary to this section. If there are mitigating facts in connection with the use of a particular name, the Commissioner may permit continued use of the name for a reasonable time, if conditions are imposed that will adequately protect the public.

13. License Display [CIC 1725] Every license to act as a fire and casualty broker/agent must be prominently displayed in the licensee's office, in a manner whereby anyone may readily inspect it and determine both its current validity and the capacity in which the holder is authorized to act.

14. License Renewal Applications [CIC 1720] An application on the form prescribed by the Commissioner for the renewal of a license, filed on or before the last day of the period for which the previous license was issued, accompanied by the applicable renewal fee, shall entitle

the applicant to continue operating under the existing license for 60 days after its specified expiration date, or until notified by the Department that the renewal application is deficient, whichever comes first. This section shall not apply to any license that is suspended or revoked.

- 15. License Number on Documents [CIC 1725.5]** Every licensee must prominently affix, type, or cause to be printed on business cards, written price quotations for insurance products, and print advertisements distributed exclusively in this state: her license number in type the same size as any indicated telephone number, address, or fax number. If the licensee maintains more than one organization license, one of the organization license numbers is sufficient for compliance with this section.

In the case of producers who are classified for licensing purposes as solicitors working as an exclusive employee of a motor club, organizational licensee numbers shall be used.

Any person in violation of this section shall be subject to a fine in the amount of:

- \$200 for the first offense;
- \$500 for the second offense; and
- \$1,000 for the third and subsequent offenses.

The penalty shall not exceed \$1,000 for any one offense. These fines shall be deposited into the Insurance Fund. A separate penalty shall not be imposed upon each piece of printed material that fails to conform to the requirements of this section.

If the Commissioner finds that the failure of a licensee to comply with these provisions is due to reasonable cause or circumstance beyond the licensee's control, and occurred notwithstanding the exercise of ordinary care and in the absence of willful neglect, the licensee may be relieved of the penalty.

Any licensee seeking to be relieved of the penalty must file with the Department a statement with supporting documents setting forth the facts upon which the licensee bases its claims for relief.

This section does not apply to any person or entity that is not currently required to be licensed by the Department, nor does it apply to general advertisements of motor clubs that merely list insurance products as one of several services offered by the motor club, and do not provide any details of the insurance products.

- 16. Aiding a Nonadmitted Insurer [CIC 703]** The following acts are misdemeanors except when performed by surplus lines brokers:

- Acting as an agent for a nonadmitted insurer in the transaction of insurance business in California
- Advertising as a nonadmitted insurer in California
- Aiding a nonadmitted insurer in any other way to transact insurance in California
- Acting as an agent or broker for, or aiding an insurer without a certificate of authority in California

The penalty, in addition to any penalty for misdemeanors, for the above actions is a fine of up to \$500 plus \$100 for each month or portion of a month during which the violation continues.

- 17. Prohibited Persons in Insurance—Federal Violent Crime Control and Law Enforcement Act [18 USC Sect 1033, 1034]** This act prohibits anyone who has been convicted of a state or federal felony involving dishonesty or breach of trust from engaging in the insurance business without a consent waiver from the Commissioner.

- No statute of limitations

- Prohibits fraud, embezzlement, falsification of company records, or coercion in insurance transactions in interstate commerce
- Penalties range from \$5,000 to \$10,000, imprisonment from 10 to 15 years, or both fine and imprisonment

A person shall not act as an agent, broker, or solicitor unless he holds a valid license to so act from the Commissioner. Any person who acts, offers to act, or assumes to act in a capacity for which a license is required without holding a license is guilty of a misdemeanor.

U N I T 3 Q U I Z

1. A person authorized by and on behalf of an insurer to transact all classes of insurance other than life insurance is
 - A. an insurance agent
 - B. an insurance broker
 - C. a life and health agent
 - D. an insurance solicitor
2. Which of the following acts as a liaison between the insurer and the employer in matters such as certifying eligibility, preparing reports required by the state, and processing claims?
 - A. Third-party administrator
 - B. Managing general agent
 - C. Insurance broker
 - D. Solicitor
3. Including Code and Ethics, how many hours of precensing education are required in total to take the examination for a fire/casualty broker-agent license?
 - A. 12
 - B. 20
 - C. 40
 - D. 52
4. All of the following are correct regarding transacting business without a license EXCEPT
 - A. the fine is up to \$50,000
 - B. it is considered a misdemeanor
 - C. it is considered a felony
 - D. it may result in imprisonment for up to 1 year
5. Sarah is a newly licensed life and health agent who would like to be able to sell long-term care (LTC) insurance. What are the training requirements she must complete prior to soliciting individual consumers for long-term care insurance?
 - A. She must complete an 8-hour instructor-led course.
 - B. The requirement is a total of 16 hours, 8 of which must be in a classroom.
 - C. In addition to 8 hours of training specific to LTC insurance, she must also complete a 3-hour course on ethics.
 - D. Sarah must complete 8 hours of long-term care insurance training every year for the first 4 years she is licensed.
6. Within how many days of an agent appointment must the notice be filed with the Commissioner?
 - A. 15
 - B. 20
 - C. 30
 - D. 45
7. The Commissioner may deny an application for a license in all of the following cases EXCEPT
 - A. the applicant knowingly represented the terms or effect of an insurance policy
 - B. the applicant has knowingly made a misstatement on an application for a license
 - C. the applicant has shown competency and trustworthiness in the conduct of any business
 - D. the applicant has previously engaged in a fraudulent practice or act
8. When all appointments on a license have been terminated, the license is
 - A. repealed
 - B. revoked
 - C. canceled
 - D. inactive

9. If a licensed life agent presents a proposal to a prospective policyholder on behalf of a life insurer for which the life agent is not specifically appointed, how many days does the insurer have to forward the agent's application for appointment to the Commissioner?
- A. 10 days
 - B. 14 days
 - C. 15 days
 - D. 30 days
10. An organization ceases to exist as an entity eligible to hold a license upon
- A. termination of an association
 - B. moving to another state
 - C. the marriage of any natural person
 - D. reorganization of a corporation

UNIT 3 ACTIVITY ANSWERS

Activity 3.A

Insurance broker	A person who, for compensation and on behalf of another person, transacts insurance other than life insurance with, but not on behalf of, an insurer
Insurance solicitor	A natural person employed to aid an insurance agent or broker in transacting insurance other than life insurance
Life agent	A person authorized, by and on behalf of a life, disability, or life and disability insurer, to transact life or disability insurance, or both
Insurance agent	A person authorized, by and on behalf of an insurance company, to transact all classes of insurance other than life insurance
Third-party administrator	Acts as a liaison between the insurer and the employer in matters such as certifying eligibility, preparing reports required by the state, and processing claims

UNIT 3 QUIZ ANSWERS

1. **A.** An insurance agent is authorized to transact all classes of insurance by an insurer other than life, health, or disability insurance.
2. **A.** A third-party administrator is a firm that provides administrative services for employers and other associations that have group insurance policies.
3. **D.** Individuals must complete 40 hours of prelicensing education in the area of fire/casualty and an additional 12 hours of instructions on ethics and the California Insurance Code.
4. **C.** Transacting business without a license is considered a misdemeanor, not a felony.
5. **D.** A newly licensed agent is required to complete eight hours of LTC training every year for the first 4 years they are licensed. Beginning in the fifth year, licensees are required to complete just 8 hours of LTC training every 2-year licensing term.
6. **A.** The notice stating a licensee is appointed to transact insurance business on behalf of an insurer must be filed within 15 days of the appointment.
7. **C.** The applicant has shown incompetency or untrustworthiness in the conduct of any business, or has by commission of a wrongful act or practice in the course of any business exposed the public to the danger of loss.
8. **D.** A permanent license is not canceled; it becomes inactive. An inactive license does not permit its holder to transact any insurance for which an active license is required.
9. **B.** The insurer must submit the notice of appointment to the Commissioner not more than 14 days after the life agent submits it to the insurer.
10. **A.** An organization ceases to exist as an entity eligible to hold a license upon termination of an association, dissolution of a corporation, dissolution of a co-partnership, or upon any change in membership of a co-partnership.

R E V I E W T E S T

1. In California, any insurer organized under the laws of Canada is classified as
 - A. an alien insurer
 - B. a nonadmitted insurer
 - C. a foreign insurer
 - D. an admitted foreign insurer
2. Which of the following is an example of fraud?
 - A. Insuring risks that are more prone to losses than the average risk
 - B. Possessing a license solely for the purpose of writing insurance on one's self, family, employer, and employees
 - C. Intentionally telling a lie to obtain coverage
 - D. Intentionally telling a lie that is immaterial to the acceptance of the risk
3. Concealment is
 - A. a material stipulation in the contract
 - B. a failure to communicate information
 - C. a false statement on the application
 - D. ambiguity found in the application
4. The office of Insurance Commissioner in California is
 - A. appointed by the governor with senate approval
 - B. elected
 - C. appointed by the governor
 - D. appointed by the legislature
5. John Doe, who happens to have a CLU designation, wishes to use his name and designation. What must John do?
 - A. Nothing; since he has a CLU designation, no approval is needed
 - B. Start operating under a fictitious name until he gets the Commissioner's approval
 - C. Petition the National Association of Insurance Commissioners
 - D. Obtain approval from the Commissioner before using his name and designation
6. When an agent promptly forwards the client's premium to the insurer, the agent is acting in what capacity?
 - A. Binding
 - B. Utmost good faith
 - C. Fiduciary
 - D. Field underwriter
7. Which of the following is not a criterion in determining an unfair trade practice based on discrimination in the business of life or disability insurance?
 - A. Sex
 - B. Race
 - C. Education
 - D. Age
8. Transacting insurance includes all of the following EXCEPT
 - A. transaction of matters subsequent to policy execution
 - B. applying for a certificate of authority
 - C. solicitation of insurance
 - D. negotiations preliminary to policy execution
9. If you change your address, the Insurance Code requires you to notify the Department of Insurance (DOI)
 - A. with your next correspondence to the department
 - B. within 60 days of moving
 - C. immediately in writing
 - D. at least 90 days before license renewal
10. If an insurance company is in an impaired financial condition, the Commissioner may file an application for an order to take control of its affairs for the purpose of improving its condition. This action is known as
 - A. replacement
 - B. conservation
 - C. liquidation
 - D. rehabilitation

11. Which of the following is NOT prohibited by the Unfair Practices Act?
- A. Using a person's sexual orientation to rate a policy
 - B. Charging a different rate for males and females on the basis of the mortality table
 - C. Imposing discriminatory rates on a blind applicant
 - D. Imposing discriminatory rates on a blind applicant and using a person's sexual orientation to rate a policy
12. According to the California Insurance Code, a license must be renewed "before or on the last day it expires for the period for which the license was issued." If a license renewal is found to be deficient, the license is extended for
- A. 30 days
 - B. 60 days
 - C. 90 days
 - D. 120 days
13. If an act or practice appears to be unfair or deceptive, but there is no specific California citation prohibiting it, the Commissioner
- A. must seek arbitration through the Attorney General's office
 - B. may immediately issue an enjoin and restrain order
 - C. cannot take action without a specific Code citation
 - D. may call for a hearing into the matter
14. Upon termination of all of an agent's appointments as agent, that agent's license
- A. expires
 - B. becomes inactive
 - C. is automatically suspended
 - D. will terminate in 30 days
15. A person cannot transact any class of insurance in California without first
- A. successfully passing an oral examination
 - B. obtaining a surplus lines license
 - C. obtaining a certificate of insurance
 - D. being admitted for that class
16. John and Mary Smith want to purchase a home from a licensed life agent. To sell his home, the agent offers the buyers a free life policy. The agent
- A. must give notice to the Commissioner that free insurance is part of the transaction
 - B. may not offer free insurance under any circumstances
 - C. must obtain the permission of the Secretary of State
 - D. may offer free insurance as an inducement to complete the transaction
17. How many hours of continuing education must a producer complete in each license renewal period?
- A. 4 hours
 - B. 24 hours
 - C. 25 hours
 - D. 50 hours (25 per year)
18. If a licensed life agent gives a proposal to a prospective client on behalf of a life insurer without first being appointed by that insurer, how many days does the insurer have to submit the notice of appointment for that agent?
- A. Immediately
 - B. 14 days
 - C. 30 days
 - D. None; they cannot appoint agents after the fact
19. The Insurance Code is composed of provisions allowing all of the following EXCEPT
- A. enabling the Commissioner to make necessary changes in the Code
 - B. preventing insurer insolvency and fraud
 - C. insuring that policies are reasonably priced and widely available
 - D. providing the general powers given to the state over insurance agents
20. A mutual insurer would be referred to as which type of company?
- A. Participating
 - B. Foreign
 - C. Domestic
 - D. Alien

21. If an agent moves from San Francisco to San Diego, the agent must notify the DOI
- A. as soon as possible
 - B. within 90 days
 - C. within 30 days
 - D. immediately
22. All insurance companies are required to have a special division dedicated to the prevention and detection of fraud. This division is known as the
- A. Special Investigative Unit
 - B. Fraud Investigation Unit
 - C. Fraud Prevention Unit
 - D. Market Regulation Unit
23. Insurers who have reason to believe a claim is fraudulent must
- A. prosecute the individual to the full extent of the law
 - B. notify local law enforcement personnel
 - C. notify the Insurance Department Fraud Bureau
 - D. deny the claim
24. When an agent handles funds in a trust capacity, the agent is acting in
- A. an agency capacity
 - B. a fiduciary capacity
 - C. a trusted capacity
 - D. an insurer's capacity
25. Agents who sell California LTC Partnership coverage are required to complete additional training. Which of the following statements is TRUE?
- A. Continuing education for life, health, property and casualty agents is required annually.
 - B. Agents must complete four hours of annual education on the subject of the California Partnership Program.
 - C. Agents that fail to complete continuing education requirements will have licenses revoked.
 - D. An agent that sells long-term care insurance is not required to take additional training beyond the continuing education requirements.
26. Transacting insurance includes all of the following EXCEPT
- A. execution of no contract
 - B. execution of a contract
 - C. solicitation of insurance
 - D. negotiations preliminary to execution
27. An insurer must file an agent notice of appointment with the Commissioner within
- A. 10 days
 - B. 15 days
 - C. 21 days
 - D. 30 days
28. Which of the following statements is CORRECT regarding pretext interviews?
- A. They are permitted when soliciting the purchase of insurance.
 - B. They are commonly used for underwriting purposes.
 - C. They are always illegal.
 - D. They are permitted only when an insurer is investigating fraud or material misrepresentation.
29. The Insurance Commissioner may deny a license application without a hearing for which of the following offenses?
- A. The applicant is not qualified to perform the duties of the license applied for.
 - B. The applicant is lacking in integrity.
 - C. Any felony committed in the last 5 years.
 - D. Any misdemeanor committed in the last 5 years.
30. When receiving funds in a fiduciary capacity, an agent is required to
- A. remit those funds promptly to the person(s) entitled to them
 - B. deposit funds into their personal checking account
 - C. deposit funds into a whole life policy
 - D. cash the client's check to make sure it is good before sending the money to the insurer

31. What is the name of the process by which a mutual insurer becomes a stock insurer?
- A. Initial public offering of common stock
 - B. Demutualization
 - C. Notice of appointment
 - D. Mutualization
32. Which of the following names used to transact insurance would most likely be approved by the Commissioner?
- A. Joan Smith, CLU
 - B. John Doe Insurance Co.
 - C. None of these
 - D. Ann Howe Underwriter
33. In insurance, an insolvent insurer is one that
- A. has filed for bankruptcy protection under chapter 11 of the U.S. bankruptcy laws
 - B. has undergone liquidation proceedings directed by the DOI
 - C. is a defendant in a class action suit and may be forced to settle such actions brought forth by such suits
 - D. cannot meet its financial obligations or has an impairment of paid-in capital in all classes of insurance it sells
34. Which of the following would NOT be a primary objective of insurance regulation?
- A. Providing consumer education
 - B. Adopting emergency regulations when necessary
 - C. Ensuring that all rates are fair and nondiscriminating
 - D. Interpreting policy provisions
35. The penalty for an unfair claims settlement practice is
- A. \$10,000 to \$20,000 per violation
 - B. up to \$10,000 and/or 1 year in county jail
 - C. \$1000 to \$5,000 per violation
 - D. \$5,000 per act and \$10,000 if the act is willful
36. When receiving funds in a trust capacity, an agent must
- A. deposit the funds in a bank trust account
 - B. remit those funds to the party entitled to these funds
 - C. deposit the funds in a bank trust account backed by U.S. government treasuries
 - D. all of these
37. Which of the following would need to be disclosed on internet advertising?
- A. All of these
 - B. Principal place of business
 - C. State of domicile
 - D. Name of the agent as it appears on the license
38. Life agents must maintain records of client transactions for a minimum of
- A. 2 years
 - B. 5 years
 - C. 6 years
 - D. 10 years
39. When the insurance department makes a written request to an insurer to produce records, how much time does the insurer have to respond?
- A. Immediately
 - B. 15 days
 - C. 30 days
 - D. 45 days
40. An admitted insurer must have which of the following before transacting insurance in the state?
- A. A producer's certificate
 - B. A certificate of authority
 - C. A surplus lines broker's license
 - D. Certificate of transaction
41. An agent pleads nolo contendere (no contest) in a judicial proceeding. The agent will be guilty in the eyes of the
- A. Insurance Commissioner
 - B. general agent
 - C. court
 - D. NAIC

42. Acting for a nonadmitted insurer in California is
- A. prohibited, unless you are an insurance agent
 - B. permitted for insurance brokers and surplus lines brokers
 - C. permitted for insurance brokers
 - D. permitted for surplus lines brokers
43. According to the Violent Crime and Prohibited Persons in Insurance Act, prohibited persons have a statute of limitation of
- A. 3 years for a state insurance felony
 - B. 7 years for an insurance felony
 - C. 7 years for an insurance felony and 3 years for a state insurance felony
 - D. there is no statute of limitations under the act
44. If an agent has not kept any records required by the Commissioner, the Commissioner may require them to establish records within how many days?
- A. 10
 - B. 30
 - C. 60
 - D. 90
45. An insurer chartered under the laws of New York and headquartered in Chicago would be considered which type of insurer in California?
- A. Alien
 - B. Foreign
 - C. Admitted
 - D. Domestic
46. Pam is buying a new home. Sue, the escrow agent, suggests that Pam has a better chance of qualifying for a reduced rate mortgage if she purchases mortgage cancellation life insurance through an affiliate. The escrow agent gives Pam the agent's card. Has Sue done anything wrong?
- A. Yes, Sue is transacting insurance without a license.
 - B. Yes; however, Sue has violated a real estate rule, not an insurance rule.
 - C. Yes, she has violated California Insurance Code 700 prohibiting tying an insurance transaction to a loan.
 - D. No. Since the passage of Gramm-Leach-Bliley, it is fine for banks and insurance companies to share information.
47. A licensee may surrender his license in which of the following ways?
- A. If the license is held by the insurer or the employer, it may be surrendered by written notice to the DOI.
 - B. All of these.
 - C. A licensee may mail the license to the DOI.
 - D. If it is a corporate license and the corporation dissolves, the partnership may continue to operate provided a new application is filed within 30 days.
48. What is the penalty for unfair discrimination?
- A. \$1,000 to \$5,000 plus court costs
 - B. \$1,000 to \$10,000 plus court costs
 - C. \$5,000 to \$10,000
 - D. \$5,000 to \$10,000 plus court costs
49. Acting without a producer license is
- A. fraud and punishable by a \$25,000 and/or 6 months in jail
 - B. a misdemeanor and punishable by a \$50,000 fine and/or 1 year in jail
 - C. none of these
 - D. a felony and punishable by a \$50,000 fine
50. An insured who signs a fraudulent claim form
- A. will suffer a premium increase
 - B. all of these
 - C. is guilty of perjury
 - D. will become uninsurable

R E V I E W T E S T A N S W E R S

1. **A.** In California, any insurer organized under the laws of Canada is classified as an alien insurer.
2. **C.** Intentionally telling a lie to obtain coverage is fraud.
3. **B.** Concealment is a failure to communicate information.
4. **B.** The office of California Commissioner of Insurance is elected.
5. **D.** John Doe must obtain approval from the California Commissioner of Insurance before using his name and designation.
6. **C.** When an agent promptly forwards the client's premium to the insurer, the agent is acting in his capacity as a fiduciary.
7. **C.** Education is not a criterion in determining an unfair trade practice based on discrimination in the business of life or disability insurance.
8. **B.** Applying for a certificate of authority is not considered transacting insurance.
9. **C.** A change of address must be reported to the Department of Insurance immediately and in writing.
10. **B.** When the Commissioner takes control of an impaired insurer's affairs in order to improve its financial condition, it is known as conservation.
11. **B.** Charging a different rate for males and females on the basis of the mortality table is not prohibited by the Unfair Practices Act.
12. **B.** If a license renewal is found to be deficient, the license is extended for 60 days.
13. **D.** When the Commissioner believes an act which is not specifically defined by the Code may be an unfair or deceptive act or practice, he or she may call a hearing to determine whether the act, or practice should be declared to be unfair or deceptive.
14. **B.** Upon the termination of all appointments, a producer's license becomes inactive
15. **D.** A person cannot transact any class of insurance in California without first being admitted for that class.
16. **B.** An agent may not offer free insurance under any circumstances.
17. **B.** Producers must complete 24 hours of continuing education in each license renewal period.
18. **B.** The insurer has 14 days to submit the notice of appointment for that agent.
19. **A.** The Insurance Code does not contain provisions enabling the Commissioner to make necessary changes in the Code.
20. **A.** Mutual companies are sometimes referred to as participating companies because the policyowners participate in dividends
21. **D.** Licensees must immediately notify the Commissioner in writing of any change in residence address, principal business address, and mailing address
22. **A.** The division is known as the Special Investigation Unit.
23. **C.** Insurers who have reason to believe a claim is fraudulent must notify the Insurance Department Fraud Bureau.

24. **B.** A fiduciary is a person or organization holding the funds or property of another in trust.
25. **B.** An agent who sells long-term care insurance must have eight hours of specific training in that area. If the agent wishes to sell California LTC Partnership coverage, an additional four hours of annual education is required.
26. **A.** Execution of no contract is not transacting insurance.
27. **B.** An agency notice of appointment must be filed by the insurer with the Commissioner within 15 days of the appointment.
28. **D.** Pretext interviews are illegal except when an insurer is investigating fraud or material misrepresentation.
29. **C.** The Commissioner may deny a license application without first holding a hearing if the applicant was convicted of a felony within the prior 5 years.
30. **A.** When receiving funds in a fiduciary capacity, an agent is required to remit those funds promptly to the person(s) entitled to them.
31. **B.** The process by which a mutual insurer becomes a stock insurer is called *demutualization*.
32. **A.** A natural person may use the CLU designation in the agency name.
33. **D.** An insolvent insurer is one that cannot meet its financial obligations or has an impairment of paid-in capital in all classes of insurance it sells.
34. **D.** Interpreting policy provisions is not a primary objective of insurance regulations.
35. **D.** The penalty for an unfair claims settlement practice is \$5,000 per act and \$10,000 if the act is willful.
36. **B.** If fiduciary funds are received by a licensee, the licensee must remit the premiums and return premiums, less commissions, received or held to the insurer or person entitled to them.
37. **A.** All of that information must be displayed when a person is advertising on the internet.
38. **B.** Life agents must maintain records of client transactions for a minimum of 5 years.
39. **D.** When the insurance department makes a written request to an insurer to produce records, the insurer has 30 days to respond.
40. **B.** An admitted insurer must have a certificate of authority before transacting insurance in the state of California.
41. **C.** The agent will be guilty in the eyes of the court.
42. **D.** Acting for a nonadmitted insurance company is permitted for surplus lines brokers.
43. **D.** The Violent Crime and Prohibited Persons in Insurance Act does not have a statute of limitations.
44. **C.** If the agent has not kept the required records, the Commissioner may order the agent to establish the records within 60 days; failure to comply is grounds for license suspension or revocation.
45. **B.** An insurance company headquartered in another state is a foreign company.
46. **C.** Yes, she has violated the Code that prohibits tying an insurance transaction to a loan.
47. **B.** A licensee may surrender his license all of the listed ways.
48. **A.** The penalty for unfair discrimination is \$1,000 to \$5,000 plus court costs.

49. **B.** Acting without a producer license is a misdemeanor and punishable by a \$50,000 fine and/or 1 year in jail.
50. **C.** An insured who signs a fraudulent claim form is guilty of perjury.