

# Producers' Legal and Ethical Responsibilities

## 4 ASSIGNMENT

The major legal and ethical responsibilities of insurance producers fall into three categories. First, producers have a responsibility to obey the laws and regulations that govern their business activities. Failure to meet this legal responsibility may cause loss of license and other penalties. The first part of this assignment deals with regulation of insurance on the federal and state levels. The laws and regulations pertaining to insurance provide minimum standards of acceptable behavior with which agency personnel should comply. (Note that in this assignment the terms “producer,” “agent,” and “broker” all represent a seller of insurance to a customer on an insurer’s behalf. Depending on various legal and contractual factors present in the relationship, the specific terms may be used interchangeably. Unless otherwise noted, this assignment uses the term “producer” to describe sellers.)

Second, producers have a responsibility to avoid errors and omissions (E&O) that could cause a loss to the customers or insurers they represent. After examining a sample of the types of errors and omissions losses that can occur, this assignment explores ways to control E&O loss exposures and examines E&O insurance—an essential coverage for agencies.

Third, producers have a responsibility to behave ethically, according to a standard of conduct higher than mere adherence to the law and avoidance of errors and omissions. Codes of ethics specify minimum ethical behavior standards for insurance practitioners who subscribe to them. The codes of ethics discussed in this assignment also provide an established set of behavior standards that individuals not bound by the codes may use as a guide.

Professionalism goes beyond adopting a set of behavior standards. The final section of this assignment describes the nature of professionalism and the characteristics of a professional.

## INSURANCE REGULATION

Unlike regulation of other interstate businesses, regulation of insurance rests with the states rather than the federal government. This is largely the result of the McCarran-Ferguson Act (Public Law 15), a federal law passed in 1945.<sup>1</sup> In passing the act, the United States Congress expressed the

belief that continued state regulation of insurance was in the public interest. Therefore, no act of Congress is to be “construed to invalidate, impair, and supersede any law enacted by any state for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such businesses.”<sup>2</sup> Federal laws apply to insurance only to the extent that state regulations do not apply.

## **Federal Regulations Affecting Insurance Producers**

No federal legislation enacted since 1945 has attempted to specifically regulate the relationship between policyholders and privately owned insurers (including the Gramm-Leach-Bliley Act of 1999, which reaffirmed the McCarran-Ferguson Act). Nevertheless, many federal regulations of several federal agencies affect the daily activities of insurance producers.

### **Securities and Exchange Commission (SEC)**

The Securities and Exchange Commission (SEC) is a federal regulatory agency for the securities industry whose responsibility is to protect investors and maintain the integrity of the securities markets. Because of an exception in the securities laws, the SEC does not have regulatory authority over the sale of most life insurance. However, the Supreme Court has ruled, for regulatory purposes, that variable life insurance and variable annuities are “securities” rather than insurance policies. To sell these products legally, a producer must hold a federal securities license and abide by federal regulations. Property-casualty insurance does not have any investment features that would subject it to federal securities laws.

### **Federal Emergency Management Agency (FEMA)**

The purpose of the Federal Emergency Management Agency (FEMA), a part of the Department of Homeland Security’s Emergency Preparedness and Response Directorate, is to prepare the nation for all hazards that can potentially cause major loss of life and of property and to effectively manage federal response and recovery efforts after any national incident. FEMA also initiates mitigation activities, trains first responders, and manages the National Flood Insurance Program (NFIP) and the U.S. Fire Administration. In administering the NFIP, FEMA sets the insurance rates, coverage limits, and eligibility requirements for flood insurance. Any licensed producer may place insurance through the NFIP, either directly or indirectly, using private insurers as servicing companies.

### **Department of Transportation (DOT)**

The Department of Transportation (DOT) is a federal department established to ensure a fast, safe, efficient, accessible, and convenient transportation system in the U.S. The department does not regulate insurance producers. However, DOT regulations affect insurance because they specify limits of



insurance that commercial truckers must carry in different cargo and usage circumstances. The Motor Carrier Act of 1980 substantially increased the effect of these regulations on insurance sales. A producer who insures commercial vehicles must be aware of applicable DOT regulations and provide a trucker with all prescribed insurance.

### Fair Credit Reporting Act

The Fair Credit Reporting Act of 1970 is a federal law enforced by the Federal Trade Commission. The law's purpose is to protect consumers from the disclosure of inaccurate and arbitrary personal information held by consumer reporting agencies and to establish procedures for reporting and correcting credit record mistakes.<sup>3</sup> The act requires an insurer to inform an insurance applicant in advance if it intends to order various consumer reports. In addition to credit and claim history, these reports may also contain information about an applicant's lifestyle, habits, personal character, and reputation. When an insurer acts based on information contained in these reports, the applicant has the right to ask the insurer which company provided the information. The consumer reporting company must then inform the applicant of its findings. The applicant can challenge the information. The applicant's version of the information must be added to the file by the reporting company and given to those who inquire about that individual.

Because insurance agencies and brokerages submit insurance applications, the producer may be responsible for providing appropriate notice to the applicant that various consumer reports may be obtained as part of the application process. Most insurance applications contain written disclosure notices and require the applicant to acknowledge the notice.

#### **E&O Alert!**

Although insurance producers are subject to federal laws regarding consumer information, some states have their own fair credit reporting acts with more stringent disclosure requirements than the federal law. Producers must comply not only with federal law but also with state laws. Some consumer reporting companies have developed training courses for producers that detail consumer protection requirements imposed by state law and the Fair Credit Reporting Act.

### Gramm-Leach-Bliley Act

The Financial Services Modernization Act of 1999, also called the Gramm-Leach-Bliley Act, is a federal law that promotes affiliation and diversification in the nation's financial banks, insurers, and brokerages and protects consumers' personal financial information held by financial institutions.<sup>4</sup> The act allows banks, insurance agencies, and brokerages to have ownership interest in one another, a right that did not exist previously in all states. Additionally,

