Insurance Regulation

Chapter Objectives

- Learn the duties of the Insurance Department
- Understand the different types of insurance companies
- Understand the licensing of agents and adjusters and their authority
- Study license revocation and suspension
- Know the unfair trade and claim settlement practice laws
- Review the state and federal insurance plans
- Understand the Terrorism Risk Insurance Act
- Review the Fair Credit Reporting Act

Introduction

This section deals with the regulation of the insurance industry. This course includes a state specific law section that contains important information regarding specific laws and regulations for your state. The information in this section is generic but is normally applicable in all states.

I. The State Insurance Department

Regulation of Insurance

The responsibility to regulate the insurance industry is shared jointly by the federal government and state government. The authority, granted to state government, was granted through the passage of Public Law 15, also known as the McCarren-Ferguson Act. This law was passed by Congress in 1945 declaring that the regulation of insurance companies should remain with the individual states. The McCarren-Ferguson Act however, reserved for the federal government, the authority to regulate insurance in areas such as fair labor standards and anti-trust matters. All other insurance regulation is reserved to the states. As such, the state carries the major burden of regulating insurance affairs, including the ethical conduct of adjusters, agents, producers and anyone licensed to conduct business within its borders.

The Insurance Commissioner, Director or Superintendent

The main role of the Insurance Commissioner, Director or Superintendent and the Insurance Department is the enforcement of state laws and regulations which are intended to promote the welfare of the general public and protect the public’s interest. This is done by:

- Monitoring the financial solvency of insurance companies;
- Monitoring the conduct of individual insurance agents;
- Reviewing and approving rates, policies and forms; and
- Assuring the public of insurance availability.
Remember, the Insurance Commissioner, Director or Superintendent does not write insurance laws. He or she is in charge of enforcing those insurance laws.

**Rates**

Insurers’ rates are filed with the states based on loss ratios of the various classes of risks. Many components are involved with rate filing. Rates are supposed to be competitive and affordable to the general public. Loss costs are based on combined loss and expense ratios. These two factors represent the most important components of an insurance rate.

Some states permit “file and use” rates which means the insurer can file rates and begin using them immediately. However, the insurance department can review those rates (usually within 30-60 days) and reject them if deemed inappropriate. In this case, the insurer would have to file new rates.

The oldest form of rating is known as “judgment rating.” Using this method, the premium is determined by considering the individual risk. No books or tables are used with judgment rating; premiums are established through careful judgment.

**Cease and Desist Orders**

All states have enacted laws that provide the Insurance Commissioner with powers to conduct hearings in regard to possible unlawful acts in the performance of agents, adjusters, and companies. Following a hearing, the Insurance Commissioner may issue a cease and desist order demanding that the offender immediately refrains from committing the offenses. The Commissioner may suspend, revoke or fine the offender depending on the nature of the offense and/or if the act was intentional. The fines and penalties for violating a cease and desist order vary from state to state.

**II. Insurance Companies**

**Types of Insurance Companies**

The Insurance Department regulates and enforces the criteria under which an insurance company can do business in an individual state. A company approved to do business in a given state is known as an “admitted” company, and is considered to be “authorized.”

Conversely, a “nonadmitted” company is said to be “unauthorized” and cannot conduct business in that state.

Once an insurer is approved it is issued a “certificate of authority” to operate in the state. The insurer may then file rates and forms with the Insurance Department and begin the process of appointing agents or marketing products through other means.
Sometimes a company may operate in a state and not be considered an admitted company. These companies are known as **surplus lines companies** and market their products through **surplus lines agents**. Surplus lines companies write coverage on types of risks that other insurers will not write. Surplus lines agents collect a premium tax on all business written through surplus lines companies which is remitted to the state. Surplus lines companies do not file rates and forms and **do not participate in the state guaranty funds** that pay covered losses of insolvent insurers. Lloyds of London is an example of a surplus lines insurer.

### Classification of Insurance Companies

Insurance companies are classified as follows:

- **Domestic Insurer** - An insurance company formed and domiciled under the laws of a particular state.
- **Foreign Insurer** - An insurance company formed under the laws of the United States or a particular state of the United States.
- **Alien Insurer** - An insurance company formed under the laws of a country other than the United States, its districts, territories, commonwealths, possessions and the Panama Canal Zone. Examples of such companies are Canada Life and Manufacturers Life.

In addition to being classified by their location (domestic, foreign, alien) insurance companies are also classified by their form of ownership and mode of operation:

- **Stock Company** - An incorporated insurance company with its capital divided into shares. Stock companies are **owned by their stockholders**.
- **Mutual Company** - An incorporated insurance company without permanent stock. Mutual companies are **owned by their policyholders**.

### Other Types of Insurance Companies

**Reciprocal Insurance Exchange** – Reciprocal insurance exchanges are associations that agree to share risk equally among its members. Lloyds of London is an example of a reciprocal. It consists of members, represented by underwriters, who place the risk among its members. In case of a loss, the amount paid is shared by the participating members who accepted the risk.

**Fraternal Benefit Society** – An incorporated society or order, without capital stock, that is operated on the lodge system and conducted solely for the benefit of its members and their beneficiaries, and not for profit. Fraternals offer insurance that is available only to their members. Most fraternals write only life and health insurance.

**Risk Retention and Purchasing Groups** – In 1981, Congress passed the Liability Risk Retention Act to give product manufacturers more options when insuring against product liability. To facilitate this process, the Act allowed product manufacturers to establish group
self-insurance programs or group captive insurance companies, called risk retention groups, to
protect them against product liability exposures and to purchase liability insurance on a group
basis through purchasing groups. They are prohibited from writing workers compensation and
personal lines insurance and are exempt from participating in the state guaranty fund.

Private and Government Insurers - Insurance companies may be privately owned or
operated by the state or federal government. The government sometimes steps in to provide
insurance that is not ordinarily available from private insurers. This type of insurance is
sometimes called residual market insurance. The federal government provides:

- War risk insurance
- Nuclear energy liability insurance
- Federal flood insurance
- Federal crop insurance
- Federal crime insurance

At the state level, the government is involved in providing unemployment insurance and
may provide workers compensation benefits through state funds.

Self-Insurance

Some companies and individuals choose to self-insure. With this option, part or all of the risk
of loss is borne without the benefit of insurance coverage to fall back on if a loss occurs. Some
large companies are self-insured because they have the resources to withstand losses and their
claims experience demonstrates that it is cheaper to be self-insured rather than pay for
insurance coverage.

Insurance Marketing Systems

There are four basic distribution systems used to market insurance:

- Exclusive agency system
- Direct writer system
- Direct response system
- Independent agency system

With an exclusive agency system, the insurance company contracts with agencies, which are
independent businesses, to represent and sell insurance only for that insurance company.

With the direct writer system, the insurance company’s agents are actually employees. They
may receive a salary, be paid a commission, or a combination of both.

With the direct response system, there are no agents. These companies sell through direct
mail or over the phone.
With the *independent agency system*, agencies that are independent contractors contract with several different companies to represent and sell for those companies. An agent who represents more than one company is known as an independent agent.

**Company Ratings**

There are several organizations that rate the financial strength of insurance companies, based on an analysis of a company’s claims experience, investment performance, management, and other factors. These organizations include A.M. Best, Standard & Poor’s, and Moody’s. These ratings are one of the most widely used indicators of financial health (or lack thereof) in the insurance industry.

The approach taken by A.M. Best illustrates one approach to evaluating companies. Best uses nine alphabetical ratings for insurers to which it gives an assigned rating, and uses other designations to evaluate financial health, which are as follows:

- A++, A+ Superior – strongest position
- A, A- Excellent
- B++, B+ Very good
- B, B- Good
- C++, C+ Fair
- C, C- Marginal
- D Below minimum standards
- E Under state supervision
- F In liquidation

### III. Licensing of Insurance Agents and Adjusters

#### General Requirements for Licensing

1. Most states require the applicant be at least 18 years of age.
2. Must be a resident of the state (special provisions apply to non-residents).
3. Must satisfy the Insurance Commissioner that the applicant is trustworthy.
4. The individual must not have committed a felony nor had his or her license revoked in another state.
5. Must satisfy the requirements for obtaining a license.

#### Law of Agency

Insurance agents are granted powers by the insurance company to bind or accept risks on behalf of the insurer. Agents are to act within the limitations specified in the contract between the agent and the insurance company. These are sometimes referred to as *agent authority*. There are three types of authority:
Express Authority – The authority specifically given to the agent either in writing or orally.

Implied Authority – This allows the agent to perform all the usual tasks required to sell and service the insurance contracts and to exercise the agent’s express authority.

Apparent Authority – This is a doctrine that assumes that the agent has the authority that a normal prudent person would think or be led to believe the agent has. An example would be the apparent authority to bind insurance coverage.

An agent’s responsibility or authority includes:

- Selling insurance;
- Collecting premiums (if the agent accepts premium it is the same as the insurer accepting the premium);
- Servicing the contract (advice and claims reporting); and
- Issuing, countersigning and delivering policies.

Agents act as the representative for the insurance company and are the link between the insured and insurer.

Once an agent or adjuster has been licensed, the state monitors the activities of both the insurance company and the licensee. There are several important laws adopted in most states that govern the conduct of the agent. These include unfair trade practices that are discussed in detail in this section.

Maintenance of Agent and Adjuster Licenses

1. Licensees must file with the Insurance Commissioner the complete address of his or her principle place of business and the complete address of his or her residence.

2. Should there be a change of address (and in some states, email address); it is the obligation of the licensee to notify the Insurance Department in the state where the license was issued.

3. In many states there is a requirement to complete some form of continuing education to maintain an insurance license. It is left up to the individual state to determine the number of hours a licensee must complete.

License Revocation, Suspension or Penalty

The following have been adopted by most states as a demonstration of lack of trustworthiness or competency. A hearing will be held and license revocation, suspension or penalty will result if the Insurance Commissioner determines that an agent or adjuster has:

- Violated any insurance law or any lawful rule, regulation, or order of the Insurance Commissioner;
 Improperly withheld, misappropriated, or converted to his own use any money received in the course of business that belongs to policyholders, insurers, beneficiaries, or others;
 Misrepresented the terms of any existing or proposed insurance contract to the detriment of the applicant or insured;
 Engaged in any pattern of unfair methods of competition or unfair or deceptive acts or practices in the business of insurance;
 Forged another person's name to any document or fraudulently procured a forged signature to any document, knowing the signature has been forged;
 Knowingly and willfully made or permitted a false or fraudulent statement or misrepresentation in or relative to the adjustment of any claim;
 Been convicted of or pleaded no contest to any felony;
 Been convicted of or pleaded no contest to a misdemeanor in connection with his activities as an adjuster or agent;
 Had an agent's, broker's, or adjuster's license suspended or revoked in any other state, district, or territory of the United States or any province of Canada;
 Obtained a license as an agent, broker, or adjuster through misrepresentation, fraud, or any other act for which issuance of the license could have been refused had it been known to the Insurance Commissioner at the time of issuance; or
 Committed any other act that inherently demonstrates untrustworthiness or lack of competence.