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Sales Practices and Sales Presentations

Producers are subject to the same rules for fair advertising practices as insurance companies, but these days just about every advertisement used by a producer needs to be approved first by the home office marketing department, so those requirements are discussed later.

However, the actual sales presentation given by the producer is also heavily regulated. Deceptive sales presentations have probably generated more complaints of unethical agent behavior than any other activity.

What constitutes a deceptive sale? Any presentation that gives a prospect or client the wrong impression about an **insurance policy** or plan is deceptive. Any presentation that does not provide complete **disclosure** to a prospect or client is deceptive. Any presentation that includes misleading or inconclusive product comparisons is deceptive. Even if the deception is unintentional, the agent has done the consumer a great disservice.

Deceptive sales presentations can be blatant. *For example*, if a producer makes a comparison of a term policy and a whole life policy that is based only on premium rates without disclosing that one type of policy builds cash value and the other does not, this comparison is obviously misleading and incomplete. But deception does not have to be so apparent to be unethical.

What if a producer describes a personal life insurance policy as a “tax shelter,” but he/she fails to mention that premiums are not **deductible** and that surrendered cash values may be subject to tax? What if the producer recommends a certain kind of health policy, but he/she does not explain the **conditions** under which the policy could be canceled or the premiums could be increased? While any of these ploys might help make the sale, they are all misleading and unethical.

Of all the concerns surrounding the marketing and the sales of life insurance, none resonate so loudly as those over the use and misuse of policy illustrations. Insurance policies have changed over the years and emphasized the growth, return, and investment aspects of permanent plans, the “unbundling” of a policy’s accumulation and protection elements, and the flexibility of premium payments. As these changes occurred, insurers and agents discovered that one of the best ways to demonstrate the complex mechanics of a policy was through the use of the computerized policy illustration.

Unfortunately, these illustrations have also been used to “predict” a policy’s potential and its future performance based on assumptions that may or may not be realized. Vanishing premiums, huge cash values, in-force lifetime benefits — all of these things

have been extolled to sell a life insurance policy, without the explanation that they are based on nonguaranteed numbers projected into the future. Consumers who have seen these illustrations often did not understand the values they were being shown would materialize only if the underlying assumptions came true.

The negative consequences of illustration-based selling became apparent in the early 1990s. Individuals who purchased life insurance policies in the mid-1980s (when interest rates were high) with the expectation that they would pay premiums for only seven or eight years then found out that their policy's accumulated values were sufficient to "vanish" but were charged against the policy's value. Others bought plans believing that premiums of a few hundred dollars a year would produce values of a million dollars by the time they were ready to retire. These individuals then discovered that they were far from their goals.

Consumer groups, politicians, and journalists declared that life insurance buyers were misled by policy illustrations that did not distinguish between guaranteed and nonguaranteed benefits. For some agents and companies, the allegations led to lawsuits. Regulators responded with stricter requirements for how policy illustrations may be used in the sales process.

The bottom line is the agent has an ethical obligation to let his client have any information that can directly affect the client's possible welfare. If the agent has access to information that may help the client to make a more educated decision, it is the agent's duty to disclose that information to the client.

A. Ethical Responsibilities at Policy Application

In securing coverage for a client, the producer's main responsibilities are to adhere to all ethical obligations the producer has to the insurer and to see that the prospect completes the [application](#) accurately and completely.

The insurer is relying upon the agent for full [disclosure](#) of all pertinent information regarding the applicant. However, the agent also has an ethical responsibility to educate the prospective insured to make sure that he or she fully understands the nature of the application process. This includes making sure the applicant understands

- Why the information is required
- How it will be evaluated
- The need for accuracy and honesty in answering all questions
- The meaning of terms such as "waiver of premium," "automatic premium loan," "nonforfeiture options," and "conditional receipt"

1. Conditional Receipt

Because the conditional receipt is occasionally a source of misunderstanding with applicants, let's clarify what it is and how insurance agents should explain it.

A **conditional receipt** is normally given when the applicant pays the initial premium at the time the [application](#) for a policy is signed. This means that the applicant and the company have formed what might be called a "conditional [contract](#)," which is a contract contingent upon [conditions](#) that existed at the time of application or when a later medical examination is completed. In other words, a conditional receipt provides that the applicant is covered immediately from the date of application, as long as he or she passes the insurer's underwriting requirements. If a medical examination is

subsequently required, the coverage is effective once the applicant passes the medical examination.

This information regarding the conditional receipt should be made clear to the applicant. Many applicants accustomed to homeowners or automobile insurance — where coverage is available immediately upon issuance of the binding receipt — assume that their life insurance coverage is also effective upon submitting the application and premium. It is your ethical responsibility to explain that the applicant is covered on the condition that he or she proves to be insurable (and passes the medical exam, if required).

2. The Importance of the Application

All of the information submitted on an insurance **application** has a direct bearing on whether the policy will be issued as requested, whether the application will be rejected, or whether another policy will be offered by the insurer. An agent who knowingly or unknowingly fails to provide all the necessary information about a prospect is not serving anyone's best interest.

Consider the following scenario: Imagine that you visit a prospective client in his home. You ask if he has any dangerous hobbies, and he says that his most dangerous activity is serving as an armchair quarterback for his favorite football team. As your client is filling out the application, you notice a picture on the wall that shows your client with a group of people on a mountain hiking expedition. When you mention this, your client remarks that he climbs mountains as a hobby, and leads rock climbing expeditions to Mount Everest. This is definitely more dangerous than serving as an armchair quarterback.

You are afraid that your client will not be issued an affordable policy if this detail is mentioned, so you advise him to omit it from the application. The policy is later issued.

But what happens if, a year later, the insured is killed in a mountain-climbing accident? It's quite likely that the insurer will contest or deny the **claim** by citing **concealment**. Rather than getting the policy proceeds, the family receives a return of premiums paid. What benefit did this policy provide? What kind of service did you render?

This example illustrates why precision and accuracy in completing the application are in the best interest of both the insurer and the prospective insured. It is vital that an agent understands this and explains the need for full **disclosure** to each applicant.

On the other hand, the agent must make sure that the submitted application is not only **accurate, but also complete**. Incomplete applications may delay the underwriting process, and consequently, policy issue. Any unanswered questions need to be answered before the policy is issued. If the insurer receives incomplete applications, they need to be returned to the applicants for completion. If a policy is issued with questions left unanswered, the **contract** will be interpreted as if the insurer waived its right to have an answer to the question. They would be later barred from any right of denying coverage based on any information that the unanswered question might have developed.

3. Replacement

Replacement is defined as the purchase of one **insurance policy** to replace another. Replacement can be disadvantageous to consumers, especially in regard to life insurance. Therefore, it is heavily regulated.

Policy replacement can be costly to the policyholder because premiums may be higher, the **applicant** may need to re-establish **insurability**, a new commission must be paid on the sale, and new waiting periods may be imposed for incontestability, pre-existing **conditions**, suicide, etc. When engaging in a replacement transaction, the agent must comply with additional requirements that include obtaining a signed statement from the applicant and a list of all policies to be replaced. The agent must also adhere to additional recordkeeping and **disclosure** requirements. Insurers must maintain a replacement register, and patterns of unnecessary replacements will result in fines and penalties by the state regulators.

Each producer who initiates the **application** must submit the following to the insurance company with or as part of each application.

- A statement signed by the **applicant** as to whether replacement of existing life insurance or annuity is involved in the transaction.
- A signed statement as to whether the producer knows replacement is or may be involved in the transaction.

Duties of the producer:

- Present to the applicant a **Notice Regarding Replacement** that is signed by both the applicant and the producer. A copy must also be left with the applicant.
- Obtain a list of all existing life insurance and/or annuity policies to be replaced, including the policy numbers and the names of all companies being replaced.
- Leave the applicant with either the original or a copy of the written or printed communications used for presentation to the applicant.
- Submit a copy of the replacement notice to the replacing insurance company, along with the application.

Duties of the replacing insurance company:

- Require from the producer a list of the applicant's life insurance or annuity contracts that are to be replaced and a copy of the replacement notice provided to the applicant.
- Send each existing insurance company a written communication advising each of the proposed replacement within a specified period of time from the date that the application is initially received in the replacing insurance company's home or regional office.

Replacement Questionnaire

A replacement questionnaire should be employed to help agents determine when replacement is in the client's best interest. Below are some questions that would be used in a typical replacement questionnaire.

*Q1. Will the new life **insurance policy** replace an existing life insurance contract?*

Q2: If the answer to the above question is 'yes', please give details about your current policy.

Policy number: _____ Policy name: _____ Insurer _____

Q3. Did the agent present you with the relevant sales material?

Q4. What kind of insurance is the new policy?

Q5: What is your expected insurance coverage for death benefit?

Q6. Please describe the purpose of adopting a new insurance policy.

Q7. Please describe the source of funds for the new insurance policy.

- a) *Current earned income*
- b) *Net worth*
- c) *Amount of liquid assets*
- d) *Others _____*

Q8. In regards to your decision to replace your insurance policy, how important is the cost of the new insurance policy on a scale of 1 to 5 where 1 is the most important and 5 is the least important?

I have examined my financial objectives including my existing policies and I find the new insurance or annuity contract appropriate to achieving my financial goals.

Signature: _____

Date: _____

PENALTY BOX

Common Producer Violations Related to the Application:

- *Making or permitting a fraudulent statement on an insurance [application](#)*
- *Misrepresenting the terms of a proposed insurance [contract](#)*
- *Submitting an application for automobile insurance that contained fraudulent driver information*
- *Misrepresenting information pertaining to a driver's history and auto accidents resulting in lower premiums being charged*
- *Falsifying an application in order to avoid a higher rate*

B. Explaining the Underwriting Process

Another ethical responsibility that is owed to the [applicant](#) is to briefly explain the underwriting process that the [application](#) will undergo. Although many insurance policies are issued on the basis of the application alone, others require additional information. No prospect should ever be surprised that he or she could be subjected to further underwriting. Therefore, the explanation of the underwriting process should include a description of the checks and balances that apply to underwriting a risk, such as the Medical Information Bureau, the inspection report, and the credit report.

The **Medical Information Bureau (MIB)** serves as a clearinghouse of medical information concerning applicants and helps to disclose cases where an applicant conceals or submits misleading medical information. A life [underwriter](#) can check the MIB for information on an applicant's past medical history. This possibility should be explained to your applicant when you ask for his/her signature on the MIB form.

An **inspection report** provides details on an applicant's lifestyle, finances, and [exposure](#) to abnormal hazards. An inspection report is usually ordered on applicants who apply for large amounts of insurance. It's conceivable that the prospect's friends and/or employer may be contacted for purposes of an inspection report. The purpose of this report is to provide a picture of an applicant's general character and mode of living.

A **credit report** is ordered when there is reason to question the applicant's ability to pay the premiums and to determine whether he or she may be a poor credit risk. Applicants who have questionable credit ratings can cause an insurance company to lose money. Applicants with poor credit standing are likely to allow their policies to [lapse](#) within a short time, perhaps even before a second premium is paid. Again, the

purpose of this report should be explained when you ask the applicant to sign the authorization form.

1. Privacy

In the course of qualifying a prospect, completing a financial questionnaire, analyzing needs, or working on an estate or business plan, insurance agents are privy to a client's personal and financial information. Ethics requires that the agent respect the sensitive nature of this information and keep it confidential. Personal information about a client should never be released without proper approval from the client. The privacy requirements of the Gramm-Leach-Bliley Act require the protection of client's nonpublic personal information through the use of physical and electronic safeguards.

The Gramm-Leach-Bliley Act stipulates that in general, an insurance company may not disclose nonpublic personal information to a nonaffiliated third party except for the following reasons:

- The insurance company clearly and conspicuously discloses to the consumer in writing that information may be disclosed to a third party.
- The consumer is given the opportunity, before the time that information is initially disclosed, to direct that information not be disclosed to the third party.
- The consumer is given an explanation of how the consumer can exercise a nondisclosure option.

The Gramm-Leach-Bliley Act requires **2 disclosures** to a customer (a consumer who has an ongoing financial relationship with a financial institution):

1. When the customer relationship is established (i.e. a policy is purchased); and
2. Before disclosing protected information.

The customer must also receive an annual privacy disclosure, and have the right to opt out, or choose not to have their private information shared with other parties.

2. Disclosures

Insurance agents have a duty to fully disclose to the insurer all material facts concerning an [applicant](#) or [policyowner](#), or situations involving both. This must be done so as to help the insurer make any decision regarding a particular case. At the same time, an agent has the ethical responsibility of full [disclosure](#) to a prospect or client.

In this context, full disclosure means informing the prospect or client of all facts involving a specific policy or plan, so an informed decision can be made. Full disclosure allows the insurance agent to help the client to do all of the following.

- Select the most appropriate policy to meet his or her needs.
- Understand the basic features of life insurance.
- Evaluate the relative costs of similar plans offered by a competitor.

To assist agents with disclosure, there are published documents available to help the consumer understand the intricacies of a life [insurance policy](#). Many agents use the forms not only as an educational tool, but also to help them in their sales presentations. These forms include the NAIC Buyer's Guide and Policy Summary.

The NAIC Buyer's Guide

The Buyer's Guide was developed by the National Association of Insurance Commissioners (NAIC) as an aid to consumers who are contemplating the purchase of life insurance. Most states require that agents make the Buyer's Guide (or similar

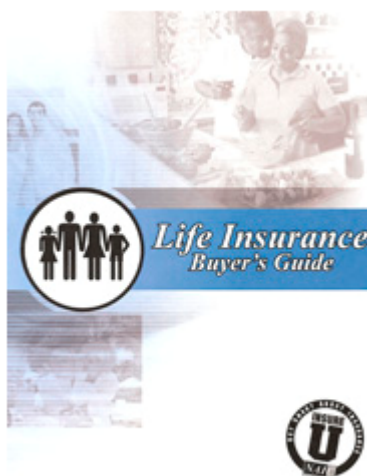
document) available when they solicit insurance sales. This guide explains life insurance in a way that the average consumer can understand. It speaks of the concept in general and does not address the specific product or policy being considered. Included in the Buyer's Guide is an explanation of the surrender cost indexes used in the Policy Summary.

The Policy Summary includes two types of cost indexes.

1. The life insurance surrender cost index
2. The life insurance net payment cost index

The surrender cost index is useful to applicants who want to compare the death benefits of policies.

The Buyer's Guide and Policy Summary are especially helpful to agents who want to explain the features and benefits of the life **insurance policy** that they are presenting. These forms also provide needed guidelines for the comparison of two or more policies.



Illustrations

The term **illustration** means a presentation or depiction that includes nonguaranteed elements of a policy for individual or group life insurance over a period of years. A life insurance illustration must distinguish between guaranteed and projected amounts.

- **General Rules and Disclosures** — An agent may use only the illustrations of an insurer that have been approved and may not change them in any way.
- **Not Part of Contract** — An illustration must clearly state that it is not a part of the **contract**.
- **Values Not Guaranteed** — Values that are not guaranteed must be identified as such.

Chapter Complete

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