Part IV Other Issues for the Agent/Producer

Estate and Tax Planning

Agents active in sophisticated estate or business markets face special ethical issues because they can trespass into other professional disciplines while offering advice or defining needs.

The legal profession is particularly alert to the unauthorized practice of law by those not licensed as attorneys. The American Bar Association has developed four guidelines to help agents avoid this improper practice. These state that:

- Persons who are not lawyers can be active in the areas of analysis of facts, the orderly arrangement of assets to provide for a client's needs while living and for the economic needs of dependents after the client's death. Persons who are not lawyers may also provide general information as to the laws governing the disposition of these assets.

- Persons who are not lawyers who do legal research, give specific legal advice, draft legal documents or apply legal principles to a client's specific situation are engaged in the unauthorized practice of law.

- A life underwriter should never dissuade a client from seeking the advice of legal counsel. It is improper for a life underwriter to attempt to divert legal business from one attorney to another.

- A life underwriter must never share or participate in an attorney's fee; a life underwriter must not pay directly or indirectly any part of his or her commission to an attorney or any person who is not a life underwriter.

These are not merely ethical transgressions. In most states practicing law without a license is a felony. When providing "general information" about insurance laws learn to preface your remarks with: "I'm not a lawyer but..." And always urge the client to consult his attorney.

Practicing accounting is not so grave an offense, perhaps because there is not a legal definition of what is an "accountant." Agents who provide small business planning services or prepare tax returns--and many do--could properly call themselves "accountants", especially if they have training in bookkeeping methods or significant experience in their specialty.

However, there is clearly a precise definition of a "certified public accountant" or a "certified management accountant" and unless you are in fact a CPA or CMA, you are being deceptive if you claim you are an accountant when you are not. When in doubt, be modest.

Also, many states are very cognizant of agents' attempts to disguise their true occupation by identifying themselves as "financial planners" or "financial consultants" or similar self-styled titles. Again, these designations are controlled by several different professional societies; unless you are a CFP or ChFC you must avoid any terminology that would suggest you are.

An exception could be made for the members of the National Association of Insurance and Financial Advisors, formerly the National Association of Life Underwriters, or the International Association for Financial Planning. But both groups, while allowing bona fide members to advertise their affiliation, don't permit the use of deceptive titles as a result. As the Greeks admonished: be yourself.

There's an old joke that goes: if you were accused of being an insurance agent and put on trial, would there be enough evidence to convict you?

Oddly, agents can also find themselves in trouble for practicing insurance.

One way is to charge a fee for insurance services without proper licensing as a consultant. Most states permit licensed consultants to provide fee-based advice provided they do not also receive a commission for the same transaction. This is most common in commercial P&C cases but is becoming more frequent in large group life and health plans, too.

A consultant's license usually requires some additional testing and higher fees than agent licenses, and sometimes additional continuing education requirements. Remember, free advice is fine--and might even be good advice, too!

Another way agents can face trouble for practicing insurance is be representing unauthorized or non-admitted insurers. This is becoming a major issue in some states.

Just a refresher: an authorized or admitted insurer is one that has a Certificate of Authority from a particular state to conduct business in that state. It collects and remits premium taxes and is subject to the Triennial Examination or Annual Statement, depending upon where the insurer is domiciled. And an unauthorized or non-admitted insurer is not permitted to do business in a particular state.

It is not a stigma for an insurer to be unauthorized in any specific state; most companies make those decisions based on marketing criteria. But it is flatly verboten for any agent to attempt to represent an unauthorized insurer. Any resulting transactions will be null and void.

Two developments are pushing the burgeoning of unauthorized insurers:

- Viatical settlements; and
- Section 419 trusts

Viatical settlements--the purchasing of life policies at a discount from living insureds--are often promoted by viatical brokers, who must be themselves admitted in many states. Few are, and insurance commissioners are enforcing restrictions against the agents who represent these brokers. If you want to be active in the viatical business, you must become licensed as a broker yourself and must only represent admitted viatical brokers.

Section 419 trusts are taxable welfare benefits plans that are often sold as health insurance policies exempt from state regulation. While it is true that true self-funded employer plans are exempt from state regulation under ERISA (Employee Retirement Income Security Act), 419 plans do not qualify because they must be insured. Agents who have sold these plans in some states--and then watched them sink into insolvency--have found themselves personally liable for the remaining unpaid health claims. If you blunder into this, your E&O will not bail you out.

There is one exception: agents who are also properly licensed as surplus lines brokers may represent non-admitted insurers in specific situations in accordance with state laws.

The Strange World of Securities

Actually, the world of securities is not so strange to a stockbroker, or an agent familiar with selling variable products or mutual funds. But for agents new to the genre...

First, securities regulation is primarily the responsibility of the federal government and its entities, whereas insurance is primarily regulated by the various states. This means that variable products are subject to both jurisdictions.

Second, securities behavior is very carefully defined and supervisory responsibility is very clearly delineated. Many of the undefined ethical issues that confront insurance agents do not concern securities representatives because they have been anticipated and regulated.

Third, securities are subject to two distinct levels of regulation--one for those selling products and the other for those selling services.

Fourth, some common insurance practices are actually prohibited in the world of securities.

Let's begin by looking at who is subject to securities regulation.

One group, already mentioned, are agents who wish to sell variable products and mutual funds. These agents must become registered representatives through an approved broker-

dealer by passing a written examination and a thorough background investigation. This group will be subject to the jurisdiction of the National Association of Securities Dealers, the NASD, an organization they must join.

(The NASD is a self-regulatory organization, empowered by the Securities Exchange Commission to control the sale of securities available through secondary markets, meaning the non-exchange markets. Since the NASD is a mandatory membership organization, it does not have a code of ethics; it is an enforcement agency.)

No one may transact business through an NASD broker-dealer unless individually registered with the NASD and appointed by an NASD broker-dealer. Unlike insurance agents, registered representatives may only represent one broker-dealer and may not conduct any securities transactions unless appointed by a broker-dealer.

When a registered rep chooses to change broker-dealers, he first must resign from one and then apply to join the other; during the transition he is in suspense.

Another group of agents subject to securities regulation are those who choose to sell investment advice for a fee. These agents must register with the Securities Exchange Commission as investment advisors, again subject to testing and background requirements and, additionally, strict financial accountability mandates.

One may be an RIA (registered investment advisor), or registered rep, or both. And, unlike an insurance consultant, an RIA may earn both fee and commission income from the same transaction, provided that the compensation is disclosed to the client in advance.

Finally, there is the group of agents who find themselves inadvertently subject to securities regulation. These agents are ones who are involved in the sale of securities without realizing that they are. They failed to inform themselves about the definition of "security."

A "security" is more than a stock or bond. According to the Securities Act of 1933, a security includes common and preferred stocks; warrants and rights; corporate bonds; interests in mutual funds and unit investment trusts; variable products; and certificates of participation in limited partnerships.

However, a "security" also includes whiskey warehouse receipts; commodities contracts; farmland and farm animals; real estate condominiums, cooperatives and timeshares; merchandise marketing programs; and multi-level distributorship arrangements. The SEC is very inclusive in defining security, and in recent years has decided that pay phone and vending machine leasing arrangements are also included.

Sometimes agents venture into these financial transactions without realizing the implications for themselves and their clients.

Fortunately, even if the transaction involves a defined "security", the unwitting agent may be "exempt" by buying or selling only through a private transaction or sophisticated investor.

These latter two terms have precise definitions but are intended to exempt those individuals who are wealthy enough to afford good, private advice from someone other than the agent.

Let's assume our agent is ethical, honest--and registered with the NASD. He is still subject to strict regulation, especially regulation of his sales practices.

First, the ethical agent-representative must provide all material information to the buyer before completing any transaction, and he must not omit any material information, even inadvertently. The easiest way to meet this test is to provide the required written prospectus--and urge the buyer to read the entire prospectus.

Second, the ethical agent-representative cannot imply that either he or his broker-dealer is approved by regulatory authorities, nor that any security being offered is approved in any way.

Third, he must not disclose any non-public or insider information. This is an important exception to the full disclosure rule.

Fourth, he must ensure that any security he sells is suitable for that buyer and he must obtain sufficient information from the buyer to make that decision.

Fifth, he must not "sell away", meaning he must not sell any security that has not been approved by his broker-dealer. Payphones, vending machines, viatical settlements and Section 419 trusts usually fall into this category; this means that agents who are registered must obtain the express permission of their broker-dealer before selling any unapproved "security." It also means that your broker-dealer must approve any outside employment you accept.

Sixth, he must conform to separate continuing education requirements for his securities registration, requirements that usually do not qualify for insurance continuing education requirements.

Seventh, a securities representative must also disclose his exact commission to his customer. This rule applies to the sales of all variable insurance and annuity products. However, it will not seem strange to agents operating in the realm of qualified plans, where it is already an ERISA requirement.

Finally, he must follow a client's instructions, even if it means selling an unsuitable product. This seems bizarre to many agents but a registered rep cannot refuse to take an order.

The strange world of securities indeed.

But there are evolving insurance parallels. Many of the practice requirements of the Medicare Supplement and Long Term Care model acts, adopted by virtually all states, are based on securities precedents. These acts include provisions requiring insurers as principals to regulate the conduct of their agents; to ensure that all product sales are suitable for the

buyer; and to report publicly the top ten per cent of their agents involved in proper replacement transactions.

Just to make life confusing, there is an odd exception to the stringent NASD requirements for variable products. Agents who sell equity-indexed annuities are not bound by NASD rules and practices and do not have to register through a broker-dealer. The SEC has determined for now that equity-indexed annuities are not securities. However, many commentators expect that position to change in the near future.

Agents who are uncomfortable with these insurance provisions should avoid selling the products, and should stay away from the world of securities. The ethical agent should have no trouble conforming to these norms.