Fiduciary Responsibilities

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Insurance agents represent the insurers that appoint them. Insurance brokers legally represent the insurance purchaser (or prospective purchasers). A broker solicits and accepts applications for insurance and then places the coverage with an insurer. The business is not in force and the insurance company is not bound until it accepts the application. Technically speaking, a broker does not represent anyone until prospect or client requests coverage — and then the broker represents the buyer.

That distinction between agent and broker becomes blurred when independent (unaffiliated) agents are appointed by various companies to sell their products. Often, a client's simple goal is to purchase appropriate P&C coverage to meet her needs – and the independent agent will present proposals from several different companies. In these situations, is the sales person an agent representing the company's products, or a broker representing the client's needs? In practice, the regulatory distinction between brokers and agents is not significant, as Florida does not issue separate licenses for brokers. Instead, licensed agents may act as brokers for their clients. There is, however, an important legal distinction: brokers owe their ultimate fiduciary responsibility to their clients; agents owe a fiduciary responsibility to the company that appoints them. Since a company can only pay commissions to appointed agents, a broker legally owes a fiduciary responsibility to both his clients and the company that pays his commission. These conflicting interests can sometimes place an agent or broker in a difficult position.

Fiduciary Responsibility to the Client

A *fiduciary* is a person in a position of financial trust. Attorneys, accountants, trust officers, pension plan trustees, stockbrokers and insurance agents are all considered fiduciaries. Insurance agents and brokers may owe a fiduciary duty to both to the companies they represent and to the insurance buying public. Agents who make recommendations to clients have an obligation to be knowledgeable about the features and provisions of the products they sell, as well as the prudent use of these products. Agents also must take the time to become acquainted with the client's financial needs, situation and objectives. Agents collect premiums on behalf of the insurers they represent, so they also have a fiduciary duty to submit those monies to the insurer promptly.

Insurance agents and brokers voluntarily accept this fiduciary responsibility and implicitly agree to carry out that duty in good faith. That has been interpreted by the courts to mean that fiduciaries must act reasonably to avoid negligence and to not favor anyone else's interest (including their own) over that of their clients or the companies that appointed them.

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Fiduciaries owe their principals (the person they represent):

Utmost Care. One standard applied to fiduciaries is the "prudent man rule", which states that the fiduciary should behave as a "prudent person" would under the same circumstances. This can be a very vague standard, but it is one that courts have relied on over the years. Professionals are usually held to a higher standard of conduct — to exercise "utmost care". This higher standard is warranted because professionals are assumed to be more knowledgeable and experienced than an ordinary prudent person. One can argue that clients seek out and are willing to pay for professional advice precisely because of the added knowledge and experience the professional brings to the decision-making process — and therefore should be held to that higher standard.

Integrity — this applies to the fiduciary's soundness of moral principle and character: the agent must act with fidelity to the principal's interest and with complete honesty.

Honesty and Duty of Full Disclosure of all material facts, either known, within the knowledge of or reasonably discoverable by the agent which could influence in any way the principal's decisions, actions or willingness to enter into a transaction.

Loyalty — An obligation to refrain from acquiring any interest adverse to that of a principal without full and complete disclosure of all material facts and obtaining the principal's informed consent. This precludes the agent from personally benefiting from secret profits, competing with the principal or obtaining an advantage from the agency for personal benefit of any kind.

Duty of Good Faith — includes total truthfulness, absolute integrity and total fidelity to the principal's interest. The duty of good faith prohibits taking advantage of the principal through the slightest misrepresentation, concealment, threat or adverse pressure of any kind.

In the case of conflicting interests, the agent must disclose the "**dual agency**" (acting for two parties at the same time) or risk being accused of fraud from either or both principals. Most brokers are compensated by commissions. This, in itself, creates a difficulty since there is an inherent conflict of interest. It is common knowledge to most insurance purchasers that agents and brokers earn a sales commission, which may mitigate the conflict somewhat.

Florida courts addressed this commonly held knowledge in the case of *Beardmore v. Abbott* — ruling that a broker does have a fiduciary responsibility to his clients, but the broker's failure to disclose the full amount of his commission does not breach that duty. In this case, the client did not inquire as to the size of the commission at the time of the purchase, and broker did not volunteer the information. If the client had asked that question, presumably the courts would have ruled that the broker must honestly disclose that information as a matter of fiduciary trust. It should be noted that the client was very familiar with the insurance market, and knew that the broker would receive a commission — it was disclosure of the exact amount that was the crux in this case. Agents should, at least, make clients aware that they may receive a commission as part of an insurance transaction.

The fiduciary duty of insurance brokers was also addressed in another Florida case: *Moss v Appel*. In this case, a broker helped a small business set up a pension funded with an annuity contract, and the broker was also hired to handle administrative paperwork for the pension plan. The broker

received notice from the annuity company that it was in seeking additional capital to remain in business, but he did not alert the clients to that notice. The annuity company later became insolvent. The courts ruled that the broker owed a fiduciary responsibility to his clients based on the sale of the annuity and the ongoing consulting/administrative contract. As the court noted: "It is undisputed that [the broker] was acting as an insurance broker, not an insurance agent employed by a particular company, when he sold the plaintiffs the annuity." Presumably that distinction means that the broker should have placed the client's interests above any duty he may have felt to keep the contract in force with the troubled annuity company (even if it was the company that compensated him for the sale). In this case, there was a contract with the clients to administer the plan. The court did not indicate how that continuing relationship affected its ruling — or for how long after the sale a broker (in the absence of a continuing relationship) owes that duty to his clients.

These cases illustrate some of the problems that can arise for insurance brokers. Independent agents are more likely to "shop around" coverage, which increases the likelihood that the producer will be viewed as a broker, and not as an agent.

Fiduciary Responsibility to the Company

A "contract of agency" establishes a fiduciary relationship between an insurer and an agent. One central tenet of this contract is the agent's duty to act in the best interests of the insurer. This duty extends through all actions the agent takes in which the insurer's interest is at stake, especially proper handling of premiums, solicitation of business, full disclosure of pertinent facts related to applicants, following insurer directives and exercising due care in their dealings.

The most obvious fiduciary duty -- one with which agents are generally familiar -- is the duty to account for premiums. Premiums must not be commingled with personal funds nor may they be used (in legal jargon, "converted") for personal expenses. Agents who do so are guilty of "embezzlement" -- a criminal offense ranging from a misdemeanor if the amount is $300 or less, to a felony, if more. If the agent deposits the applicant's premiums in a bank account, the agent should be sure to maintain a separate bank account for that purpose to avoid the appearance of impropriety. (If the agent collects premiums on behalf of an insurer for which the agent is not appointed (most likely, excess or rejected business), the funds must be held in a separate account). Florida law requires that agents maintain records of premium payments for at least three years. Lastly, premiums accepted by the agent must be submitted to the insurer on a timely basis.

In the solicitation of insurance, the agent has an ethical and fiduciary responsibility to solicit business that will be profitable to the insurer. Agents should focus their solicitation efforts on business that is likely to result in a reasonable claims ratio. For the life insurance agent, that means selecting prospects who are in reasonably good health and who are in a position to pay both the initial premium and future premiums. Although insurers are unlikely to expect agents to act as home office underwriters, this requirement, nonetheless, places a burden of care on agents not to present unsuitable applicants to them.

Agents must be sure to make a full disclosure to the insurer of all pertinent information that bears on the placement of an insurance policy. The agent report, attached as part of the application should note, the agent's pertinent first-hand observations and knowledge of the insured (for example, did the applicant smoke cigarettes while answering "nonsmoker on the application). The important word is in these statements is "pertinent." Unless the agent is certain that the information is not pertinent and is in a position to adequately judge its pertinence, the agent should not fail to note it on the application. The agent that decides not to list an applicant's illness on an application because he or she felt it was not important may have violated this part of the fiduciary and ethical obligation.

Likewise, agents who assist policyholders in submitting claims forms must keep the insurer's best interest in mind. Again, full disclosure of pertinent facts is required. Claim form completion may be somewhat less of an issue in the case of a life insurance claim since a death certificate must accompany the claim form -- although there may be discrepancies in the insured's true age, which may have a bearing on the level of the policy's coverage. In the case of health insurance or property & casualty insurance claims administration is extremely important, as there is the possibility of multiple claims under a single policy. Filing false applications or claims forms is considered "fraud" under Florida law; a felony.

As was mentioned earlier, one ethical issue that arises in implementation phase of the sales process is following through on business transactions within a reasonable time. The definition of a "reasonable time" is ultimately left to the courts based on the facts of the situation. Some courts have held a property & casualty insurance agent liable for not obtaining coverage only two days after commencing the search for it, while another held that three weeks was a reasonable time to spend searching for coverage. In the case of life insurance or health insurance, applications should be completed and business submitted within the earliest possible period of time. Applications and premiums for life and health insurance should be submitted within one business day of being taken, while applications for property & casualty insurance should be submitted within one business day of locating an insurer willing to accept the application. The standard boilerplate in most contracts reads: "Time is of the essence" -- agents should realize that such language exists for a reason.

Another fiduciary duty is that of loyalty and obedience to the represented insurer. In plain terms, agents owe a legal and ethical duty of loyalty to their represented insurers. Loyalty to our insurers manifests itself in our acting in good faith and with integrity in our dealings with them. Agents have an obligation to follow their carriers' lawful and reasonable instructions. Because of the litigious environment, especially where the deep pockets of insurance companies are concerned, this obligation is of particular importance. Partly in reaction to the legal environment, many insurers are providing thorough instructions regarding the solicitation of business and the type of illustrations that agents can use. Instructions like these are designed both to limit the insurer's liability and provide a minimum standard against which agent conduct may be measured. Agents that choose to ignore the instructions from their insurers may find their contracts terminated, and, if sued, they may be required to face the lawsuit entirely on our own. Clearly, the agent that disobeys his or her carrier's compliance requirements does so at considerable risk.

Along similar lines, an agent has an obligation to carry out authorized activities with reasonable care. An example of this principle is the requirement that we not attempt to engage in business in

which we are not capable of performing with a level of skill possessed by others that are similarly engaged. In other words, if the agent is not familiar with the area, he or she should seek the assistance of another agent that is. That may involve working with your company's pension specialist, disability expert or someone else that has particular skill in the area.

Lastly, agents frequently face conflicts of interest. The standard applied to an agent's actions with respect to this principle depends upon whether the agent is a captive agent or an independent agent. Not unexpectedly, a captive agent is held to a higher ethical standard in this regard than an independent agent. We can see an example of that differing standard in the products sold. Although an independent agent may represent multiple companies, each offering identical products that compete with one another, a captive agent's representing the same companies would constitute a breach of fiduciary duty.

Client Expectations

As courts have shifted their legal reasoning from *caveat emptor to caveat vendor,* sellers in the marketplace are under increasing scrutiny. Agents, as salespersons, should be aware of this increased scrutiny of their actions and deal with both client and insurers in an ethical manner.

While agents can find themselves in breach of their ethical responsibilities by the actions they take -- their failures to act can also result in liability. In legalese, agents are liable for there "acts of commission", as well as "acts of omission". Customers have a reasonable expectation that the agent they deal with is a professional. As such, they can expect that the agent will exercise due care in representing insurers to the public and be competent in servicing of that business once it is placed. Failing to do so, in the eyes of many courts, exposes the agent to personal liability.

For example, an agent forwards a customer's signed application and first premium payment for flood insurance to the insurer. The agent assures the client that coverage will be underwritten. The insurance company, however, rejects the application, and notifies the agent -- but the agent fails to notify the applicant. A flood strikes and the client learns he is uninsured. Courts have held, in circumstances like these, that the agent was held liable for the flood-related losses.

Similarly, agents who fail to exercise "due diligence" may be personally liable for their failure. As we discussed earlier, agents who represent unlicensed insurance entities are personally liable for losses their clients believed would be covered under the fraudulent contract. In addition to the personal liability, the agent is also guilty of a felony by representing an "unauthorized entity". Good intentions are not enough ...... agents must exercise due care in their business.

While no substitute for due diligence and competent business practices, Error and Omission Insurance (E&O) is a type of "malpractice" insurance available to insurance agents who may unwittingly be caught up in such circumstances. As our society becomes ever more litigious, agents will want to seriously consider such coverage.

When delivering policy documents, most agents will take the time to describe to an applicant the full range of rights the policy will confer. This is usually a good way to cement the client-agent relationship and dispel any lingering misunderstandings the client may have about the policy. There is one right, however, that could adversely affect the agent: the so-called Free Look provision. Some types of policies give the policyholder a short period of time to reconsider the purchase and an opportunity to recover his initial premium for any reason he or she feels is important -- or for no reason at all. In Florida, state law requires a Free Look provision on all life and health insurance policies, as well as all annuity contracts. Beginning in 2008, the Free Look provision for most policies in Florida was extended from 10 days to 14 days. There are two notable exceptions: Medicare Supplement (Medigap) and Long Term Care policies must have a minimum 30-day Free Look. Insurers may extend these timeframes for their policies, but may not shorten them. If the applicant cancels the policy within the policy's Free Look timeframe, the agent will not earn his or her commission. This creates a conflict of interest between the best interests of the client and the interests of the agent, and this conflict must be disclosed. The agent's failure to advise the policy owner of his or her rights under the Free Look provision or to explain the details of the provision constitute unethical behavior.