

# ETHICS IN INSURANCE-CALIFORNIA

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## CHAPTER ONE - INTRODUCTION

**NOTE:** This text is written "gender-free," and any reference to the male gender – he, him, salesman, etc. – should be considered as also being compatible with the female gender. It is much easier to read and understand (and write) by using a single-gender, as opposed to his/her, him/her, etc.

It should also be noted that most of the discussions of ethical situations contain questions as to what ethical action should be taken, or whether an action was ethical. Some of these questions are not answered in the text and some are purely rhetorical. They are intended to make the reader think about the proper ethical action. Sometimes, there can be more than one ethical action, at other times there may simply not be a ready answer as more detailed information would be needed.

The final chapter of this text discusses the Code of Ethics for the Chartered Life Underwriters and for the Chartered Property and Casualty Underwriters. These are the two principal professions within the insurance industry so their Codes are representative of other Codes of Ethics. Other professions, such as Society of Actuaries, Life Office Management Association designate, and many others within the insurance industry, all have their own specific Codes. Those in the various fields will be well served to obtain a copy of the Code of Ethics that pertains to their particular field or discipline. A Code of Ethics offered by CEIS is also included.

### DEFINITION OF "ETHICS"

**(Webster says) Ethic(s) is the "discipline dealing with what is good and bad and with moral duty and obligation." "A set of moral principles or values and the principles of conduct governing an individual or a group." "Ethical" is defined as "of or relating to ethics, and conforming to accepted professional standards of conduct."**

### MORALITY

Morality has often been described as a "social system of rules created to allow people to adjudicate disputes rationally without resorting to physical force so that the relationship is affected by the dispute can endure and, perhaps, even flourish. Because most disputes are generated over the question of who is entitled to certain goods, the pursuit of goods and the question of who is entitled to certain goods, the pursuit of goods and the avoidance of harm are at the core of any moral system. Hence, we can claim that the creation of some benefit or the avoidance of harm is the goal of any activity." (*McGill's Life Insurance, Chapter 18*)

Ethicists have taken a variety of ways to arrive at ethical approaches for a multitude of problems, but basically ethics primarily relates to enhancing the quality of life on one hand, and at the same time, maintaining the issues of fairness and justice. The principal message here is for one to pursue his interests fairly and unselfishly, with particular attention to treating every person the same. Logically, this would mean that differences in treatment can be justified if, and only if, there are relevant differences. Selfish behavior, on the other hand, is where one pursues self interest without regard to the interests of, or at the expense of, others.

It can be difficult at time to treat two (or more) situations/persons/objects exactly the same. If a married couple has twin boys, what one is entitled to, so should the other be entitled to the same. Children recognize this early in their life, as something that a sibling receives, if different from what they receive, is "not fair"—whether it is a bigger piece of cake, staying up later, etc. Therefore, as soon as children began to notice differences and to use reason, they are aware of the basis of fairness, that "the same should be treated the same." Therefore, if we truly believe that most people are alike in most morally relevant respects, then they should be treated the same in most respects. This can be hard to understand at time, particularly when terrorists blow up helpless people and commit atrocities (as Paul Harvey, radio commentator, often says, "It really isn't one world...")

Still, most of us have been installed with respect for the Golden Rule: "Do unto others as you would have others do unto you." This principle reinforces the notion that others are the same as you in most relevant respects and is repeated in this text.

Some may see "selfishness" as unethical when related to the principle of fairness, but by "selfishness," that does not mean only the pursuit of self-interest, which is natural and acceptable. The pursuit of self-interest is a perfectly natural and acceptable activity. Selfishness, on the other hand, is when a person pursues self-interest *at the expense of another*—when the person is not entitled to the good or material pursued—in effect putting their own interest ahead of the interest of another when doing so will hurt the other party. As an example, taking so much food at a party that there is not enough left for all of the others. If other people need or want the same thing but only one person can have it, who (and how) decides who gets it? Since situations like this occur often, society has created rule of fair distributions—and such are the *ethical* rules of society.

Ethical rules emerge as societies grow as justice and the betterment of the quality of life must have some sort of ethical rules for appropriate behavior governing the society. They usually start through the process of trial and error plus the assignment of responsibilities which not only perpetuates society, but allows it to grow. In the western world, those societies in the Greco-Roman-Judeo-Christian tradition developed these general principles into more specific rules based upon the Ten Commandments, which include prohibitions against murder, stealing, lying, adultery, etc., as a template for judging proper behavior. It should be obvious that these Commandments reinforce the general prohibitions against selfishness and unfairness.

Back as far as recorded history, there has been distribution of goods that have allowed civilization to advance. Those who derived food from the land would trade with the hunters, thereby creating the first acknowledgements of civility. If, for instance, a grower of food was not able to obtain what would be considered "equal" compensation in barter for meat from the hunters, either some sort of agreed-upon arrangement was made or war could result. The free exchange of goods in a market requires the *informed consent* of both parties, but neither party would consent if they would not benefit on an equal basis.

Applying this to insurance with the sale as a market transaction, it is easy to see that misrepresenting the product or withholding significant information would not allow informed consent—therefore that constitutes misappropriation of the buyer's goods. Any way one looks at that, this type of sale would involve an unfair and unjust transaction, and basically is a form of stealing.

The necessity to be fair and just requires procedures to be set forth for the distribution of benefits and other obligations, such as the entitlement to benefits which are *rights*. What is a right due to one party is usually determined by the relationship to the person with the obligation. As an example, if I have a right to an education, then there are those who have an obligation to provide such educations. If you become a parent, your obligation is meet certain obligations to care for and educate your child. (No, there is no obligation to provide the child with his own car on his 16<sup>th</sup> birthday...) Then there are relationships that exist because of a commitment to them. Societies establish divisions of labor—set up jobs for persons—and there are those who accept the responsibilities of one or more of these jobs. A commitment to jobs and relationships automatically carries responsibilities.

Under the assumption that the majority of the social rules or jobs that we assume, are legal, necessary and beneficial to society, then we must take a look at the various relationships as a result of the division of labor. Looking at the relationships helps to determine what our responsibilities are in respect to applying ethics of relationships to the insurance industry and thereby determining the rights and responsibilities of those in the industry. In this text, particular practices that are ethically suspect are discussed for the purpose of showing why they are inappropriate or appropriate as the case may be. If the practice is problematic, then reasons both for and against them will be discussed.

### *A Look at Insurance*

Insurance is first of all a cooperative enterprise which has been defined to be a social system created to minimize the risk of financial loss from specific unforeseen future events for the insured and beneficiary(s) (if applicable). When a person acquires insurance they enter into a private contract to become a member of a group, and by doing so, they collectively assist each other to minimize the specific risk. Immediately, an ethical question arises in respect to the fairness of discriminating for some and against others who wish to join the group. A good example would be where a group of healthy people join together to (for instance) insure their lives. Their cost of this protection would be much cheaper if they could exclude those with unhealthy conditions, histories and/or lifestyles. Is it ethical for such a group to be exclusionary? If an unhealthy person, with worse health than those in the group, wishes to apply to join the group, what would be a fair price for their joining? Based on these facts, there is already an ethical and moral difficulty, starting whether such person should even be allowed to join the group as; obviously, joining the group would be at the expense of those in the group. What justification could be provided to counter the negative influence of the person and his effect on the entire group? These reasons address the fundamental ethical concepts.

Life insurance is rather unique when compared to property and casualty insurance, as life insurance is designed principally to provide support for dependents, whereas property and casualty insurance minimizes the risk to the insured, rather than survivors. Life insurance in its basic concept benefits others than the insured. Or as *McGill's, Life insurance*, puts it, it is "other regarding."

Life insurance has evolved into a financial instrument that has taken on the atmosphere of investment, a viatical tool, or source of long-term care, but originally it required the ignoring of self-interest for the sake of others—the very essence of unselfish behavior. The antithesis of selfishness is ethical behavior; therefore an insurance agent becomes a promoter of that type of altruistic behavior.

Simply put, the original purposes of insurance is simple—the joining together of a group of people for the purpose of pooling their resources to protect themselves and/or their property from risk—the products and the distribution of such products have become quite complex over time.


There have been examples of unethical behavior in respect to marketing these products with resulting adverse publicity for the entire insurance industry—the general public has a difficult time in separating types of insurance and has a tendency to place all insurance companies in the "same basket." These situations seem to focus on the misrepresentation of the values of certain products, or on the unnecessary replacement of policies to further for the benefit of the agent (as opposed to the benefit for the policyowner) with the overall purpose of meeting quotas so as to increase the profits of the insurance company.

This is only one type of unethical behavior in life insurance, as other problems involve the ethics of underwriting in respect to the demands of the insurer and the demands of the client; and some issues stem from the greed of the agent, and yet other situations place an agent in a no-win situation.

### GENERAL BUSINESS ETHICS

Business ethics has become a much discussed topic in the press over the past few years, primarily because of Enron, Tyco, WorldCom, and other companies because of unethical behavior of corporate officers, accountants, attorneys, and others. Well-heeled corporate officers in these firms have been indicted, fined heavily and others are awaiting indictment.

True, there are other reasons other than "cooking the books" that caused chaos in these and other similar companies, but in nearly every situation, the proper application of "ethics" would have avoided—or, at least, diminished—the suffering of stockholders. Sometimes we forget that a public corporation may have thousands of stockholders, with a large number of retirees who depend upon the performance of the stock for their income and therefore, are hurt the most. It is fair to say:

 **When ethics are discarded, those affected are generally those who will suffer the most and who can ill afford the consequences.**

The best way to start this discussion is to use examples of unethical behavior. Some of these situations may now be illegal. The differences between "ethical" and "legality" will be discussed later. However, a salient point in this respect is:

 **Repeated unethical activity will usually be made illegal—eventually.**

The health insurance industry has experienced many publicized unethical actions in recent years, with the result that they have also had many new laws and regulations imposed with the result that the health insurance has been under the microscope and there has been a considerable amount of "housecleaning." Abuse has been rampant in some areas, and many health insurance agents can attest to being aware of situations where a policyholder had multiple coverages on the same risk because a "slick" agent convinced them that they needed the coverage—which would probably never be used. Unfortunately, many of the "victims" were elderly persons.

The elderly has always been a ready market for unethical agents; hence the very strict laws regarding Medicare and Medicare Supplements. The government stepping into the insurance

business and dictating the standardization of Supplement policies is a direct result of sales abuse. Particularly in California, there have been many draconian—but entirely necessary and welcome to policyholders—laws and regulations in respect to marketing to the "senior" population in the area of life insurance, annuities and long-term care insurance in particular, which have been enacted and strenuously enforced.

As life insurance, in particular, became more of a financial product instead of a protective device, many agents have evolved into "financial planners." Laws are more stringent now as to who may hold themselves out as financial planners, but at one time all an agent had to do was represent himself as a financial planner and he was ostensibly one and there was a plethora of financial planning designates appearing in the Yellow Pages. It should be no surprise that many of these "planners" were involved in questionable (to say the least) ethics. For instance, a problem in ethics arises where a "financial planner" (who is also an insurance agent) is made privy to the financial records of a client, and who then passes this information on to a stockbroker or mutual funds salesman, sometimes for a "fee" and sometimes for "goodwill." This raises many ethical questions (discussed in more detail later) such as should the agent disclose his connection to the broker and/or to his client and would that make it OK? Or is it just the right thing to do if it is apparent (to the agent) that the client would benefit more by investing in a mutual fund (for example)?

### **TEMPORARY INSURANCE AS SUBSTITUTE**

There is an interesting situation familiar to many health insurance agents, wherein a client comes to them with the problem of unaffordable premiums with their present carrier because of age, and they are nearing the magical age of 65 when they will be eligible for Medicare. Many agents will suggest a "Temporary" policy with higher deductibles and which are usually issued for only one year and have limited health questions, but have a much lower premium. One of the primary reasons for the low premium is that they do not cover *any* preexisting conditions under any circumstances. For relatively healthy older persons, this is acceptable and in some cases, commendable from the viewpoint of the client.

An ethical problem can arise in some situations; if for instance, the client has 3 years (or so) before qualifying for Medicare. Some agents simply find another application (a good Health agent will usually have 2 or 3 applications in their briefcase) and rewrite the policy with another company. The problem is that an agent may "forget" to tell the client that any illness that occurs while covered by a Temporary policy will not be covered under a new subsequent Temporary policy. This could mean that the client may not have coverage if the illness is related in any fashion to a preexisting condition. While performing a service to the client by providing temporary coverage, an agent must, ethically, make certain that the client fully understands the hazard involved with multiple sequential Temporary policies.

### **UNLICENSED INSURERS**

While this situation seldom arises now, for several years health insurance on small groups was placed with an unlicensed company under the pretext that the company did not have to file rates or receive approval from the Insurance Department, because of ERISA (Employee Retirement Income Security Act) regulations that stated under certain situations, employee benefits for an employer are not required to be licensed by or under the jurisdiction of the State Insurance Department.

This was often used by an out-of-state "Trust" that would actively market small businesses offering good coverage at affordable prices (and often good commissions). Problems arose at time of claim and eventually many policyholders not only found themselves without health coverage, but legitimate claims were never paid, so when the companies left the state or went into receivership, they left many uninsured (and in many cases, uninsurable) employees. The fallacy was that under an ERISA, in order to qualify; only employees of a SINGLE EMPLOYER can be so insured. Further, there were agents who, after discovering that a "Trust" covering their insured groups had "flown the coop," had simply replaced the coverage with another similar "Trust." This example of the lack of ethics generally does not exist today as the majority of these agents have lost their license, and in some cases, they have become personally liable for any losses suffered by their clients.

This brings up the point of whether there are bad agents who sometimes do good things and/or good agents who sometimes do bad things. The point is that

☞ for some agents, what is right and what is wrong is not as apparent to them as it is to others.

### ***EXAMPLE OF BREACHES OF ETHICS—EQUITY FUNDING***

This is an actual story of company ethics gone haywire and executive's completely ignoring ethical behavior. This happened to a life insurance company, but it could have happened to other types of companies as well—the health insurance industry is full of stories of unethical companies and executives, as well as agents. One of the interesting sidelights of Equity Funding Life Insurance Company was that the agency force apparently had no actual knowledge of misdeeds, but there is little doubt that some of their large general agents had an inkling of something going on as they had a hard time believing that the company was writing as much business as it was claiming. When they asked about it at the home office, they were never completely satisfied with the answers.

Example: This story broke in the newspapers in April 1973. On April 2, the Wall Street Journal headlined "A Scandal Unfolds—Some Assets Missing, Insurance Called Bogus at Equity Funding Life. Allegedly Phony Policies Sold to Reinsurers for Cash—Firm Declines to Comment."

(Quoting from Wall Street Journal) "From Beverly Hills, California, comes the story of the one of the biggest scandals in the history of the insurance industry, breaking around Equity Funding Life Insurance Corp. of America, a financial services concern with a "go-go" growth record in insurance sales. This scandal centered on the life subsidiary, Equity Funding Life Insurance Co. This company had four subsidiaries, and they reported total life insurance in force of \$6.5 billion at the end of 1972" (a substantial company in those days) "and Equity Funding Life accounted for about half of that."

"An unknown 'but sizeable' hunk of this insurance did not exist, apparently bogus business put on the books and then 'sold' to reinsurers for cash. Known in the company as the 'y' business, it was conceived and operated by several managers and executives of the subsidiary and parent company and treated as a big joke."

This story contains many ethical questions—particularly accounting ethics—but it involved more than just "accountants." It also involved company underwriters, policy issue personnel, actuaries, and policyholder service personnel that were aware of what was going on to some extent or other. Agents, for the most part, were kept in the dark.

For those who participated in this gigantic fraud, they HAD to know that they were not only operating in total violation of any ethical code—and they had to know that it was stealing so it was also illegal. What is interesting is that in interviews with some of the persons involved, to most it was just a "big game." It was certainly more than that because those involved in falsifying thousands of policies were paid extremely well. One miscreant later stated that he had been able to put his children into expensive private schools, so he did this "just for his kids."

### ***IGNORANCE IS BLISS?***

"Ignorance" of ethics has universally been understood to start at early childhood. This is obvious in those situations where the parents have been involved in unethical and/or illegal activities as the child soon learns to accept such action as the "norm." If they are exposed to such activities, not only from family but also by others with whom they associate, they will soon develop the attitude that "it must be right because everyone does it." Obviously a child that grows up in such an environment will not know what's right or what's wrong.



**Bad ethics are often taught by example.**

So how does that apply to an insurance agent? Consider the following situation which is fictitious only in the use of names:

John joins the Acme Insurance Agency after selling siding for several years. He is trained by an experienced agent designated as a "trainer" because he has the highest production, a rather typical situation. John is a good student, and one of the things that he learns is that there always are several forms to be signed by the client. If he turns in a form that is not signed, he does not get paid for it until he goes back and gets the required signature.

One of his early sales was for a substantial policy and he was looking forward to his commission check until he discovered that the applicant had not signed one form. Remembering that the applicant was not a particularly pleasant individual and had been a rather hard sell, plus the fact that the applicant had stated he was going on vacation for 3 weeks, brought John close to tears. In admitting this to his "trainer" who lent a sympathetic ear, the more experienced agent offered to "get the signature." John could not believe it, but when the agent came back to his desk in a couple of minutes with a signature that matched the other signatures on the application, John was introduced to the practice of "windowpane signatures"—holding a signed form to the window, and then tracing the signature onto another form at the proper place.

Assume that John knew that forging a signature was wrong (and illegal, to boot). What has he learned? He has learned that it is OK to "windowpane" a signature when necessary, because that is not really "forging." Besides, if his trainer does it with all of his experience, then it must be OK.

Unfortunately, this is how many agents learn their "ethics." Taking this one step further, assume that John moves to another agency where he is put in charge of training of new agents. Assume further that John teaches "windowpane signatures" to a new agent, and John is proud when

the new agent brags on how his trainer had saved a case for him. Further assume that the owner of the new agency was highly ethical and besides, the agency owner knows he will lose his license if one of his agents is caught forging an application with his knowledge. The result would be obvious – John would go back to selling siding and not fully understanding why he lost his good job as a trainer.



**Sales ethics are the hallmark of the marketing entity.**

There are similar examples in the property and casualty field where this situation arises. With an automobile policy where uninsured motorists is sold, with some companies the agent must obtain a signature on a form that shows that the applicant (1) declines the uninsured motorist's coverage; (2) agrees to purchase the uninsured motorist's coverage on a non-stack basis; or (3) accepts the uninsured motorist's coverage. Since this requires a signature outside of the usual application signatures, sometimes the signature "slips through the crack." Does the "ethical" agent then forge the signature so that the necessary coverage is not delayed? If the applicant accepts the uninsured motorist's coverage, the premium may be higher than if it is declined, and if the agent did not point this out, the normal response would be that the applicant does not want the coverage. Unfortunately, there have been situations where a claimant has stated that they did not decline the coverage, as they wanted that coverage in particular (especially now that they are involved where the other driver has no insurance), and they further state that it is not their signature on the form declining the coverage. Of course, to forge a signature is illegal but in some cases, the agent may think that they are highly ethical by "helping" the client obtain immediate coverage.

There are agents located in coastal areas principally, who market homeowners policies with hurricane coverage. Books have been written about unethical agents and insurers who deny coverage to those whose homes and possessions have been demolished by hurricanes—such as the situations where flood insurance does not cover water damage to water driven by wind and the homeowner policy does not cover storm surge damage. This has happened too often, leaving a policyholder who has paid thousands of dollars in premiums for homeowners and flood insurance, but with no coverage for hurricane wind and water damage to their homes, many of whom have gained publicity on television and other news media, asking basically one question: "Why didn't my agent tell me I didn't have the coverage?" Why, indeed?

In a similar setting, when the National Weather Service Forecast Office or the National Hurricane Center issues a hurricane watch or hurricane warning, insurers will not accept homeowner's or flood insurance applications. There have been, and are, agents who are known to back-date applications so that their client can have hurricane or flood insurance—much like selling fire insurance to someone whose house is on fire. Many of the agents earnestly believe that they are not only ethical by doing this, but they are providing a needed service to those people who cannot afford to carry homeowner's or fire insurance for a long period of time before a hurricane hits. The real problem is that agents who have been caught or accused multiple time for such shenanigans, are very often working out of the same agency and very possibly have been taught to so "protect the client."



**If a person's early training taught that one could get away with wrongful acts and make money; then the individual needs re-training and re-education as to what is right and what is wrong, and WHY it is right or wrong.**

### ***GREED***

While some people act only out of ignorance when making ethical decisions, the ugly green monster, greed prompts others. Psychologists have discovered that people respond positively to rewards but negatively to punishment. Businesses, including insurance, knows this well as they often reward the high producers with bonuses, gifts, commission increases, trips to exotic places, company cars, and many other rewards. Productivity is rewarded, often regardless of how it was achieved. It should not be a shock to discover that persistency of insurance is worse on business sold during a company promotion, "President's Club" qualification period, or some other such contest period.



**If only productivity is rewarded, any sales with any business suffer in quality when increasing in quantity.**

Take heart, though, there are companies that reward their employees handsomely if they exhibit ethical behavior in their business pursuits. Companies are becoming more aware that commission structures and contests that reward productivity may not be the best way to go; so many companies are restructuring their commission schedules and promotions to reflect more acceptable agent behavior by including such things as persistency standards.



**Since realistically we probably all have our "price," the smart person will simply not put themselves in situations where they are tempted.**

### **THE AGENTS' RESPONSIBILITY TO THE CLIENT**

While discussing the agent's responsibility to the client, it must be kept in mind that this is actually a three-part relationship including the insurer, in which the agent is a mediator between the company and the client, (the relationship which includes the insurer will be discussed later). As is often pointed out, the responsibilities of the agent toward the client changes during the course of the relationship. In the beginning of the relationship, the client is only a prospect prior to the policy becoming effective, so the ethics of marketing would apply at that stage and the agent is obliged to adhere to the requirements of honest marketing, such as necessary disclosure and the avoidance of undue pressure which could limit the client's freedom to buy or not to buy, and "suitability." Then when the insurance goes into effect the customer is then an "insured" and a client, and new responsibilities arise, such as servicing, helping with claims, and updating policies.

Actually, one general principle can cover all phases of the relationship, basically that of the Golden Rule—treat the client as the agent would like to be treated. The professional pledge to which all CLU and ChFC designees commit specifically applies that Golden Rule when it states: "I shall, in light of all conditions surrounding those I serve, which I shall make every conscientious effort to ascertain and understand, render that service which, in the same circumstances, I

would apply to myself " The CPCU Canon #1 states: "CPCUs should endeavor at all times to place the public interest above their own" which is a little different but with the same intent.

These rules exist and require compliance because insurance agents are subject to the normal conflict between self-interest and the interests of others. Agents should make recommendations based on their client's needs, but obviously they need to sell policies to make a living and their company needs to sell policies to stay in business. Consequently, from time to time, there can be pressure based on the agent's personal financial situation or from the agent's company and manager to sell the client what he or she does not need. According to *The Market Conduct Handbook for Agents*, "The insurer may say it wants the field force to provide careful needs analysis but, in fact, the reward system for the agent is based on sales-not service. If an agent discovers that less service and needs analysis can result in quicker sales, then the agent faces the ethical conflict of whether to make more sales and more money at the expense of the clients' needs." Of course, for the agent to act in his own self-interest at the expense of another is the very core of selfishness and is universally condemned.

Besides avoiding selfishness and not selling what does not need to be sold, the agent certainly has an obligation to ascertain a client's needs for insurance. Simply put,



It is unethical to sell a client an unnecessary insurance policy as the mere attempt to sell an unnecessary policy would usually involve lying and/or deception, practices universally considered unethical.

OK, there could be times when deception may not be a factor because of the ignorance of the agent in respect to the product they are marketing. The agent might not have known what the client needed and subsequently recommended an unsuitable product but it is the duty of the agent to recommend the proper product and if there are areas that are unknown to the agent, it is the responsibility of the agent to either become adequately educated or to divulge his ignorance and withdraw until he is properly educated. As with the IRS—ignorance of the law is no excuse. If the agent takes a professional approach and does needs analysis, then that puts the further requirement of product knowledge on the shoulders of the agent.

Besides the Golden Rule, there are other obligations in the agent/client relationship.

**Confidentiality:** While discussing the product with a prospect, with the necessary obtaining of information for the application, an agent is able to learn a lot of private information—often *very* private—in respect to the personal and financial status of the applicant. This information should be treated as if it were classified "*Need To Know*" and this information should be shared with only those who have a legitimate right to the information and **after the client has authorized a release of this information.**

**Policy Delivery:** This is an area where there are disagreements as to whether the agent is responsible for delivering the insurance policy to the insured and (many times) also collects any premium which may be due at the time of policy delivery. Since some coverage do not take effect until the policy is delivered, timely delivery is crucial. Some agents are afraid that by approaching the client again and answering questions about the policy, the client may have "buyer's remorse" and not take the policy. Therefore, they contend that it is better to either mail the policy to the client or have another agent deliver the policy (who could claim ignorance if need be). This, of course, leads to problems. Obviously, the agent should not only deliver the policy, but he must take the time to explain all the policy provisions, including riders and exclusions, to see

one more time if the policy meets the needs of the client, and to explain how the agency handles ongoing service. If there have been any changes that have been made in the policy that were not in the original application, then it is mandatory for the agent to deliver the policy and fully explain such changes.

One of the principal consumer complaints about many types of insurance is that the agent seems to feel it is a "one-shot" deal and the client never sees the agent again. Some agents do not "want to be bothered" by their customers calling about every "little thing" involving their policy. Not only is this unethical, but it borders on pure stupidity. Those who service their policyholders have the best persistency and are usually awarded for this, but they also are a ready source of other insurance products as they become the "customer's own agent."

**Claims Handling:** When the situation arises for the owner or beneficiary to make a claim, the agent has a responsibility to assist the beneficiary (in life insurance situations) or the insured by explaining what must be done in order to collect on a claim, helping the insured or beneficiary expedite the claim settlement, mediating between the insured or beneficiary and the insurer, and explaining the final settlement if the settlement is not what the owner or beneficiary expected. With some insurance products, particularly in the commercial lines, the agent may become quite involved, or in some cases, by custom or by insurer fiat, the agent is never involved in claims—in which case this should be explained to the client as often the agent is the "face" of the insurer, i.e., the only one they really know, and his absence would raise questions that need not concern the client.

**Servicing:** The professional and successful agent always reviews the client's policies periodically and, in particular, if there have been any changes due to company requirements or recent legislation that might affect the policyowner. Situations change through the passage of time, so it is very important to review the policies to see if they provide the coverage currently needed. Also, another good opportunity to provide more coverage if needed.

**Unfair Trade Practices:** In insurance, the most attention in respect to ethics pertains to market misconduct and unethical behavior of the agents in this regard.

As an example, the misrepresentation of the benefits or terms of a policy; misrepresenting dividends as guaranteed when they are not; misrepresenting the financial condition of the insurer; misrepresenting a policy as other than what it is; or an agent misrepresenting himself by claiming to be a financial planner when he is not.

This text goes into considerable detail in respect to twisting, churning and replacing of policies, which can be unethical and in many cases, may also be illegal.

There is also the practice of *rebating*, which is usually considered unethical, although there is some argument. "Rebating is defined as any inducement in the sale of insurance that is not specified in the insurance contract." An offer to share a commission with an applicant is the prime example of such an inducement, and is illegal in most states except California and Florida—where there are very strict rules as to acceptable rebating which usually has the effect of discouraging such rebating practice. Rebating is generally considered wrong because it gives one agent an *unfair* advantage over other agents, or is seen as unfair to those clients who are not given a rebate. Defenders of rebating argue that it is not unfair, but rather should be viewed simply as a competitive market ploy.

The agent owes the client the truth, therefore it is unethical to "company bash," i.e., misrepresent the strengths and weaknesses of the competition—either company or agent—particularly

if it is known to be untrue. This seems simple, but it can be difficult at times, particularly if there is a company that is known to be weak financially by those in the insurance industry, but not publicly known. When a client asks an agent about a company or agent that is less than reputable, what is the agent to do? There are several answers, including "tap-dance" around it, pleading total ignorance (even though the agent is supposed to "know his business"), ignore the question and hope it goes away, change the subject, or take a more ethical approach: tell the client to call the state Department of Insurance Consumer Affairs and ask that question.

Certainly if a product is not meeting a client's needs, or if clients are being misguided by another agent, the first agent has an obligation to disclose that fact, but it should be based on **facts**, not the needs and desires of the agent to replace the company business of another agent.

Discrimination against clients for reasons other than sound actuarial principles is unethical. The word "discrimination" is pejorative because of unethical and illegal discrimination affecting a large portion of our population, but it actually only means excluding people (or including people) based on some relevant characteristic. *Unethical* discrimination is exclusion committed on the basis of some unjustified bias or hatred toward a person or group, such as race, sex, religion, nationality, or ethnic group when those considerations are irrelevant and when they are done from motivations such as sexism, racism, or antireligious bias. On the other hand, there are insurance companies that are affiliated or associated with a particular religious or national group, such as Fraternal Insurance organizations (which generally are no longer discriminatory). Their exclusion of nonmembers is not unethical—but if a company is not an exclusive company from its inception, then such exclusionary policies are unethical. There are, however, legitimate reasons in underwriting for exclusion.

In a famous court case where the question was whether the discrimination was permissible concerned granting of premiums to young women drivers that were lower than the premiums applied to men. Actuarially, as a group, young women had safer driving records than their male counterparts. Was this sexist? Because it was not based on denigrating women, and in fact favored them, it was not deemed discriminatory in the unethical sense.

It is unethical for the agent to discriminate against a client based on considerations such as race, it is not discriminatory to ask if the person is worth the risk and/or does the person have the ability to pay?

These, in brief, are the ethical responsibilities an agent has toward his or her client. We now need to consider the responsibilities the client has toward his agent or the company.

### **CLIENT RESPONSIBILITIES**

The agent-client relationship is not the only relationship where ethical consideration can arise, as the client has ethical responsibilities to the agent as well. As with the agent-client relationship, the client should do nothing that is deceitful, unfair, or harmful to the agent or the company.



**The insured owes the company the truth.**

The chief examples of a client's unethical behavior include fraudulent claims, lying to the agent and withholding information on an application.

There is a widespread practice involving fraudulent claims, particularly in the disability income area where back injuries are faked in order to collect compensation. There are jokes about the practice even though they are certainly unethical. They are fraudulent and unfair because their cost is borne by those who pay premiums and/or by those who receive less return on their investments.

Another common type of unethical practice is lying or withholding information on an application. There are a number of stories told in which a client, while smoking a cigarette, has told the agent he is a nonsmoker. There are those clients who actually believe that if they smoke a cigar after dinner they are not considered smokers—would a person who has a glass of wine with dinner be considered an alcoholic? Unfortunately, there are agents who will write the policy as requested by the client—sometimes the theory is that if a person is a smoker, then that will turn up at claims time and the claim won't be paid, but that is the price of lying for the client.

Here the discussion is focusing on the ethics of the client. The client has no ethical reason to put an agent in that spot, to lie to the agent, or to ask him to violate his obligation to the company. There are agents who are so ethical that in such a situation, they walk away and refuse to take an application under the theory that the person would probably not tell the truth to the company in case of a claim and therefore, the person is not acceptable to the insurer.

*McGill's Life Insurance* illustrates the subtle kind of unethical behavior engaged in by the client when he puts the agent into a conflict of interest situation, by the following example:

The agent's brother-in-law, Sam, is an attorney and is has an inoperable malignant brain tumor. Because of the aggressive nature of the treatment, he may live for up to 3 years, or he may die within 3 months. Sam feels he is woefully underinsured. He is concerned for his family's financial welfare after his death. So is the agent.

Sam has always been a bit of a spendthrift. He has lived the good life, spending everything he has earned over the course of the years—and then some. The agent knows that he will probably have to help support his family if he dies without adequate life insurance.

Sam approaches the agent, an experienced, professional life insurance agent and asks for his help and understanding. Sam wants to apply for life insurance—not a big policy, but \$100,000 of annual renewable term, which he feels is just enough to guarantee his children's college education. He plans to deny his medical history when he is examined for the policy—if a physical is needed as often a paramedical exam in the home is sufficient for such a term policy if the applicant denies any health problems. He will claim that he has no attending physician.

Sam is prepared to take his chances that he will live beyond the policy's contestable period. As an attorney, he believes that he fully understands the implications of what he is about to do, at least as far as those implications may affect his beneficiaries. He does not however seem to have given much thought to how they may affect the agent and his career. What are the agent's ethical obligations to Sam, to Sam's family, to the insurance company (if the business is submitted), and to the agent, himself?

The example is interesting because selfishness on the agent's part is not involved; rather there is a conflict of loyalty. Sam, as a member of the agent's family, puts a claim on the agent in the

name of family loyalty and, in this situation, the family's interest conflicts with the company's interest.

What these examples show is that clients have at least three obligations: 1) to tell the truth on an application, 2) to file honest claims, and 3) to not put the agent into an unnecessary conflict-of-interest situation. Acquiescence by the agent is essentially collusion against the insurer and the other policyowners.

### **CHARACTER**

We have all heard the word "character" in referring to certain individuals. Some seem to have it, and some don't. Actually, those who have overcome temptation tend to have developed a stronger character as a result. So, what is character? The dictionary has about 50 lines (in small print) of definition, but the most applicable would be: "one of the attributes or features that make up and distinguish the individual." Therefore,



**the goal of an ethical individual is to develop a *strong* character.**

Many scholars, authors, and others, consider *virtue* as the telling factor in a strong character. Simply put, **virtue is like a habit to do good things**, such as "honesty is a virtue." Virtue is not something that anyone is born with, but it must be developed. Children go through a phase when they come up with some "whoppers" and while this upsets many parents, it is a natural part of growing up and it is the responsibility of the parents to teach honesty (a virtue) to the child.

On the flip side, people can develop habits of doing "bad" things – this would then be called a "vice." People usually don't start doing "bad" things all at once—like virtue, it must be developed. Normally it is not taught by parents, but by others in the environment, associates, friends and those to whom a child respects. This usually starts with something small, like a "little white lie" that gradually develops into falsehoods so rampant that people simply no longer believe them. Unfortunately, it is easier to develop "vice" than it is "virtue," as virtue demands continual attention and it must be exercised frequently. Since it is harder to be virtuous, virtue is praised more by others.

People, nearly all people, at some time in their life face situations where they can easily succumb to temptation to do something that they know is wrong, even though they know that another action would be right. Unfortunately, many people take the low road. The importance of ethics training comes into play here, so that the person will do what is right and will be therefore, working towards building a strong character.

At this point, it seems proper to discuss individual agent ethical problems in more detail.

### **QUANDARIES**

When a "What to do, what to do?" situation arises, it is called "a quandary, dilemma, or just "a gray area." A quandary has been described as a puzzle wrapped in a dilemma wrapped in a quandary... This situation comes into play when it is just not clear as to what is right and what is wrong.



**A quandary or dilemma occurs when in a certain situation, the person is not sure as to what to do, as there is good reasons for the action and good reasons against it.**

## ***INSURANCE QUANDARIES***

It is quite easy to find oneself in a quandary in the insurance business. Assume for instance, that a client, an elderly widower, decides to disinherit his children because they are objecting to his desire to leave most of his money to a nursing home that had taken care of his late wife and is now taking good care of him. You are a financial planner so you are familiar with his situation and he respects your advice. But when asking for up-to-date financial information, you discover that the person who has been making his investments is the son of the owner of the nursing home, and he has informed your client that his investments have tripled in worth since he took over—which is dubious, to say the least.

What should you do? Follow the professional code of ethics and investigate by asking for more specific financial information, or should you simply do as he asks and change the beneficiaries of his estate (and policies) to reflect his desire to name the nursing home?

Or, should you perhaps contact his doctor to make sure that his mental condition is good enough to make such an important decision? And even "stickier," understanding the need for confidentiality, do you contact his children (assuming that you know them well as decent human beings)? You should not make this contact unless the client gives his permission to do so—or there are other circumstances that would indicate that such notification is necessary.

### ***TRYING TO RESOLVE DILEMMAS***


These decisions are not easy, and as the world of business become more complex, so do the ethics decisions. But before a dilemma can be solved, there are certain steps to be taken before one can start applying ethical theories or ethical principles.

#### **COLLECT PERTINENT INFORMATION**

Every effort must be made to collect all of the information possible that pertains to the "dilemma." In the situation previously discussed, it would be easier to make the proper and ethical decision if it were known that the client is not incompetent. It may be surprising to learn that

 **many quandaries are solved when all of the information is collected.**

#### **DISCOVER ALL OF THE PLAYERS**

 **Before it can be determined as to what is fair, those that are involved in the dilemma must be discovered.**

Sometimes this is not easy and will require a lot of "digging," but as they say, "You can't determine the program until you know the players." Sometimes there are hidden agendas discovered when all participants are known. Also, sometimes there are those with "shady" reputations on one side of the question, which would raise red flags and which alone could determine the proper ethical decision.

#### **DETERMINE THE OPTIONS**

Some ethicists maintain that since a dilemma (or quandary) must have at least two options, in order to determine the proper option, a third option is necessary. The reasoning seems to be that if one has not spent enough time and thought to the problem without coming up with at least a third option, then they simply haven't thought enough about the problem.

Practically speaking,



**in order to solve a dilemma, there MUST be another choice, other than just two.**

There would not even be a dilemma if there were not two choices—a right choice and a wrong choice—and the dilemma is trying to figure out which is correct, or at least the better choice. Sometimes the third choice is an acceptable combination of the other two, sometimes it is completely different, but in any case, it usually is not easy to discover.

### **ESTIMATE THE AFFECT OF THE OPTIONS**

If the action under consideration is fair to all parties, benefits the client, and is consistent with such actions in other situations, then there really is no reason not to choose that action. Conversely, if taking such action requires that a commitment is broken, or it is harmful and unfair, then that action would not be proper.

Of course, it is really not that easy in "real life," primarily because of the conflict that occurs when an action is beneficial but it still not fair—hence the quandary/dilemma.

### **UNDERSTANDING THE RISK**

One of the primary ethical actions of an insurance agent is to make sure that both the client and the agent understand the *risk*. An example of this from the files of an experienced agent:

The life insurance agent is selling a life insurance policy to meet accumulation goals that the prospect is attempting to obtain. The agent gave the prospect a choice of a 12% interest variable life, a 9% universal life, and a whole life policy showing a 6% - 7% illustration. If the agent had stopped here and had discussed only one product, obviously the 12% variable product would have been an "easy" sale.

This agent was not satisfied with a quick sale as he felt something was missing. He told the prospect that he understood that 12% was more than 7%, so there was no need to belabor that point. The question was, "Do you think you can make the right investment choices for the next 30 years to achieve a consistent 12% return?" The agent had presented this several times in the past with the usual reply that they were confident that they could do so, etc. However, in this one instance the agent was surprised when the prospect told him that he would make 25% "like clock-work." The agent asked the prospect if he had a line of credit, and the reply was that of course he did, and the interest rate was low.

The agent asked why the prospect did not take his credit line to the very maximum at that low rate, and then invest it at the 25% return program. His answer was that the line of credit was on his home, and he did not want to "gamble" on his home—the *risk* of losing his home was unacceptable.

After a little more discussion, the prospect ended up buying a "nice" (as the agent called it) whole life insurance policy. The ethical lesson here is that discussing risk will educate a client or prospect and help him make the proper choice for their circumstance.

## ***EXAMPLE OF ETHICS IN LONG-TERM CARE INSURANCE***

"Bill" is an agent that sells primarily Long Term Care Insurance, representing 3 different companies and he has the right to broker individual cases with other carriers if he wishes.

### **INSURERS**

Of his primary companies, Company A is an "old-line" life insurer with an AAA+ rating with Best's, that offers a comprehensive policy but comparable benefits are a little more expensive than with other insurers. Also, commissions are a little lower but once a year they have a sales contest that can be quite rewarding. Underwriting is considered as "typical," i.e., not conservative or ultra-liberal. It only offers tax-qualified plans.

Company B is an A+ rated company; well known but is not as large as the Company A, and is licensed in 25 states. Its underwriting is more liberal, premiums for comparable benefits are lower than Company A and the standard commission is a little higher.

Company C is a smaller company that has a B- rating from Best's. It specializes in LTC Insurance and is licensed in 10 states. It is known to be innovative and offers several different plans, including one that does not protect benefits from taxation (non-qualified), but in all other respects, has excellent benefits. Commissions are higher than most companies', and underwriting is more liberal in medical (contrasted to mental or cognitive) history. This company is owned primarily by the CEO and his family and other company officers, and industry "scuttlebutt" has it that they are trying to write as much business as possible in anticipation of a sale or merger with another company as the CEO is 72 and wants to retire.

### **INDIVIDUAL CONSIDERATIONS**

Bill was introduced to Emily, a 60-year old widow, by one of his regular clients. Emily has an income of \$100,000 to \$150,000 a year (depending upon the stock market). While she can afford to pay for nursing home care, should it be needed, she has 2 children who are concerned about losing their inheritance if she would have to spend much time in a nursing home. She is in relatively good health and should be insurable for LTCI, and she drives, shops and generally takes good care of herself. She has no mental problems and prides herself on remembering detail. She is a little overweight but not significantly.

### **ANALYZING OPTIONS**

Agent Bill's agency contracts with 3 LTCI insurers. Therefore Bill must consider all 3.

- To start with, should Bill even sell her an LTCI policy? Actually, she does not need one, so ethically, she should be made aware of this. Bill also realizes that if he doesn't sell her a policy, her children will probably find someone that will. One option here is for Bill to walk away and if another agent sells her a policy that would no longer be of any concern to Bill. But, if he wants to sell her a policy, then there are other options to consider.
- With Company C, Bill gets more commission but underwriting is looser so he is confident they will accept her regardless of the possible overweight. Company C would save Emily about \$500 a year for the best policy, plus there is a liberal 10-year experience-refund provision included, and is not available with standard premiums at the other companies. This is of interest to Emily, as she will only be 70 then.

- Company C 's lowest priced policy is not tax qualified, but the policy Bill is considering for her is tax-qualified, so it does guarantee that benefits would not be taxed as individual income. Bill knows that while the likelihood of the IRS taxing long-term care benefits of a senior citizen will probably never happen, there still is no guarantee as present laws indicate that they would be taxed. Is the lower price worth the risk?
- Bill must, ethically, take into consideration whether the company will always be there to pay the benefits, ergo the "scuttlebutt" about Company C. All insurers in the state belong to a guaranty fund—which helps to reduce that concern.
- Another factor: Bill's agency leads the country in sales for Company B and the contest period is nearly over. Since the premium for an LTC policy on Emily would be substantial as she can afford better-than-average benefits, this sale could tip the production in favor of his agency—and the agency owner would be most appreciative.
- On the other hand, Bill has promised his parents that they would all take a trip out West this summer in his (hopefully) new mini-van. If he would place this case with Company C, his commission and renewals would then give him enough to purchase his van. With Company B, he would come close, and maybe do better if the agency manager was quite generous in showing his appreciation.

This "example" is patterned after a situation faced by an experienced LTCI (but nameless) agent two years ago. At this point, the question should be: Have the necessary steps been taken to resolve this dilemma? Remember, this is an exercise in *ethics*, not in financial management.

1. Bill has done a good job in collecting facts to help him determine what would be in the client's best interest. One thing that might be done, if he can do so without hurting the relationship—finds out if her income disturbs the principal. If it doesn't, that would be another reason that she probably does not need the plan, but if she elects to purchase a plan, she could afford higher premiums for a plan with better benefits.
2. Determining as to whom a stake in the activity has is a little difficult, as he must decide if he wants to contact the children. In this case, since the children are the driving force behind Emily's interest in LTCI, they probably should be so, *unless Emily objects to his contacting them*. If Bill contacts the children, how much should be emphasize the fact that Emily may not need LTCI? If it is felt that Emily should purchase a plan, should Bill discuss the various coverages available with the children? Practically, it is highly unlikely that Bill (or any other agent in this situation) would decline to write the policy on the basis that she did not need it, if only because there is little doubt that another agent would be there writing the policy the next day.
3. Analyzing the options is, of course, the principal discussion here. What options are *fair*, *beneficial* and *consistent with commitments* and *not harmful to others*?

### **FAIRNESS**

- Is it fair for the children to receive a diminished estate if their mother should become incapacitated and require nursing home or individual care?
- Is it fair to require higher premiums just to justify the financial standing of the insurance company which, since they are all regulated, would probably never become insolvent?

- Is it fair to the agency owner not to write business that would benefit the agency the most?
- Is it fair to the agent (Bill) not to collect a higher commission when the policy benefits would be the same as a policy with lower commissions?
- Is it fair to even offer Emily an LTC Insurance policy?

#### **BENEFICIAL**

- Is it beneficial to Emily to purchase a policy that she does not really need?
- Is it beneficial to members of her family that she has such a policy in place?
- Of what benefit would it be to Emily if she should receive benefits, to have them taxed, weighing the fact that it probably would not happen (but technically it could)?
- How would a sale in Company A benefit the agency? Company B? Company C?
- How would a sale in Company A benefit Bill (& family)? Company B? Company C?
- Is it really beneficial to keep "investing" in blue-chip companies if she can get a much better policy with better benefits at a lower cost in a company not so highly rated?

#### **CONSISTENCY**

- The commitment here is to provide a method of paying for long term care costs in case that Emily is incapacitated and unable to take care of herself.
- Bill's commitment to Emily is to provide her with the most secure plan, with the best benefits, at a reasonable cost, so that she can not worry about benefits being paid at a later date.

#### **SUMMARY**

In this illustration/example, there are undoubtedly other areas that could be explored. However, based on this information, what would be the most ETHICAL action, i.e., what should Bill recommend to Emily? This illustrates the fact that sometimes these situations are not easy, and it gives a background into further exploration into the intricacies of Ethics.

In case you are wondering, what did the agent—who is known for being ethical and who has an excellent reputation—do in this (actual) case? When asked how he solved this dilemma, he stated, "After finding out how much money she actually had, I was able to convince her to invest heavily in annuities, thereby giving her a guaranteed income for life. Then, since I was not married and was about to retire, I married Emily and we are enjoying our winters aboard our yacht!" (He was just kidding, of course.) Actually, he volunteered the fact that since the situation was rather complex, there were many disciplines were involved, including actuarial, financial and legal, the decision was to place the policy with Company A, basically because of the company's strong financial standing. He bought a used van.

## ETHICAL THEORIES

These principles of fairness, consistency and beneficial to the proper parties, as discussed above, plus such things as "morality," and other such items to consider, may be called "ethical theories" that form the basis for ethical rules. But as one would suspect, very rarely is there a clear-cut situation where such rules can be applied with no hesitation and with knowledge that the ethical solution has been reached—no ifs, ands or buts.

What if you promised your family to take them to Disney World this summer? However, just a few days before the planned trip you are informed that your daughter, who has a learning disability, must be tutored during the summer months in order for her to be admitted to the next grade with all of her friends. It is highly important for a parent to address this family dilemma as the solution must not only be honest, but it must be ethical, if for no other reason that to teach the children that problems arise in normal life and there are ways to tackle these problems—ways that are ethical and that they "can live with" even though it may be difficult.

In this specific case, there are certain points to be considered.

Tutoring is expensive, which means that you probably cannot buy a new bicycle for your son that was promised him, so that he can go to and from Little League practice and games in the fall.

If you took a week to visit Disney World, your daughter would lose that much tutoring and the information that she did not learn could be crucial to her final grade and for her moving to the new class.

Another, emotional, type of ethical dilemma is that if you did not take them, they may think that you had lied to them from the beginning and was just looking for excuses not to take them to Disney World.

This is called a "**real**" dilemma as more than pure reasoning is involved—obviously there are emotions involved also.

Without going into a technical discussion as to the "types" of moral dilemmas, it should be mentioned that



**there are those who appeal to fairness and rights over the consequences, and then there are those who appeal to consequences over fairness and rights.**

No discussion of dilemmas would be complete without bringing up the decision that was made by President Truman to use atomic bombs in Japan, and by doing so, ending World War II. Those who agreed with his decision say that it was worth taking the estimated 80 or 90 thousand Japanese lives in order to bring this bloody war to an end, and otherwise, in all probability, it would have cost millions of lives if the country of Japan had been invaded. On the flip side, there are those who (still) maintain that dropping the bombs was immoral and not just because of the loss of innocent lives.

Dilemmas usually cry for solutions, and multitudes of such dilemmas arise every business day. Solving these dilemmas is what gives us "ethical theory" and which requires more study.



**Simply put, an ethical theory lays the foundation for a principle, which in turn constitutes the most important justification for pursuing or following a course of action.**

In determining whether an action is ethical—or not—may depend upon "who is asking?" There are those who prescribe an action for ethical reasons based upon whether it benefits more people than it harms. Those who automatically look at every situation as whether or not it is "fair" regardless of the consequences might look at a situation differently than one who always looks at every situation in the light of what benefit it would be to him.

Those that look for the benefit to themselves find that problems arise when what is good for them can only be accomplished at the expense of another. This is the key for whether such consideration is selfish, or just self-concern. Selfishness would indicate that the extreme of ignoring how an action would affect others is the most common example of unethical behavior. In many professions, the code of ethics requires one to act in a way that will best serve the **public** interest.

### **DETERMINING ACTION IN LIGHT OF THE CONSEQUENCES OF THE ACT**

Another type of person will always determine an action *in light of the consequences of the act* and they will then always compute the benefits and the harm of every action. Therefore,



**an action may be justified if it brings more happiness than unhappiness for more people.**

This seems rather straightforward, but the problem is determining whether an action brings out the maximum amount of good, or whether it is good to a maximum number of people. If it brings out the "good" to a maximum number of people, then the problem becomes as to how these "goods" are to be distributed. Next problem is how one decides as to what counts as "good?"

Sometime "good" is defined as to what satisfies the desires of the individual the best—actually defining "good" as pleasure and happiness. Happiness is considered by many as the ultimate "good." This discussion can (and does) fill page after page in text books, but it is presented here just as an example of how professional ethical theorists can determine whether a specific action is ethical or not.

### **ACTING ONLY FROM DESIRE**

Another consideration to determine if the action is ethical—if a person acts strictly from desire, then he is acting more like an animal inasmuch as there is no *moral* reason to take the course of action. The question should be not what action will fulfill the *inclinations*, but what fulfills the sense of duty or obligation.

### ***ETHICS OF VIRTUE***

There is one more class of person, or perspectives used by a person, in determining whether an action is ethical, and that is usually referred to as the ethics of *virtue*, or as some prefer, ethics of *character*. The first word that comes to mind to most is "honesty." While the classical sense of virtue is not necessarily confined to honesty, it is most descriptive for this discussion. Accountants, for instance, have the responsibility to always respond truthfully and there is little doubt that this is a virtue that is mandatory for a professional accountant.

Another virtue can be *loyalty*. As an example, as an auditor, does he practice good, solid (some say "hard-nosed") auditing practices? This points out that some "virtues" can conflict in all industries and professions. How much loyalty to a client should an auditor have? Should an auditor warn a client of an audit problem before the audit report is filed? In any event the question may be—loyal to whom? And, "to thine own self are true" in which case, is their loyalty to clients and audit firm (or for an insurance agent, loyalty to client or insurer)? If the loyalties conflict, then comes the dilemma.

While it certainly would not hurt any professional to spend the time to become better educated in philosophical studies of ethics with its many ramifications, as a practical matter, most people do not think about the principles to be used in determining whether an action is ethical. Most people simply go by their "gut-feelings," their intuition or their own personal feelings. Some simply go entirely by what their training has provided them to consider.

Since people in the same vocation or endeavor have various reasons and motives for acting as they do, there must be a published code of ethics for any profession if for no other reason than uniformity.

### **DETERMINING THE PROPER ACTION**


Once these steps have been taken, then the options available must be evaluated to determine which would be correct. There are several ways to determine the right action but there are four basic steps:

1. Is the action that appears correct, beneficial to the parties concerned? Sometimes at this point it would be helpful to use the "smell" test, i.e., if the action doesn't "smell" right, then it probably isn't.
2. Is the action to be taken, fair to the parties involved?
3. Is there a responsibility to perform the action because of a prior commitment or promise made?
4. Is it legal?

The proper evaluation of these options is the heart-and-soul of "Ethics" and is discussed below in more detail.

### ***DEALING WITH RIGHT OR WRONG***

Obviously, "Ethics" can be said to deal with right or wrong. Believe it or not,

 **nearly everyone has a (n) (ethical) set of beliefs as to what is right or wrong and these beliefs do not necessarily remain the same among all persons.**

For instance, abortion, capital punishment, and adultery can be good or bad, right or wrong, or acceptable or unacceptable, to a person or a group of like-minded persons.

Cheating, stealing, and not keeping promises, or abusing children, elderly persons or animals are usually considered as "wrong" or "bad." These all constitute moral beliefs, and if one were to write down all their similar beliefs, they would, in essence, create a personal code of ethics.

The primary subject of "ethics" is human actions, referring specifically to any action that is deliberately taken. If a person thinks about a particular action and then chooses to take this ac-

tion, then it is a deliberate action and if the person has any control over this (these) action(s)—then they can be held responsible for their actions.

### **PERSONAL RESPONSIBILITY**

In today's society, many feel that "personal responsibility" is becoming an "ancient" belief that is not "relative" to today's situations. A mother drowns her children, but it is "not really all *her* fault..." A sniper kills innocent people at rest stops, but it was only because of the (fill in your own reason)... A corporation goes bankrupt, leaving many vendors, employees and investors with empty pockets, because an accountant employed by the company "went along" with the desires of the company President to over-inflate the value of high-end inventory items in order to show the profit to the Board of Directors that the President had promised—but the accountant is not at fault because he was just doing what his boss wanted him to do... etc., ad infinitum.

True, the actions of individual humans are not the only subject matter regarding ethics that must be considered. The activities of a group of individuals can be called "social practices" (if one delves deeply into the study of Ethics), which may or may not be ethical. A practical example would be an individual using insider information to buy certain stock; or in the case of a stockbroker, to notify his clients of a probable decrease or increase in the value of their stock because of "insider information."

Remember the earlier discussion of Equity Funding. The stock analyst who was first made aware of this situation also faced an ethical problem. The analyst had been informed of the situation over lunch with an executive of Equity Funding, and after lunch the analyst did some quick checking and as a result, was convinced that the executive was telling the truth. He contacted many of his clients and recommended that they get rid of their Equity Funding holdings. As a result of this action, the New York Stock Exchange charged the analyst with violating exchange rules with information about Equity before regulatory authorities made it public.

Ethical questions arose as insider trading is a "general practice" and his using this information was an individual action. One question that was asked: "What was the analyst to do?" When he became aware of this information he was not able to completely verify the information, but he felt that it was his duty to his clients to pass on the information that he possessed, just in case. Ethically, was it not his duty to protect his clients? If he had not notified his clients and it later was disclosed that he had known of the situation, would he not be susceptible to criticism for ethical reasons, but perhaps also legal action? Another related ethical question in respect to the informant was "Why did the executive wait for three years before exposing this situation."

### ***SENSITIVE JUDGMENT***

"Sensitive" judgment is often used in Code of Ethics of some professions, but should be used for all professions, including insurance. It simply refers to the total of all factors involved in ethical judgments, i.e., the professional should be aware of all matters pertaining to the morals and judgments of all actions that may arise during any personal or general actions.

Every person has some sort of moral beliefs, and usually they include the simple belief that "everyone should do their own job." Therefore, a person must determine whether they should do their job under *every* situation and circumstance.

Many Codes of Ethics state that the members of the organization should accept the obligation to "act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism." This sounds good, but is very difficult to achieve at times. Is

an agent, for instance, to place his (or his family's) interest above that of the public? What if the needs of the company conflict with the needs of the client, or as importantly, the public?

There are always situations where there are conflicts between one's profession and their job or between either and their personal life. What to do—what to do? How does one know what is acceptable and what is not, what action is acceptable, etc? Thus, the Code of Ethics (or Principles, etc.) has been created by nearly all "professions" and by most businesses of any size.

### **INTEGRITY**

The Code of Ethics for any profession will state in some fashion or other, that the member should perform with the highest sense of "integrity," or words to that effect.



**The acknowledged definition of integrity is "firm adherence to a code of especially moral or altruistic values."**

One could look at the way this principle is stated and then ask, "Am I showing integrity in the way that I am performing?"

It is important for the student of Ethics to realize that accepting just anyone's beliefs does not make it correct—as everyone alive today knows of the vast differences in the beliefs of the Western world as contrasted with many in the Middle East, for instance, with their suicide bombers, slavery, annihilation of a race of people, etc. Therefore, beliefs must be regarded in the sense of morality, and moral beliefs involve emotions, desires, preferences, and entrenched values. One thing for sure, they are intangibles—one cannot touch, see, feel, etc., morality.

Many simply ask, "Are there any *good reasons*" for doing a certain thing, or are their *good reasons* why one does NOT want to do a certain thing?

Many "old-timers" would ask, "**Is it proper?**" when deciding what to do in many situations. When asked how a person could know if it was "proper," the answer usually was, "You just know."

### **JUSTIFICATION**

Suppose you were 16 with a driver's license, and you had been looking forward for months to taking Susie (or Ralph) to the movies in the family car, all by yourself. Your father had agreed to let you use the car to go to the movies when you got your license. When the day came and Susie (Ralph) had agreed, you asked your father for the car keys, but he says that you cannot have the car. You are understandably upset, and you cannot understand how he can go back on his word. You father can then say that he is not obligated to give you the car, therefore his belief is not justified or he should justify it to you. Maybe he just doesn't feel like it right now.

This justification probably wouldn't satisfy you because he did "promise." And, people should always honor their promises (a basic of Ethics). This could mean that any promise is not worth much—business deals will fail, marriage will come apart, and the world will go to wherever in a handbasket.

However, what if he said that the XX@&\$!)\*\*&% thing blew the carburetor today when he was driving home and he can't get the parts until Monday. Now, there's a reason for not honoring the promise. In other words, there is *justification*. This proves that



**moral beliefs are right or wrong, correct or incorrect, and they can be justified if there are good reasons.**

This is an important precept in understanding ethics and ethical behavior.

### ***BELIEFS LEARNED AS A CHILD***

A good exercise in order to better understand moral beliefs is to list those beliefs that you learned as a child. For many, this could start with the Ten Commandments and the Golden Rule, and everyone will agree that you should not lie, steal, cheat, harm or kill.

On the other hand, the overwhelming reason for taking an action for many (too many) today is that is best to do anything that is good for you, it is in your interest to do a certain thing, or perhaps more importantly, will it benefit you? *Better* reasons, more understandable perhaps, are that by doing something you should ask if it is just or fair (or "proper"), or you promised to do it and it will not do harm to others—and, one does not break promises.

Take this one more step where you can look at whatever action you are considering.

### **IS THIS GOOD FOR ME?**

Like it or not, this is typically the first thing that goes through the average person's mind when it becomes necessary to make an ethical decision. This is not always true—Mother Theresa rarely, if ever, thought of herself first. For the rest of us who are not approaching Sainthood, if you can actually perform an action that benefits yourself, can you think of a better reason for doing it?

Of course, this is applicable only if it is "meaningful" work—usually defined as work that can be beneficial to the person. Most people have a need to be productive and to work towards that end (some don't, but they wouldn't be professionals), so therefore, work is good for us all.

Conversely, if an action causes harm to one self (not necessarily physically) then that is a primary reason for not doing it. This can be overemphasized frequently, as some people seem to think that any actions that are beneficial to themselves must therefore, not be the right thing to do. Of course, this is silly, as if a person doesn't consider or concern him or her with an action that benefits them, then who will? You cannot go through life without looking out for yourself.

A good rule to follow in determining if an action is good for you is that in most cases,



**there can be justification that an act can be good simply by showing that it is good for you.**

### ***HOW DOES THE ACTION AFFECT SOCIETY?***

The next step is actually to take a step back and look at the "big picture." Is this action not only going to be good for me, but is it going to be good for everyone else (society) as a whole?

One outstanding example of determining what is good for society, as often quoted in such discussions, involves Tylenol and Johnson & Johnson. When Johnson & Johnson were made aware that some of their Tylenol bottles had been tampered with and it was nearly impossible to determine just how many bottles were involved, they immediately made the judgment call to recall ALL Tylenol from the shelves of the many stores and warehouses, causing the corporation

untold millions of dollars in profit. This was a decision based upon whether the action would affect society properly, and fortunately for Tylenol users, this was the right decision.

An interesting point is that the business press solemnly but loudly (in some instances), prophesized that Tylenol would never regain its market prominence. It did.

### ***IS IT FAIR, JUST AND PROPER?***

Children (in particular) voice objections to some situations that they believe is just "not fair." This usually brings the response that "life isn't fair." Yet "fair" is used in many adult situations, including laws and regulations—fair trade in particular, but in insurance, there are "fair" claims practices, fair underwriting practices, fair sales practices, etc. In law, there is fair & impartial, fair and proper assessment, fair and valuable consideration, fair market value, fair consideration, Fair Credit Reporting Act, fair dealing, fair market value, fair plan, fair rate of return, etc.

"Fair" means impartial, just, equitable disinterested (everyone thought that the umpire was fair), free of bias or prejudice (used particularly in trying for a fair and impartial jury). *Black's Law Dictionary*

"Fairness" is part of the foundation of ethical behavior (as covered initially on the first and subsequent pages of this text). Fairness relates to equality, which raises the question as to whether all persons are equal in all respects. The Declaration of Independence states "We hold these truths to be self-evident, that all Men are created equal..." However, people do not always remain equal—what a dull world this would be if that were true. Of course, all people should be treated equally unless there is some relevant difference. Nearly everyone has a "boss," countries have rulers or Presidents, etc., and without someone "being in charge," our civilizations would never have grown and prospered. That does not mean that there should be slavery or indentured servants.

If an insurance agent sells insurance to a newly arrived immigrant who has difficulty with the language, the agent may be able to "sell" a policy that does not fit the need of the client but brings the largest commission to the agent as the client did not completely understand the "technical" terminology. Perhaps the agent followed the rules closely enough so that the sale was legal, but in no event would such a situation be ethical.

### ***IS THERE A RIGHTS VIOLATION INVOLVED?***

Every American has the right to be treated "equally." And, further the Declaration of Independence says that we all have the right to life, liberty and the pursuit of happiness—and, to be technically correct, to property. Furthermore, the government grants us certain rights and when these rights are infringed upon, then we are protected by laws and regulations. The use of coercive marketing techniques and deceptive advertising is considered as a violation of our rights to liberty. Even the laws that enforce the rights are often considered as a violation of a business entrepreneur to his right to do business.

Certain rights have become known as "entitlements." These entitlements include the right of a child to be educated, for instance, but the means for this education must come from others who are obligated to provide this right. Healthcare and housing for everyone are not "rights" per se, but in certain situations, these rights could be assumed. If they are so assumed, it is the right of the taxpayer to know whom, how and how much these "rights" can affect the rights of the taxpayer to keep and hold property. More pertinent to this discussion is the right of a purchaser of

stock in a corporation to be provided with accurate financial information regarding the corporation.

So, if a proposed action treats all persons involved equally and fairly and there is no violation of their rights, then this is a reason to continue with the action. Conversely, if the rights of another would be violated, even to a small degree, then this is a **big** reason not to take the action.

### ***HAS THERE BEEN A PROMISE MADE?***

A promise is a commitment, and if one has made such a promise/commitment, and then one should do all in their power to honor the promise/commitment. This is an inescapable reason to pursue the course of action contemplated.

Is there any promise/commitment beyond those that were agreed upon by the parties involved? Implied promises are generally a distinct and very important part of most transactions. For instance, if one purchases a set of golf clubs, there is an implication that the club shaft will not break or bend if the club is used properly and for the task for which it is designed. Those who purchase insurance products do not expect that when the insurance is needed, the "small print" will void their agreement with the insurer.



**It is an inherent trait of civilization that promises between persons are kept even though most of the promises are implied.**

What would happen to commerce if there were no implied agreements between an employee and an employer that the employee would show up for work every working day?

But what if you borrow some anti-freeze for your car from your neighbor with the promise to return what you do not use. He later asks for what was not used as he had had learned that a cat would readily drink anti-freeze with the result that they assume room temperature. And further, the cat belonging to the person across the street has been intimidating his poodle, and he is going to solve that problem, "once and for all." Do you break your promise in this situation, knowing what the result of keeping your promise will be, that harm that will come of returning the anti-freeze would outweigh the promise? (This may be arguable with some that really, really, hates cats – but you get the point.) Or is it proper to lay and say that you used all the anti-freeze? Or, perhaps, pour what is left into the ground and then tell the neighbor what you did and why?

### **STUDY QUESTIONS**

1. Ethics is
  - A. a social system of rules created to allow people to adjudicate disputes rationally.
  - B. a system of distribution of goods.
  - C. a religious concept that only deals with business matters.
  - D. the discipline dealing with what is good and bad and with moral duty and obligation.
2. When ethics are discarded those affected generally are
  - A. who will suffer the least.
  - B. those who can afford the consequences.
  - C. those who will suffer the most and who can ill afford the consequences.
  - D. those who are disinterested.

3. Repeated unethical activity
  - A. will eventually become ignored.
  - B. will become the norm where it no longer is unethical.
  - C. will usually be made illegal—eventually.
  - D. is a synonym of illegality.
4. Bad ethics
  - A. are usually taught by example.
  - B. are birth defects.
  - C. are automatically changed as soon as they are recognized for what they are.
  - D. is synonymous with good business.
5. If a person is taught that he can get away with wrongful acts and make money
  - A. then there is no way that his thinking will change.
  - B. he will usually become a respected millionaire.
  - C. he needs retraining and re-education as to what is right and wrong and why it is so.
  - D. he will only do things that are unethical, not illegal, as it is not in his nature.
6. If only productivity is rewarded,
  - A. then quality and quantity will both suffer.
  - B. then quality and quantity will both increase incrementally.
  - C. any sales with any business suffer in quality when increasing in quantity.
  - D. the only attorneys would be rich.
7. It is unethical to sell a client an unnecessary insurance policy because
  - A. the sale would usually involve lying and or deception, unethical practices.
  - B. it is not ethical for one agent to make more commission than another.
  - C. the insurance company may end up having to make double claims payments.
  - D. it is also immoral and always illegal.
8. A quandary or dilemma occurs when in a certain situation
  - A. there is an obvious profitable situation and a not-obvious unprofitable situation.
  - B. both the agent and the client are unethical.
  - C. a person is not sure what to do, as there are good reasons for and against it.
  - D. an agent is required to market a product that the agent knows is not the best on the market.
9. In order to solve a dilemma
  - A. the solver must have a degree in ethics psychology.
  - B. there must be another choice, other than just two.
  - C. one must be able to run a random computer program.
  - D. one must only look at the legal solution.

10. Nearly everyone has an ethical set of beliefs as to what is right or wrong, and
- A. only the Catholics look for divine guidance in ethical problems.
  - B. these beliefs do not always remain the same among all persons.
  - C. the beliefs that are the most profitable are the most ethical.
  - D. every civilized nation adhere to the same ethical rules of right and wrong.

**ANSWERS TO STUDY QUESTIONS**

1D 2C 3C 4A 5C 6C 7A 8C 9B 10B



## CHAPTER TWO - PROFESSIONALISM AND ETHICS

### IS INSURANCE A PROFESSION?



**Insurance, as an industry, is not a profession.**

This does not mean to say, in any way, that there are not professionals within the industry, as there certainly are. A person in the insurance business does not wear a uniform, there are no requirements that insurance employees be "board certified" or professional workshops that must be attended, journals that must be read, etc

The subject of whether insurance is a profession or a business was posed to Dr. Overman, former president of the American Institute of Chartered Property Casualty Underwriters. His thoughtful response, as outlined in *Winning by the Rules*, (Ken Brownlee, CPCU), is perhaps one of the most succinct and understandable answers to this question. He listed several criteria that separate a true profession from other vocations, and they include

- There must be a highly unified body of specialized knowledge.
- There must be a broad educational background, which also contains generalized knowledge.
- There must be a detailed and thoughtful Code of Ethics.
- There must be a need to strive for the "ideal of altruistic attitude and behavior." Used in this context, "altruism" is the concern for the welfare of others over the concern for one's self.
- There must be detailed (he calls them "searching") examinations to determine if there is sufficient mastery in the specialized skills of the profession.
- There must be a professional organization that controls entry to that profession, and further, it must monitor the member's "continuing adherence to the tenets of that profession."
- Another condition was added by Brownlee, "the need for careful mentoring of the professional by his/her colleagues as they enter the particular field."

While "insurance" itself, is not a profession, a career in insurance may be considered a professional vocation, as there are many professions within the industry. When one takes a look at the "profession" requirements, it immediately becomes apparent that a graduate degree is not required—even though available at many universities—and a background of general knowledge is not even required.



**Licensing and training does not make a profession.**

## ***INSURANCE EDUCATION AND LICENSING***

Some in the industry may point to the licensing and continuing education requirements for insurance agents as proof that insurance, itself, is a profession. That argument is rather specious as even dogs and automobiles require licenses and there are examinations for plumbers, electricians and bus drivers, to name a few.

An agent must be subject to considerable training, and the quantity and quality of training varies by company. Unfortunately, the attitude of many agents and some insurers is that if an agent can pass the state examination to be licensed, then all that needs be taught is product knowledge. Actually, training is supposed to teach the student how, whereas education teaches a student why.

Real professional insurance training is time-consuming but it is available through universities and through the American College, the College of Insurance, and the Insurance Institute of America. The Society of Insurance Trainers and Educators (SITE) have identified sixty-nine insurance professional designations, generally requiring class attendance, study, and the subsequent passing of written examinations.



**However, neither the insurance industry nor the public as a whole nor through the regulatory body (insurance departments), require that a practitioner have even one of these designations, nor do they require undergraduate degrees.**

In some cases, those with professional designations are given special recognition—such as those with CLU or CPCU designations may not have to take licensing examinations in most states. Actuaries who have the Fellow (or often, Associate) designation in Actuarial Science are afforded certain recognition in the certifying of assets and/or reserves in some states. *Insurers* may require that people in certain positions hold certain designations, but as an industry, designations are not required to practice the vocation of "insurance."

One ethics requirement that permeates all of the insurance professional's training and ethics is that



**the professional must always be aware of and protect the client's best interests.**

The often quoted as Dr. Solomon Huebner, the founder of the American College presented one of the best analyses of exactly what constitutes a "professional," because he was concerned about life insurance salespeople becoming professionals. One of the characteristics and probably the most important are:



**"In the applying that knowledge (of the vocation) the practitioner should abandon the strictly selfish commercial view and ever keep in mind the advantage of the client."**

Often followed by other professions, the CPA Commission on Standards of Education and Experience for CPAs which expounds on the definition of professionalism, and applies equally well with most professions, states that "...a member of a profession requires the individual being involved in a standard of conduct which governs the relationship of the practitioner with clients,

colleagues, and the public, plus there must be shown an acceptance of social responsibility which is inherent in a profession that is required to show public interest." (Our underlining) This certainly indicates that in order to be a professional, one must accept ethical standards that require that selfish commercial views be abandoned.

While some economists take the position that the primary (and some say, *only*) responsibility of a business is to increase profit, that approach is not correct according to most economists and scholars, because they insist that the pursuit of self-interest must be constrained by ethical considerations of justice and fairness.

When one is engaged in a profession, then others rely upon the knowledge and experience offered by the professional. In these situations there is great temptation to abuse the position of power a professional has because of their knowledge and experience, as it is easy to take advantage of another. This would be the "cardinal sin" of any professional, because if their clients cannot trust the professional, he dishonors his professionalism and the profession as a whole.

Professionalism is usually contained in the Code of Ethics of a profession, for instance:



**the acquisition and maintaining of knowledge required is stated to be the *individual* responsibility of the professional.**

Another such statement on professionalism states, in essence, that the distinguishing mark of a profession is acceptance of its responsibility to the public, which consists of clients and reiterates that a "distinguishing mark of a profession is acceptance of its responsibility to the public." This reinforces the idea held by the public at large that the purpose of most professionals is to "maintain the orderly functioning of commerce."

Regardless if the insurance agent has a professional designation, such as a CLU, CPCU, ChFC, CLF, REBC, FLMI, FSA (and ASA), RHU and similar professional designations in the insurance industry and is a member of such a professional organization if he *practices* what the Code "preaches" then he is acting as a professional. Therefore, the almost-universally accepted standards in the code should be followed by anyone who holds himself or herself out to be a "professional."

### **INSURANCE ETHICS AND THE LAW**

Many times the problems that are faced by insurance personnel may be either legal or ethical, or both. It is necessary to understand applicable law when studying ethics because:



**Law sets minimum standards, whereas ethical behavior is the highest standard.**

Therefore, law and ethics address similar problems, but the standards differ. An agent that is privy to certain pertinent facts affecting the decision of an applicant for insurance, may not *legally* be required to disclose any of this information, but ethically they **MUST** make the applicant (and the insurer) aware of the situation.

### ***INSURANCE DEPARTMENTS***

Any person who has taken an insurance agent's examination or who has worked for any time in the insurance industry is aware of Public Law 15 issued in 1945 (also called the McCarran-

Ferguson Act), which established that regulation and taxation of the insurance industry should be a state function. However, it also says, in effect, that if the states cannot actively regulate insurance, then the federal government will do so, which it has done in providing a Medicare program for those elderly citizens who were unable to obtain commercial insurance, protecting retirement funds of employees (ERISA), providing portability and other regulations in respect to health insurance, flood insurance, and other situations where state regulation has not been sufficient in the eyes of the federal government and regulators. In many instances, ethical problems have resulted in legislation.

As an example, the Medicare program was instituted in 1965 which provided basic health coverage to a certain segment of the population, and which opened up a "supplemental" market as Medicare was not intended to provide all health services to the beneficiaries. The Medicare Supplement market flourished, but there was an inherent problem—the beneficiaries were mostly senior citizens and many of them were confused by the program. Therefore, unethical agents (unfortunately, there were many of them) would sell the person more than one Supplement policy, even though they only needed one policy. It was not uncommon for a Medicare beneficiary to have several health insurance policies, intermingled with long-term care policies, and all of which were creating unbearable financial strain. The federal government later enacted regulations which created ten base policies that pretty well covered all the basics, and they required all companies to sell only those policies. These regulations also outlawed the sale of more than one Medicare Supplement policy to a beneficiary, including any policy of any kind that duplicated the Medicare coverage they already had.

Penalties were severe, the state insurance departments enforced these regulations plus similar state regulations, so those specific ethical problems were solved by regulation.

Regardless of the intent, laws and regulations almost always have problems, many times leading to further regulation. The various states attack these problems that may also affect other states through the National Association of Insurance Commissioners which provides model bills for the insurance departments to present to their state legislatures for passage.

### **CALIFORNIA REGULATIONS**

California is a prime example of regulators being aware of ethics violations, particularly in the area of marketing insurance products to seniors. Annuities and Long Term Care Insurance (LTCI) marketing created the majority of the ethical problems in this respect. The California Department of Insurance and the state legislature have been successful in the elimination of many of the ethical problems, and are reducing the frequency of others.

The examples are numerous and when a California agent obtains his insurance license or takes continuing education courses—particularly annuities and LTCI—it is apparent that the regulations were devised in order to eliminate or minimize ethical problems. One example involves the practice of marketing primarily annuities by inviting senior citizens to seminars, many of them luncheons (at no cost to the seniors) where the advantages of annuities over other investments are "discussed." Those holding these seminars were often identified as estate planners, financial planners, financial consultants, or some other dignified-sounding name, when actually many of them were just insurance agents. Regulations now require that such invitations or announcements contain a statement that "insurance" will be discussed.

Realizing that ethical problems abound in marketing in the senior's home, regulations now state that the senior must be informed of any visit to the home, along with information as to the purpose of the visit and who will be present. Another regulation in respect to the sale of life insurance or annuities to Seniors requires an agent that offers to sell an "elder" any life insurance or annuity product, to advise the elder or the elder's agent that the sale or liquidation of any stock, bond, IRA, Certificate of deposit, mutual fund, annuity, or other asset to fund the purchase of the product may have tax consequences, early withdrawal penalties, or other costs or penalties as a result of the sale or liquidation. Further, the agent must advise his client that he/she or elder's agent, may want to consult an independent legal or financial advisor before selling any assets or before selling or liquidating any annuity product being sold, offered for sale or even being solicited.

Obviously, there had been numerous ethical incidents where an agent had convinced a trusting senior that they should liquidate an existing investment and replace it with an annuity or other product that the agent could provide that was not to the advantage of the elder person. That, of course, was unethical and now it is illegal in most situations. An agent may still abide by the regulations and replace an investment with an annuity or another type of investment (mutual funds, for instance, if the agent were so licensed) including all of the required warnings that replacement may not be in their best interest and the client signing that they had so been notified and warned. Therefore, the legal requirements would be complied with and the client could replace the investment. However, assume that the agent represented more than one insurance company and was aware that the client could have had better results with an annuity from Company A, than with Company B, but he places the business with Company B because the commission was better, or perhaps it would help him to qualify for a sales contest with Company B. Therefore, ethics took the legality of the transaction to another step.

### **LITIGATION**

An insurance research organization has concluded that "unrepresented" (not represented by legal counsel) claimants receive a higher net recovery on the average, than "represented" clients. Not only that, but the unrepresented claimant received settlements MONTHS earlier. It is the unalienable right of a customer to sue and the numbers of those who acquire legal help in the settling of claims has increased in recent years. A lot of this is because of *punitive damages*. After all, with all the publicity of people receiving millions in punitive damages when they sued an insurer (also known as "deep pockets") and with the availability of attorneys working on a contingency basis, why not? Is this out of control? Probably

Agents may find themselves in situations where they feel that ethically, they should recommend that the client (or claimant) obtain outside legal assistance. Would this really be that ethical, considering what is known about settlement amount and timeliness?

### **MARKETING ETHICS**

As anyone in insurance marketing knows, the insuring public typically comes in contact with insurance only when the coverage is first purchased, and when there is a loss and claim is made. Not surprisingly, it is at these times that insurance standards are the most highlighted.

It is a "given" with many (if not most) insurance agents that *price sells*. Whether this is right or wrong, this attitude permeates the industry. However, people only get what they pay for, in insurance, groceries or automobiles. If they want quality and the person or organization selling

the product is ethical, then they should end up with a quality product. If they want the cheapest product, then they must bear some of the responsibility if the product "crashes and burns" or does not perform as expected.

For most products, there is the rule of *caveat emptor* (let the buyer beware), but



**caveat emptor cannot ethically be applied to the sale of insurance.**

Insurance products are intangibles—they cannot be inspected or experienced before they are used (unless the customer had experience with the same company and same coverage previously). An insurance policy is called an "Aleatory" contract—a promise to perform certain acts. Therefore, the insurance agent, the insurance company and the underwriter must at least attempt to provide what the customer needs and wants and at a price that is fair and adequate.

Sounds simple, but those who have been selling insurance know that it not always so simple as the customer may not have the faintest idea as to what they want exactly, or more importantly, they might not have a clue as to what they *need*, but they are just concerned with the price. This presents a very common dilemma:



**Should the agent sell the customer what they (think) they want, or should they try hard to sell the customer what they really need?**

### ***ETHICS AND UNDERWRITING***

Insurance is simply the spreading of the risk among a large number of similar units, but difficulties arise in defining a "similar unit" whether the "unit" is automobiles, business, buildings, homes, ships, cargo, property or persons.



**Underwriting evaluates the differences within a similar group of units.**

Any decision regarding the exposure of risk within the group must be based upon the knowledge of the underwriter and such knowledge must be very accurate if the underwriter is to make the proper decision for insurability, and if so, insurable on what basis. These factors that the underwriters must take into consideration must be considered in every underwriting decision.

Insurance is usually a long-term relationship between the insurer and the insureds and involves considerable amounts of money if maximum claims are reached. There must be a considerable amount of trust involved in any insurance agreement, and the underwriter certainly is well aware of this trust. The character of the applicant is often investigated and an underwriter, who is comfortable with the ethical conduct of a proposed insured, is inclined to be more lenient in underwriting.

The conduct, reputation and ethics of the agent is always (or should always be) taken into consideration in the evaluation of any risk. There are insurance underwriters, for instance, that keep meticulous records of agent conduct which may have considerable influence on their decision on difficult underwriting decisions. If a health insurance agent comments on an application that the applicant does not appear to be in as good health as they insist they are because they have a noticeable shaking of their hands, their coloring is very pale, and they speak very slowly, etc., then an underwriter would know to dig deeper into the health history. The next time that the

agent has a questionable case but insists that the situation is better than it appears, the underwriter seriously consider the agent's statements. Actually, it is part of the job of a professional underwriter to know which agents they can trust and which they cannot. One thing is certain; the agent who is not trusted will have his business scrutinized very thoroughly, in detail, and often.

Another ethical question here, what if the agent who reported that the applicant was not in as good health as reported, later submitted an application on an individual who would be usually considered as overweight but the agent maintains that the extra weight is mostly muscle because of the applicant's exercise regime and the fact that he competes in local events requiring considerable physical strength. However, the underwriter "went by the book" and offered an increased premium because of overweight. Would this be ethical behavior on the part of the underwriter? Realistically, could the underwriter expect that the agent would be so cooperative in the future? Incidentally, this seemingly overweight situation occurs in health and life insurance and underwriters can increase the premium with no further questions, decline the risk in some cases, ask for additional medical records or tests, or sometimes, if the applicant is not dramatically overweight according to their height/weight tables, will accept the word of the (known to be ethical) agent.

Underwriters base their decisions upon available information, verifiable and actuarially sound. When enough information on all variables is assembled, then the risks can be grouped and then matched against loss expense for that particular exposure. But where does the underwriter get the information?



**The main source of underwriting information is from the agent who must obtain accurate information from the applicant and combine this with other data, depending upon the risk.**

For instance in a large commercial risk, prior loss experience is necessary. Assets must be verified in many cases, and annual reports and company brochures are necessary.

Regardless, the only determination that can be made as to whether the process is ethical, is the accuracy and completeness of information submitted. Answers to every question must be honest and detailed.

### ***PRICING***

State insurance codes specify that all insurance premiums are **actuarially sound, fair, adequate and non-discriminatory**. Whether the premium is actuarially sound is determined by studies of past loss ratios and then projected forward using techniques that are acceptable to the actuarial professional and to the state departments of insurance.

*Fair, adequate and non-discriminatory* are all factors that contain ethical considerations as well as legal and code compliance. The most precise definition of "unfair" as it applies to insurance premiums is attributed to Professor Arthur Williams of the University of Minnesota in an essay in 1969:

"An insurance rate structure will be considered to be unfairly discriminatory if, allowing for practical limitation, there are premium differences that do not correspond to expected losses and average expenses or if there are expected average cost differences that are not reflected in premium differences."

Unfortunately, insurance premiums have become a political issue. There is at least one U.S. Senator who campaigned on his disapproving insurance premium "hikes" when he was Insurance Commissioner in his state. Since that time, several of the more financially strong insurers have either left the state or have restricted their coverages.

When insurance companies do not receive their (statistically) needed increase, many have just stopped writing business in that state. The effect is that, for instance, when Worker's Compensation or Auto Liability coverages require a premium increase, the increase is not granted. As stated before, insurers are not eleemosynary institutions, so they pull out of the State or do not offer coverage in that State. That means that the policyholders must go elsewhere for coverage, nearly always at a higher rate from non-admitted or substandard insurers, or in the case of drivers, enter the assigned risk pool

### ***NEEDS SELLING-SUITABILITY***

It cannot be said enough or loudly enough, insurance company representatives must properly assess each customer's **needs**. Many, if not most, life insurance professionals question the ethics of companies who advertise on the radio and on television for an on-line service, where the applicant "shops" for the price on a certain amount of life insurance. Or for that matter, for automobile insurance companies who market heavily in the media, including sending out junk mail, on the basis that they can write the same coverage as other companies, but for less premiums.

The agent or broker's product is the result of the analysis of the risk and subsequent service, particularly in property and casualty insurance. If the agent/broker is not familiar with the problems, hence the needs, of the customer, every effort should be made to determine what these needs are. Not only are there ethical questions in this respect, the agent could sell the wrong product to a customer and find himself with a professional liability problem.



**It is the duty of the agent not to only sell the right product to the customer, but it should also be sold at the right price.**

An agent ethically must not sell just for the purpose of making sales. Actually, this makes good sense anyway, as an unsatisfied customer can spread his story among friends and associates and the agent could find his business decreasing without knowing specifically why.

However, the agent is not the only one with ethical considerations in insurance sales. The customer who purchases more insurance than they need might not have been misled by an unethical agent, but may they have an ulterior motive. One indicator of client fraud is over-insurance, or the claimant presses for a quick claims decision.

Homeowners insurance presents a good ethical study on overinsurance. Some states have a valued policy law, which states in effect that if property is totally destroyed, the insurer must pay the policy limits, regardless of what it costs to replace it. (Otherwise, the policy would be a *replacement cost* policy.) For example, if the home can be replaced for \$200,000, but the insured insures the home for \$300,000, in case the house burns down completely the insured would receive \$300,000. This is an ethical problem for the insured—and the agent if the agent knows

that the house could be rebuilt for a lesser amount. The agent could get into trouble if he initiated such a substantial disparity between the replacement amount and the valued policy limit but this would not be realized unless the house is destroyed—which may never happen and the insured pays excess premiums for years.

### **WHO IS RESPONSIBLE?**

In most lines of insurance, this is a non-question as the insurance company is always responsible for claims. However,



**when there is a high deductible there is, in essence, more claims responsibility on the insured as they are assuming part of the risk.**

Many large companies partially self-fund their liability risks, which differs from self insurance as every claim—regardless of size or whether it is within the deductible—is subject to the terms as they appear in the insurance policy. As a matter-of-fact, most liability and Worker's Compensation policies reserve the right of the insured to settle or defend for the insurance company (and not the insured).

The same situation theoretically arises when there is a "fronted" program, i.e.; a "fronting" company is involved. Another similar situation is where a policy is retrospectively rated.

In these situations, the insurer must take the desires of the insured into consideration for settlement purposes. Also, courts have often stated that an insurer, who held ultimate responsibility for a claim, did not act in good faith in a situation regarding the setting of reserves for a retrospective rated policy.

Ethics would require that the insured be made very much aware of his acceptance of part of the risk and how it would affect him with a claim. The agent must educate prior to policy issue, and not rely on the claims department at time of claim to educate the insured on coverage.

### ***TWISTING OR REPLACING***

Agents may often find themselves in a situation where an insured wishes to replace an existing insurance policy with another policy. It is important to differentiate between "replacing" a plan (which is legal) and "twisting" (which is not legal). "Twisting" is where an agent or broker attempts to persuade a policyholder *through misrepresentation* to cancel one policy and purchase another one. Replacement is the substitution of one insurance policy for a policy of like kind and value (no misrepresentation involved). State laws universally protect policyholders from "twisting." Replacing requires notification of the existing insurer of a replacement of one of their policies, often giving them time to respond.

Replacement can be a "good thing," such as when the first interest-sensitive life insurance policies were introduced. Millions of policyholders had life insurance policies where their cash value was credited at 3% or lower during a time when anyone could walk into a bank and get a much higher rate of return on a Certificate of Deposit. Legitimate, honest replacement possibly saved the life insurance industry from the "buy term and invest the difference" syndrome—or at least it had a very positive effect. In such situations the replacement still can be called into question because when a policy is replaced, the agent receives a new commission. So while the agent may provide a service to the client, regulations have had to be strict as there would be the temptation to misrepresent policy benefits of existing policies so that a new sale can be made.

The principal reason that replacement can be very good for the client is because of the ethics of the agent. As mentioned earlier, agents frequently represent more than one company and can, therefore, have choices in legally replacing a policy—financial condition of the new insurer, detailed comparison of benefits, easier ways to qualify for benefits, etc.—even without taking the commission differences into consideration. An ethical agent must always look at the replacement through the eyes of the client.

Another ethical question can arise—if the agent encourages, or does not dissuade, an applicant to cancel present coverage so that they can qualify for a new policy—then this is unethical. What will happen if the insured does not qualify for the new policy? This has happened more often than most people realize, primarily in health insurance, but also in other lines, particularly where there are no immediate binding receipts used.

Secondly, the agent is the one that completes the replacement form in most cases, even if the insured is required to sign it. It may be hard to believe, but agents have been known to not tell the truth when replacing policies. For instance, they indicate the reason for the replacement is that the original agent has moved or passed away, the other company has had bad press about claims practices, the insured has not been able to communicate with the insurer, or the insured's relative had a legitimate claim refused by the insurer so they want to change. (These have actually been on replacement forms, plus some that are so "far out" that the application was returned.) Plus, one experienced agent actually told fellow agents at a local underwriters meeting that he never asked the insured's to sign the replacement form, as it would just raise too many questions, and besides, he was quite expert at "window panning" or "obtaining a secondary signature" as some call it.

Since many agents push insurance products just to gain sales (read commissions) many commercial risks purchase coverage net of commissions, and pay the agent or broker a fee for their services. This does not completely solve the problem because some insurers (often because there are built-in rating factors) still charge commissions and return them to the agent/broker. This brings up an interesting ethical question—if the agent or broker has been paid a fee, should they then return any commissions paid by the insurer, to the insurance company? Obviously from an ethical viewpoint, it should be returned, but as a practical matter, many disagree.

In some cases, there are contingency profit arrangements wherein a broker or agent (who may or may not be retained by the insured on a fee basis) is rewarded by the insurance company for bringing a block or book of profitable business to the insurer. Whether this is ethical or not seems to be side-stepped, as many who address this situation, particularly in publications, maintain that the present distribution system (agents and brokers) had been originally set up to meet the needs of marketing to small and medium size organizations and to individuals. The large international corporation of this century does not really fit this type of organization, particularly since insurance is only one way of financing risk with these large firms. Therefore, even the relationship between the insurer and the insured is much different than it was in the "good old days."

### **INSURER COMPETITION**

In the modern business atmosphere, mergers and acquisitions are a fact of life and insurers and brokers are no exception. There was concern in the commercial property and casualty insurance field that because national brokerage firms acquired smaller firms and affiliated with others in the 1970s, that the days of the independent agent were limited. Fortunately, this did not hap-

pen, as many independent firms are still involved in commercial coverages. There was consolidation and mergers though, particularly in brokerage firms, as shown by the fact that in 1990 there were ten top brokerage firms, and today there are three. What this has done, is to lower choices for commercial clients, and lessening the number of choices does not benefit consumers.



**The difference between a broker and an agent is a matter of representation. A broker represents the insured to the insurance company, while an agent represents the insurance company to the insured.**

To many in the industry, the lack of choice creates an ethical problem. One situation arose when a large brokerage firm maintained that its corporate insureds did no longer need risk managers as the brokerage firm could provide these services. The problem with this is that a commercial risk manager takes into consideration several forms of the financing of risks, and not just by insurance. Since the broker represents the insured to insurers, by using the broker's services competing risk financing is eliminated, so the broker benefits—but not necessarily the insured. It is possible for a broker to be working on a contract fee basis, which alleviates the ethics of a conflict of interest somewhat.



**Conflict of interest is a major cause of unethical behavior.**

### CLAIMS SETTLEMENT

The National Association of Insurance Commissioners (NAIC) addresses unfair claims practice as:



**"Not attempting in good faith to effectuate prompt, fair and equitable settlement of claims submitted in which liability has become reasonably clear."**

Contracts should be executed in the spirit of good faith and fair dealing, and insurance policies, it must be remembered, are simply "contracts." Taken from the viewpoint of pure contract law, the "legality of purpose" criteria for contracts refers mostly to insurable interest considerations, such as an individual cannot purchase a life insurance policy on the life of a stranger without having a financial interest in that person's life. Basic insurance 101, but agents have been known to create a fictitious interest—either financial or familial—in the life of an applicant in order to get the commission or by request of the applicant because they owed (usually an illegal) debt to another person, or for same-sex living arrangements. Often illegal, unethical or both

If the premium is not adequate because of incorrect or insufficient information being furnished, then the *consideration* criterion for a contract has been avoided. Therefore, the contract is ethically unequal, even though there has been some consideration.

### GOOD FAITH

Note that the NAIC act mentions "good faith" so the question then becomes—what is "good faith?" *Black's Law Dictionary* states that good faith is "a state of mind consisting in (1) honesty in belief or purpose, (2) faithfulness to one's duty or obligation, (3) observance of reasonable commercial standards of fair dealing in a given trade or business, or (4) absence of intent to defraud or to seek unconscionable advantage."

"The phrase 'good faith' is used in a variety of contexts, and its meaning varies somewhat with the context. Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party; it excludes a variety of types of conduct characterized as involving 'bad faith' because they violate community standards of decency, fairness or reasonableness. The appropriate remedy for a breach of the duty of good faith also varies with the circumstances." (*Restatement [second] of Contracts #205 cmt. a (1981)*)

An essential part of good faith is the fact that it is absolutely necessary that there **be complete and mutual understanding of the relationship between the insured and the insurer, and also potential third parties to the contract.**

The insured trusts that when a covered loss occurs, the insurer will be there to fulfill their part of the insurance contract. Just for exchanging some money and a piece of paper, the insured may receive thousands or even hundreds of thousands of dollars to indemnify them. That is a demonstration of faith on the part of the policyholder.

The insurance company also has to trust its insureds as it is a given that some policyholders will make claims. The insurer expresses its faith in the insured by providing that claims are made fully, timely and in good faith.

### ***ETHICAL BEHAVIOR***

"Ethical behavior" may seem like a religious term—actually religion and ethics are closely entwined as ethics, by its very nature, relates to moral behavior. So does religion and faith of the individual as in the balance of things, they both are higher than the law. As with ethics, faith has a higher standard of behavior than the law.



**One identifying factor of ethical behavior is that the person takes responsibility for his actions.**

Therefore, people and organizations that do take responsibility for their actions are showing high ethical behavior. The Tylenol situation is an excellent example of taking responsibility, indeed, the company already had procedures in place for recalling a product long before the tampering with Tylenol occurred.

Opinions as to what behavior is "moral" vary and what one may think is an ethical situation, may not appear so to another. The news media is full of situations that may or may not be "ethical." As a matter of fact as this text is written, certain big-city newspapers are under fire for reporting information that many, including a large number of congressmen, feel is deleterious to the war on terror. They had been asked by those responsible for the security of our nation, not to publish this information, but it was the opinion of the newspaper(s) that it was something that people should know. The legality of this is under question, but perhaps a better question would be "Did the newspaper(s) act ethically when they hurt the security of the nation after being asked not to divulge this information?"

### **MORAL BEHAVIOR**



**In determining whether an action is ethical, it must be approached as whether it is or would be "moral" behavior.**

As a matter of fact, ethical behavior can usually be called moral behavior, and actions to the contrary would not only be unethical, they would also be immoral.

Take the situation of an automobile accident where a person in one of the cars is injured. Does the uninjured driver offer emergency help even though they may not be qualified? If there is no one else around immediately, of course a party is obligated to offer assistance, and in some cases may be so required by law. If the injured party is bleeding badly, and the other person has had no medical training, but elects to wait for the medics or someone who is professionally trained as they feel that they are not qualified and they could possibly injure the person even more—is this an immoral act, and an unethical act as well? Or is this highly ethical as by not trying to help the injured person, he fulfills one of the basic ethic rules: **Do no harm.**

What most would consider as immoral/unethical behavior is considered by some as just common business practice. A nurse may not stop at an accident and render medical help as she is afraid that she could be subjected to a malpractice suit even if protected by a "Good Samaritan" law. A used car salesman may represent an auto as being safe and in good working condition, knowing full well that the brakes are about gone (perhaps not a good example as many used car salesman are rather notorious for being unethical).

A health insurance agent takes an application for Major Medical insurance on a family who has no health insurance. In order for the application to be approved, it was necessary to obtain medical records on the father. The insurer had a firm practice of never paying more than \$50 for medical records, but the physician belongs to a large medical group who has a firm policy of charging a minimum of \$100 for records to be sent to an insurance company. This impasse could mean that the applicant would not get his health insurance (and the agent would not get a commission). Since the agent was not aware of the physician's charge—normally \$50 would have been enough—he had indicated to the applicant that his payment of the first month's premium (usual health insurance practice) would be all that the applicant would have to pay up front.

If the agent simply cancels the application with no explanation (he was embarrassed to admit that the applicant might have to pay something for his records), then the client and his family has no insurance and have been without insurance during this period of time.

If the agent pays the extra \$50 out of his pocket for the medical records without notifying the company or the client, is this ethical? The insurer probably would consider this as a form of rebating and would not allow an agent to pay part of an applicant's premium. Therefore, if the insurer found out that the agent had paid his own money, the agent could lose his ability to represent the carrier. If it were kept "secret," it would still probably show somewhere on the medical records as a receipt for \$100 for the records. If the agent instructed the physician's office to hold the records and he would pick them up, and then he "loses" the receipt for \$100, this is dishonest and therefore unethical, even in the face of serving the "greater good."

A dilemma must have more than one response, so another response that could possibly happen "in the real world," is that the agent would contact either another company with whom he is licensed and see if they would pay the \$100, even though the other company may not have as good a policy or pay the commission of the agent's regular insurer. Would this be an ethical approach? It would be ethical only if (1) the regular insurer who has already seen the application, is notified that the medical records cannot be obtained for \$50; (2) the client is made aware that another insurer is available to provide his coverage; (3) the agent meets with the client and com-

pletely explains the benefits under the new policy proposal and honestly and fully compares the benefits between the policies; and (4) explains fully the reason that he had to go to another company. This response would mean that the client either accepts the new plan, or does not take either of the plans—which would mean that the agent did not do a good job in explaining the problem, or possibly the client may offer to pay the additional \$50 out of his own pocket.

There are other alternatives, for instance the agent may pay \$50 to the client who then writes a check to the insurer for \$50. This is not honest, therefore it is not ethical. Is this done? Probably

In any event, this must be the original idea of the client, or it is **really** unethical.

Another alternative is available: If the agent is not licensed with another health insurer, he (or other agents or even the agency manager) would likely know another agent who could write the application and whose company would pay the records fee. Is this ethical? Probably, *provided* the client is made aware that another agent will be calling on him and the reasons thereof, the agent's primary carrier is made aware of the situation (they may waive their \$50 rule if it appears that they might lose the case) and the commissions are paid to the new agent only. This has worked in a number of situations, and is known as the "scratch my back..." approach as the next time that the new agent has a similar situation he cannot handle through his carrier, he may "re-pay" by referring a client to the original agent.

What has happened in similar cases is that the agent explains the situation to the client, including the alternative use of another insurer that would cover the cost of the records. When the client is made aware of the situation including the fact that he may have to complete another application, in many cases the client will thank the agent for being truthful. The client may volunteer, or the agent may suggest, obtaining the records personally and then forwarding them to the insurer as the medical records actually belong to the patient. If this does not work, sometimes clients will volunteer to pay the additional cost—\$50 in this case.

It would be fair to say that similar situations arise in all lines of business where coverage cannot be provided by one carrier because of their internal regulations, but the agent attempts to avoid the problem, sometimes correctly, sometimes unethically. Brokers, on the other hand, face these situations differently as they represent the client. In the above situation, brokers are often used as they can provide coverage in difficult situations. Financial arrangements that are legal and ethical can occasionally be worked out between agent and broker.

### **UNETHICAL INSURANCE PRACTICES**

Is it possible for the insurance industry (which would die a horrible death if it ever were to be determined as unethical because people must take them at their word for the industry to thrive) to actually do something unethical? Of course

Example: In recent years, the most popular automobile is the SUV (Sports Utility Vehicle, in case there is someone in the world who doesn't know). SUVs manufactured by a particular company who was the major producer and who will remain nameless, but they could *afford* to be involved (just a little pun), seemed to suffer more rollovers than others. This was investigated after several very serious rollover accidents. The auto manufacturer pointed the finger at one tire manufacturer as nearly all of the accidents involved this tire manufacturer. The tires were all recalled, the auto manufacturer improved stability of their SUVs, and things seemed to have settled down.

What does this have to do with insurance ethics? It has been said by some that the insurance industry must be considered as at least a *little* culpable as they maintain voluminous records of automobile accidents in order to arrive at proper premiums. Therefore, the insurance industry was involved in every aspect of these problems, as after all, they did insure the tire manufacturer and the auto manufacturer. The question then becomes: Why didn't the insurance industry notice these problems from their records? They were involved in every accident as, if for no other reason, auto insurance is mandatory. True, they were not legally bound to investigate but ... Interestingly; one auto insurer reduced the premiums on the SUVs even after they recognized the problem.

### **INSURER'S RESPONSIBILITY TO THE INSURED**

Many of the following considerations concerning the relationship of the agent to the insured have been previously discussed. As the company's agent, the agent is responsible for acting on behalf of the company from which arises his responsibilities. However, the insurance company has responsibilities to the insured also.

Considering the ethical responsibilities of an insurer, their responsibilities include developing and marketing the insurance product and when the product is applied for, the company must underwrite the product. Underwriting creates a custodial situation with the insurer and they are then privy to sensitive private information about their insureds. Perhaps the most important responsibility is their promise to meet the insured's (legitimate) claims. *Each of these relationships carries with them ethical responsibilities.*

The first responsibility is the creation of the insurance policies (products) that must be dependable and not harmful, particularly because an insurance policy is a promise to pay compensation when a specific harmful event occurs—therefore, an insurance policy is an ethical instrument. Morally (and legally) the company must remain fiscally sound so that it can meet the obligations for which they have contracted. The product should be fairly priced as discussed earlier. The product should not be too complicated for the average lay person to understand and understand its value—this places another ethical burden on the company to give fair value.

#### ***Marketing Responsibilities***

This discussion has shown that there are many ethical constraints on insurance marketing. The old principal of *caveat emptor* (buyer beware) should not and in most cases now, does not, guide the marketing of products of all kinds—pharmaceuticals, electronics, automobiles, food, insurance policies—which are too complicated and complex for the buyers to be aware of quality, safety factors, or even fair market values. Liability laws attest to the fact that the guiding principal of marketing in today's world is now *caveat vendor* (seller beware). Honesty in marketing is now the responsibility of the producer.

As with any business, an insurance company owes truth in advertising to its potential customers. As one television advertisement so aptly suggests, the normal person does not trust television advertising because they know that they are trying to sell something. However, if a *gecko* tells them about insurance, they are more apt to accept it! The very base of marketing is ideal exchange which in turn requires full information on the product and autonomous individuals making the choice to exchange freely. In medical ethics this is known as *informed consent* which means that there is no misleading, coercive or manipulative advertising. An ad that says "guaranteed renewable" when in reality it is not, is deceptive and unethical.

### ***Underwriting***

For life and health insurance, the most relevant health risks must be known. This leads to one of the classic theoretical ethical dilemmas—should a company underwrite a client who is a known health risk, such as an AIDS patient. Further, should insurers provide insurance coverage for those who have AIDS? Technically, any risk can be insured (but the premiums would be prohibitive in many cases). So, in discussing insurance for those with AIDS, the question is "into what insurance pool should they be placed?" There are those who might insist that they be put into the general pool, but that would be unfair to others in the group as they would be subsidizing the AIDS patients. But, as noted, if they were to be put into their own pool, the premiums would be prohibitive. This could bring out those who maintain this would be an area for social insurance, funded through taxes. Remember, Medicare was created out of a need for insurance on those who could not obtain private insurance because of age and/or physical condition.

There is a different, but interesting, problem for life and health insurance companies in respect to genetic testing and/or genetic screening. This provides a rare paradox for ethicists as the more accurate the predictions of time of death or future health of a person, and then there is a greater role for the risk factor as to who gets coverage and for how much. If the insurer knew that an insured is going to become ill and his medical costs will be \$X at that time, should he underwrite and insure the client in such a manner that there is no revenue loss to the company? After all, insurance companies are not eleemosynary institutions. Insurers make promises to deliver money based upon certain contingencies, and therefore, they have an obligation to their policyholders to stay in a financial condition so that they can fulfill these obligations. Therefore, including persons with known and highly predictable health risks into an insurance group at premiums that cannot be properly underwritten violates the insurer's trust to those policyholders (and investors) who depend upon its financial stability. To some this may seem cruel and hard-hearted, but actually it would be the proper ethical path. The insurer has not only the right, but also the duty, to be discriminatory in underwriting—but not unfairly discriminatory—so the underwriting must be fair. This would amount to treating its constituency fairly in accordance with the ethical fairness that governs marketplace transactions.

### ***Redlining***

The NAICs Unfair Trade Practices Act does not allow the practice of "redlining"—which gets its name from the practice of realtors of drawing red lines around a geographic area on a map to keep certain people out of that area. Redlining is a form of unfair discrimination and is more common in auto and property insurance than in life or health insurance. However, there are companies that do not want to insure in certain geographic areas for reasons other than racist or sexist biases, and do so on legitimate grounds. For instance, homes that are very likely to be damaged or destroyed due to hurricane, mud slides, or other such natural causes, and that are congregated in a particular area, may be excluded from insurance because the risk is more than the insurer is willing to assume. The Gulf Coast at the present time is "redlining" many areas where hurricane coverage is no longer going to be offered. Of course there can be various interpretations as to what are "legitimate grounds" for "redlining."

### **Health Records**

For underwriting purposes, often insurance companies receive an extraordinary amount of private information about people, particularly in life insurance contracts where a physical examination may be required. Privacy laws abound and are quite strict, but nevertheless, it is an important responsibility for a company to keep confidentiality, including the maintenance of privacy and the protection of confidential health records.

There can be a conundrum when an insurance company rejects or rates an insurance risk because of confidential information which the applicant may not have wanted to be given to family members. What if an applicant for health (or life) insurance is rejected because of a sexually transmitted disease (STD) and the person is married with children and the spouse has no knowledge of the disease? Actually this has happened, and more than once. Only those persons who have legitimate claims to such knowledge should have access to it. In such a case, should the spouse be made aware of the reason for the rejection as they are at risk for the disease? What if it is a more serious disease, such as syphilis? Should the insurer notify the agent as to the reason for the declination, and if so, should the agent notify the applicant and then drop it, allowing the applicant to handle it with the spouse as they seem fit?

Does a pharmaceutical company have a right to access the list of a Health Maintenance Organization's client records so it can push its prescription drugs? No matter what the case, to have information on someone is to hold that information in trust and it is unethical to divulge it except to those who are legitimately entitled to it which are, and only are, those the client has authorized to receive the information.

### **Claims Settlement Practices**

Volumes have been written about how claims should be handled, but simply put, the insured has a right to prompt, fair, and equitable settlement. "Prompt settlement" is defined as the efficient processing and payment of a claim within a reasonable time. "Fair settlement" is defined as paying what a claim is worth—any attempt to settle for less than what a reasonable person would expect is unethical. If the claim has to be compromised, the company must then give the reasons for such compromise claims settlement. Further, it is the responsibility of the company to make known when and where appeals procedures are available.

### **Cancellations—Non-renewals**

When an insurance company finds that a certain type of policy that is markets is not profitable and its recourse is to discontinue selling that particular policy or form, then several things could happen. If the policy is guaranteed renewable, there could be an automatic reinstatement period which allows the policyowner to automatically reinstate the policy after the end of the grace period. In such a case, sometimes the company will change its procedure and require policyowners to apply for *and qualify for* reinstatement, and when reinstated, it is on a modified basis. Sometimes beneficial riders are dropped and promises of return of premium are discontinued.

Sounds drastic, but what if the company is forced to adopt such a policy in order to minimize loss? If a company is burdened with commitments that are unexpectedly much more than anticipated, what is their responsibility at that point to the policyholders? What is their responsibility to their shareholders? The question seems to be in these situations, "To what degree and when can profits override policy obligations?" Then what would happen if the situation changes so

that the terms of a policy now benefits one party and injures another far more? Should the insurer's main concern be profit or the concern only for the benefit of the client? But what if the company needs to make changes and adjustments just to stay in business and fulfill obligations of its policyholders? Sometimes overlooked is the fact-of-life that the client cannot be benefited unless the company remains competitive in the marketplace.

### ***Responsibilities in Hiring, Firing and Retaining Agents***

A company has the responsibility of due diligence in the hiring and firing of agents. The biggest problem many insurers have is acquiring agents. Recruiting of agents can make or break an insurer or line of business of an insurer. Further, if the insurer does not recruit agents well, they may find themselves with unethical agents. It is not unknown for some agencies to operate "on the fringe" and shuttle business from one insurer to another, depending upon how much money the agency can make on the business and still keep their licenses. For an agency recruiter who does not know the reputation of agents in a city or area, it is easy for them to find themselves with a group of unethical agents with accompanying problems. Along with the responsibility of diligence in the hiring of agents, the company also has an obligation to provide for the training of its agents.

*McGill's Life Insurance* asks, "Should a company keep a top producer if it becomes clear that top producer writes business by cutting ethical corners? Recently a CEO of a major insurance company that had recently ceased commission payments on internal replacements contemplated offering no commissions for external replacements. The reason was simple—such a move would disincentivize replacements. Clearly, this was an insurance executive who took the company's responsibility to its clients very seriously. But is such a plan fair to the agents who also had to work hard on replacements? Would it be fair to the shareholders of the company if it forced productive agents to look for another company? This example shows that responsibilities are not simply one-sided but involve a multitude of responsibilities, some of which may be in conflict."

In this discussion of insurer's responsibilities, it becomes apparent that in many cases, things are not cut-and-dried, but to the contrary, there are many who have an interest in an action or a situation. Because there are several that hold similar interests, many times there arises conflict of interest and/or obligations among those involved. In the above situation, the CEO has duties to many persons—his agents, shareholders (or policyowners), clients, and to himself and his family. When such cross-purposes exist, and only ethical course of action is to attempt to resolve the problem without hurting another party in the process, and still be fair and true to yourself.

### **GOOD FAITH – FAIR DEALING**



**Legally, the insurance company owes good faith duty to only its insurance customers (policyholders) —with some court-ordered exceptions.**

These "court-ordered exceptions" refer to some courts that have recently ruled that insurers also owe a good faith duty to third party claimants. These decisions are generally based upon a state's "unfair claims settlement practices" acts, but some are the result of regulations regarding consumer fraud and unfair trade-practices. It is fair to assume that "good faith" and "fair dealings" would all reflect mostly ethics as these types of laws reflect ethical behavior and, like many such regulations, are a result of unethical behavior. So the history of court decisions involving

third party claimants have little uniformity, it would be correct to say that the *vast majority* of rulings are that the insurer owes good faith duty only to its insureds.

This is extremely important for those involved in insurance claims, as bad faith claims against insurance companies often arise because the insurer has not protected the insured's interest in a third-party legal action. The primary reason is that the insurance company and/or its representatives have failed to disclose certain information to an interested third party—legal problems because of lack of proper ethics.



**Most claims of bad faith arise because the insurance company has not acted ethically in that it did not keep its insured informed and did not allow the insured to participate in the decision-making process.**

This is a rather complex area but stems from court rulings in contract law that state that no party to the contract shall do anything to destroy or injure the rights of another party to the contract to "enjoy the fruits of the contract." Third party claims arise from the defense of and/or settlement of claims against the insured, involving such things as coverage, liability issues, and improper action of the insurer in investigation, representation, etc., whether illegal &/or unethical.

#### **DISCLOSURE OF COVERAGE**

The importance of client education in coverage has been stressed earlier but still requires further amplification. Insurance policies which define coverage are looked at by the public as unintelligible documents (which sometimes they are) out of necessity in order to define exactly what is insured and what benefits pertain to the risk. Some of the archaic language was created by marine insurance which, to this day, still uses rather archaic words and descriptions because throughout time, specific meaning and interpretation have been relegated to certain words and phrases.

This is the age of consumerism, and therefore nearly all insurance policies are now written in understandable—and even, friendly—language, such as using "you" and "your" and "we" and "us" to define the insurer and insureds in the policy. This has worked quite well, particularly in individual policies and policies covering personal property. Commercial policies are not as "insured friendly" inasmuch as there must be great care exercised in the description of property and coverages; therefore they must be defined in legal terms. Insureds of commercial policies are considered to have legal representation in business matters; therefore they should have the ability to use legal counsel as a matter of business practice.

Regardless, *disclosure* is important in any insurance transaction. Whether legally or ethically, (or preferably, both)



**an insurer must take the initiative to make sure that the policyholders know exactly what is and what is not covered.**

Further, it is not only good business sense and good ethics, but legally the insurer is required to keep the insured fully informed during a claims investigation. Failure to keep the insured properly informed is the principal reason for the majority of litigation between insureds and insurers.

## ***EQUITY***

"Equity" and "equitable" are often used in any discussion of ethics. *Black's Law Dictionary* defines equity as "fairness, impartiality, evenhanded dealing, such as 'the company's policies require managers to use equity in dealing with subordinate employees.'" Also, "the body of principles constituting what is fair and right" (with reference to the Declaration of independence). The next definition is of particular interest:

 **"(Equity is) the recourse to principles of justice to correct or supplement the law as applied to particular circumstances."**

This helps to clarify the statement "law establishes standards, equity establishes higher standards." Keep in mind, however, that "Equity" is also a legal term, so for purposes of discussing ethics in "non-legal language," equity means natural justice.


## ***GOOD FAITH***

Actually, an insurance company's duty is higher than just "good faith."

 **The duty of an insurance company is the duty of "utmost good faith."**

This also applies to agents, brokers, independent adjusters, defense attorneys, actuaries, and others involved in the business of insurance. "Good faith" implies that the action taken must be above reproach and held to the highest ethical (and moral) standards. Like "charity," good faith starts at home. The insurer must offer loyalty to its employees, who in turn are loyal to the insurer, but it goes further—it spreads to the actions and relations between every party involved. The insurance business is rather unique in the fact that it **MUST** operate in good faith because of its relationship with its clients—the policyholders.

## ***FIDUCIARY OR AGENCY RELATIONSHIP***

 **A fiduciary relationship means that one who acts on the behalf of another is, therefore, held to the standards of utmost good faith.**

An agency relationship is a lesser relationship, and the parties are subject to good faith only. Fiduciaries can be trustees, receivers in bankruptcy, guardians, executors or administrators of estates, and others who are appointed to act in the best interests of another. Often, they are required to be bonded.

The majority of insurance attorneys maintain that there is no fiduciary relationship between the insurer &/or its representatives, and its clients. The reason that it is necessary to establish such relationship is because of the good-faith requirement—an ethical issue. A fiduciary relationship would place a much higher burden of responsibility on the insurer or agent, one they are just not willing to accept.

A salesman for a manufacturing company may represent the company with its clients, but its relationship is not that of a fiduciary. However, one must always remember that insurance is an intangible until a loss occurs. To many, that makes a huge difference.

Some courts have maintained that there is no fiduciary relationship between the insurer and its clients, because the interests of the two parties are the same and are equal **unless the insurer requires the insured to take some action outside the policy provisions.**

For instance, if an insurer takes over the insured's loss by requiring that the insured use a particular auto body repair shop, or a health insurer requires that a claimant use a particular doctor or have a particular medical procedure, then the insured is taking action outside the policy provisions. However, if for example, the health insurance policyholder has been made aware that certain physicians must be used in order for the insurer to cover the loss under the policy, and it is so stated in the policy, this then does not create a fiduciary relationship.

But what happens if a third party is involved, as can often occur in a liability policy? A typical liability policy gives the insurer the right and duty to settle or to defend, and the insurer maintains the right to determine which. Legally, in these situations, the insurer is acting on behalf of the insured, and in a position of trust, under these forms.

California courts have ruled both ways. The insurance industry seems to be changing its stand on this, as evidenced by a textbook on casualty insurance claims wherein the author states that the claims representative is a fiduciary agent, but a later version of the same text, replaced "fiduciary" with "special trust and confidence." Therefore, it behooves the insurer and its representatives to treat a claims situation as a (more strict) fiduciary relationship.

### STUDY QUESTIONS

1. Licensing and Training
  - A. does not make a profession.
  - B. is not necessary in insurance sales.
  - C. only applies to those in medicine, law and architecture.
  - D. is unusually difficult and expensive in most occupations, much less professions.
  
2. The professional must always be aware of and protect
  - A. themselves.
  - B. their employer or insurance carrier.
  - C. the client's best interests.
  - D. others in their profession.
  
3. The acquisition and maintaining of knowledge required is
  - A. the responsibility of the professional organization.
  - B. a matter of law.
  - C. the individual responsibility of the professional.
  - D. forced upon insurance agents by their carriers.
  
4. Law set minimum standards, whereas ethical behavior
  - A. sets lower standards.
  - B. sets standards exactly equal to the legal standards.
  - C. does not have standards.
  - D. is the highest standard

5. The rule of *Caveat emptor*
  - A. means that price sells.
  - B. can ethically and legally be used in the sale of insurance.
  - C. cannot ethically be applied to the sale of insurance.
  - D. means "seller beware."
  
6. The main source of underwriting information is from
  - A. the agent.
  - B. medical records.
  - C. the Medical Information Bureau (MIB).
  - D. policy records.
  
7. It is the duty of the agent not to only sell the right product to the customer, but
  - A. also make sure that all agents collect commission on the sale.
  - B. to make sure that it is sold at the right price.
  - C. to make sure that it is sold at the lowest price.
  - D. to return a portion of the commission to the client.
  
8. A major cause of unethical behavior is
  - A. alcohol.
  - B. unethical insurance companies.
  - C. unfair and uneven laws that work against the agents.
  - D. conflict of interest.
  
9. One identifying factor of ethical behavior is
  - A. the person takes responsibility for his actions.
  - B. the person taking the action is rewarded magnificently.
  - C. that no other person is aware of any transaction.
  - D. it is usually a legal transactions.
  
10. Legally, an insurance company owes good faith duty to
  - A. only its representatives.
  - B. only its insurance customers (with some court-ordered exceptions).
  - C. the state Department of Insurance.
  - D. its reinsurers.

### **ANSWERS TO STUDY QUESTIONS**

1A 22C 3C 4D 5C 6A 7B 8D 9A 10B



## CHAPTER THREE—ELEMENTS OF INSURANCE ETHICS

### PRIVACY

Privacy may be considered an ethical right even though it is not mentioned in the Constitution as such, but it has been established by the courts. It was never questioned as an ethical behavior prior to its legalization, but now the protection to the right of privacy raises many ethical problems. One of the most recent problems involves Internet privacy. For a person to order something from a firm or individual via the Internet, to make inquiries, to register a product, or nearly any other Internet activity requires identifying information of some sort—ranging from credit card numbers, social security numbers, addresses, bank references, etc. There are innumerable unethical businesses and individuals preying on the typical and honest individual using the Internet.

In respect to the nebulous "right to privacy" in insurance matters, does an agent have an obligation, legal and/or ethical, to "invade" the privacy of the insured by inquiring into an individual's lifestyle, personal habits, health condition, driving record, preexisting conditions, financial status, or other situations that might influence the pricing or acceptance of the risk? Obviously the agents not only have a legal obligation; **they have an ethical duty to their carrier to notify them of any condition that affects the risk involved.**

Ethics are often heavily involved in claim practices, particularly in disability claims. Everyone has visions of a "totally disabled" client collecting disability payments while they were being photographed or videotaped performing some physical activity that they claimed they were unable to perform. Some question whether it is ethical for a claims investigator to "sneak" around and take pictures unbeknownst to the claimant. Is this an invasion of privacy? Is it really unethical? Does one unethical action cancel out another unethical action, such as if the accepting disability payments when not actually disabled is unethical, then is the act of collecting evidence of the non-disability unethical because it is an invasion of privacy?

Most courts have maintained that surveillance and photographing a claimant is not an invasion of privacy. However, they have just as often found that unauthorized electronic eavesdropping, wiretapping or recording on hidden cameras installed in a residence are invasive and intrusive and may be considered as elements in an unreasonable investigation.



**If the scope of an investigation is relative and pertinent to the claim or to the coverage, it is ethical. However, if such investigation goes beyond that limitation, then it is unfair and invasive.**

Legally, an individual who files a claim automatically loses some of his right to privacy as the insurer has a right to investigate the claim according to policy (contract) provisions. However, they cannot excessively intrude into the insured's privacy. The investigation is limited to a reasonably unobtrusive type of investigation that would be in the best interest of a defendant in preparing its case. The investigators are limited to an ethical pursuit of the facts, and any excessive activity or harassing the insured would be considered as an invasion of privacy by the courts.

## SUITABILITY

Selection of the proper product to insure a particular risk is definitely an ethical matter, as it is entirely possible to legally sell a client an insurance product that does not address the client's concern and reason to purchase insurance. There have been many instances of improper marketing to the point that the California legislature has addressed the suitability problem through a variety of regulations, in particular addressing the marketing of annuities and Long Term Care Insurance to seniors.

Selling annuities to a senior is a financial product sale, and an effort must be made to make sure that the client and product suit each other. It is extremely important that detailed financial records be kept of all transactions with the seniors as typically some of the material discussed will be otherwise forgotten, including the tax situation of the client. The tax situation of the client is important in determining suitability as if the client really has little or no income tax liability and none is anticipated, then serious consideration must be given as to whether (a) this is the proper product for the client, and (b) if the client can afford the financial strain of investing in an annuity.

In the marketing of annuities, since annuities are not designed to be effective short-term investments, if the client does not have sufficient liquidity to maintain a decent life style after purchasing an annuity, then it could be entirely possible that an annuity is not suitable. If it appears that the client may need or want the funds that are invested in the annuity in the near future because of, for instance, liquidity problems, then other types of investments or products should be used—not an annuity. The surrender charges and taxation penalties for short-term investing in annuities must be fully explained so that the client understands that if he purchases the annuity for short-term needs, it can be quite costly.

Suitability is even more important in the sale of a variable product as in order to obtain the maximum benefit from such a product, a variable annuity for instance, the client should be knowledgeable in investing and care must be taken that such a purchase does not deplete present investments upon which the client depends for living expenses.

If the recommendations by the agent are suitable, the insurer (and the agent) must maintain adequate records so that in the future at any time, after the fact, it can be determined if the recommendations were suitable for that client.

Ethics must apply in the selection of the proper insurance product and the product selection process. It would be a near impossibility for an insurance agent to be familiar with the vast variety of insurance products available, and the large number of coverages available and with varying amounts, this creates the problem of selecting the correct product with the proper coverage and in the correct amounts. For large commercial risks, there is usually a risk manager who dictates coverages and amounts, but outside of that area, not only is it difficult to select the right product, it is as difficult—sometimes even more difficult—for the client to fully understand what it is that he has purchased. This is an ethical problem as laws can not determine whether the insured understands the product without interrogation by a court. With multiple risks, this problem can be multiplied exponentially.

Does the insured really know what coverage he has? This problem was illustrated during recent hurricanes where television news programs showed row upon row of destroyed houses with the names of their insurers spray-painted on the still-standing walls by the homeowner. One still must wonder, however, how many of those with destroyed homes actually had the insurance

coverage that they thought that they had. Did they fully understand the deductibles and the valuation process? If they had an ethical agent and an ethical insurer, they either had their home rebuilt or they knew how much they would have to contribute to the rebuilding prior to the loss.

"Cafeteria" plans used in employee benefits provides one ethical solution as the employees choose between various life and health benefits. This is conducted on a group basis and there are individuals readily available who are knowledgeable in the various products that can, and do, fully explain the products and their applicability to the employees.



**In order to assure of the suitability of a product, it is the ethical duty of the agent/broker to explain fully and completely, the various options to their clients, including suggesting that the client acquire additional expert advice in areas where the agent/broker is not expert.**

### ETHICS IN THE SENIOR CARE MARKET

Ethical marketing of insurance products to seniors has been mentioned previously, but is so important that it should be independently addressed. The concerns of the California Department of Insurance and the California legislature have addressed those concerns in respect to the marketing of insurance products, centered principally on annuities and Long Term Care Insurance (LTCI). Any agent or broker who markets, or intends to market, these products must be aware of these laws and regulations, many of which were the direct result of unethical marketing practices by insurance marketers. Even with the multitude of regulations, there continues to be ethical situations that arise when marketing insurance to seniors.

LTCI is a relatively new insurance product, and only in the past few years has the IRS acknowledged it as "insurance." This plan is a very important part of the insurance portfolio, particularly because "baby-boomers" are already starting to retire. Unfortunately, there is no reason to believe that they will be much more educated in LTCI although as a whole, although some have been introduced to the plan through an employer-sponsored benefit program. In addition, they will know more about investments and annuities than the present group of senior citizens.

A common ethical problem arises in discussing LTCI with seniors because many Medicare recipients believe that if they go to a nursing home, Medicare and their Medicare Supplement policy will pay the nursing home charges, which can run \$5,000 per month or more. In many cases an agent has an ethical mandate to make sure that the seniors fully understand that if they need long-term care—as many, if not most, of them will—they could be facing a disastrous financial situation including losing their home. The problem of "suitability" arises often as even if the senior decides to purchase LTCI, first it must be determined if they can afford the premiums. Secondly, it must be determined how much of the cost of long-term care can the senior pay for out of their own funds as that would have an impact on the waiting period, etc. Ethics are important at this point, as the agent must work towards what is best for the senior, not how much coverage they can sell (and receive more commission).

Ethics permeate marketing LTCI in many other areas. For instance, if the agent notes a wheelchair in the house, even if it is folded up and out-of-the-way and the senior indicates that it is not needed—or even if there is a cane readily available—this must be reported on the application. An applicant may be required to undergo a memory test, either on the telephone or by a pa-

paramedic, and the temptation is great for the agent to "coach" them as to the best way of "beating the system." If the agent detects some memory loss, the temptation may be to ignore it, hoping that it will not be picked up by the underwriter or paramedic.

Many times the most ethical approach, and one of the most difficult, in some of these situations is for the agent to carefully explain that LTCI insurance may not be for them. If LTCI is suitable to the client and if the applicant is insurable, with these types of policies the agent has a client that will need more servicing than is usual with clients. The agent must be prepared to be available to answer questions and to otherwise service the client as long as the policy is in force. Agents have been known to notify their clients that they are no longer in the insurance business in order to forestall any questions that may be raised after the policy was in force—after all, they do not receive any extra compensation for the time they spend with existing clients. This is, of course, a highly unethical approach.

Some agents that market Medicare Supplement policies do not mention LTCI because they do not understand the product and do not want to sell it, plus it is time-consuming and difficult to sell, therefore they do not inform their Supplement clients that such a product even exists. There have been recent lawsuits filed by family members because the agent did not inform the senior that such coverage was even available. This does not mean that agents must become LTCI "specialists," but ethically, they should make their clients know that such coverage was available, and if they did not market the policy, make arrangements for another to do so. This has particular application to financial consultants and estate planners.

Some agencies now require that when a Medicare Supplement policy is sold, the client must also sign a form stating that they had been informed of the availability of LTCI and that they understand that Medicare does not provide complete coverage for nursing home or home health care costs, and that they are or are not interested in purchasing such a plan. Good marketing technique? Sure. Is this ethical? It is absolutely ethical. Even if the client does not purchase LTCI coverage, they are now aware of how it works, and many times they will discuss it with their family, thereby avoiding a financial crisis affecting the whole family if the senior should need such care. If the agent's company or agency does not offer LTCI but the need is apparent, it would be a breach of ethics to submit this information to another agent *without the client's knowledge and permission*.

### **SCARE MARKETING**

A discussion of ethics in marketing would not be complete without mention of "scare marketing." Since insurance provides coverage for future unforeseen events (except for title insurance), many insurance sales are made because the agent or broker has stressed the hazard of not purchasing coverage and the likelihood that something bad was going to happen to the applicant. This was stressed to the point that coverage was purchased primarily because the applicant was "frightened" into buying.

The use of scare marketing varies by insurance product and life insurance (for instance) is one product where a certain amount of "scare" is inherent by its very nature. Nobody wants to think about dying but everyone instinctively knows that they will die, so when they talk about life insurance, the insured risk will always occur—eventually. Life insurance is sold for many reasons other than that of providing funds for survivors in case of premature death. Many agents, who use life insurance as a solution to a particular financial situation, are expert in creating a vision of the effect of the early death of the client without the proper coverage being dis-


cussed. Is this unethical? Or just realistic and the agent is providing a real service to get a person to provide for their survivors in case of premature death (often defined as anytime after day-after-tomorrow)? There have been instances of a person deciding to hold off purchasing life insurance for a period of time, and the following day or week, is killed in an accident. Happens

The amount of life insurance for pure protection is usually debatable. Dr. Huebner, a founder of the American College, created the "Human Life Value Concept" which is a method of determining how much life insurance an individual really needs. Financial planners and estate planners can vary widely in the amount of insurance recommended in identical situations. Ethically, an agent must explain the product and its use as clearly as possible and it must address the client's individual situation. If the agent is truthful and the client fully understands the plan, then no ethical questions should arise.

A lot of life insurance is sold over the telephone or Internet (as is auto, health and other insurance) by which an applicant may be able to obtain a lower premium than through an agent. Is it ethical of an agent to point out that the individual is losing a valuable asset—that of the personal attention and service of an individual that they know and who resides in the community, etc.—particularly when most life insurance agents (in particular) never see their clients once the policy has been placed? (Which is very much an ethical problem—disappearing agents?)

Is it unethical for an agent selling a dread disease policy to remind, by word and by documents and illustrations, that one out of three Americans will be struck by cancer (which, in itself, is true)? How about when selling a LTCI policy the agent emphasizes that the prospect certainly would not want to spend their waning years in an "old-folks home" that smell of urine and Pine-Sol (amazing the number of elderly folks who can still "smell" in their mind the odors of the county old-folks home.)?

Flood insurance is sold to those who live in areas where their property could be flooded with detailed expressions of catastrophic results; homeowners are made aware of how they could lose everything they own and will own in the future because of a lawsuit if a child is injured on their property; earthquake insurance is sold to a new arrival to California by showing them buildings supposedly damaged by earthquake (which is generally dropped after the new arrival discovers that none of his neighbors carry the expensive earthquake insurance); those who live in hurricane-prone areas are informed about the damage that those powerful storms can do, complete with pictures of damage because of previous hurricanes; and there are innumerable other such examples of what some may call "scare" selling.

 *There must, however, be a delineation between unreal and unlikely situations and those risks that are real but not necessarily imminent—*

Which actually is "needs" selling. One experienced agent, an "old-timer" is reported to have said, "When their eyes get big and they start trembling, then you are scare-selling. If they buy and their hand is not shaking, it is needs-selling."

### **LEVELS OF COVERAGE AND PREMIUM**

 **Contrary to popular belief, the lower levels of insurance is the most expensive.**

Agents know this because they understand that the lower levels are the ones that will have the most claims as they are used first. "Cheaper by the dozen" is applicable to insurance as the

larger the protection coverage, the lower the unit cost. This is particularly applicable in liability coverage as the per-thousand premium coverage decreases substantially as the amount of the policy benefits increases. This should always be explained to the client—and it probably is explained most of the time.

Some clients, though, may only qualify for the smaller amounts. A person with a bad driving record, for instance, will probably end up with restricted coverage in an assigned risk pool. Even so, regardless of what the applicant indicates that they need, other factors other than price should always be explained. More times than not, a client who seems to know all the answers and only wants the least expensive coverage, really does not understand the coverage but is just trying to save money. It takes diplomatic handling at times, but it is important and ethical to make sure that every client knows what coverage is available, rather than just the price.

When a client wants limited coverage, the obvious first question is "**Why?**" If cost is the only reason, a little discreet questioning may bring out that the individual is a bad credit risk. Youth may be the reason that there are limited choices. Some auto insurers offer discounts for students who maintain good grades, or have taken drivers education courses. Of course it is ethical to discuss the possible discounts, but an interesting question would be whether it is ethical for an agent to discuss driver's responsibilities to the young drivers?

Carrying this a step further, if it seems apparent that the individual is a bad driver because of a bad driving record or attitude problems (with the youths); or perhaps the applicant is elderly but obviously is too feeble to really be a safe driver, then is it ethical to suggest to the applicant that he forget about the expensive coverage (even if he could get it) and simply use public transportation and/or the assistance of others to move from place to place?

A way to lower premiums is to increase the deductible, but there must be a *balance* between affordability of premiums and affordability of the portion of a potential claim paid by the client. Sometimes a client can truly only afford a high deductible, but if that is the case, they would probably have a difficult time paying their share of the claim. The ethical approach would seem to be to discuss this situation so that the client understands fully that there could be other alternatives. It is also important for the client to fully understand that the deductible may not apply to some claims—for instance, on some health insurance policies, certain health claims are "first dollar coverage" and the deductible does not apply.

When an applicant has limited income, no employee-provided coverage and can only afford a very high deductible—is it ethical to suggest that they check eligibility for Medi-Cal, particularly for the children? What about the situation when the children are eligible for Medi-Cal but the parents may not be eligible? This actually releases funds (that would have been spent on premiums covering the children) so that better coverage can be affordable to the parents. Another ethical question arises if the agent recommends moving children from insurance coverage and having Medi-Cal provide the coverage, this reduces premiums that would otherwise go to the insurance company. By taking insurance away from the insurer, is this ethical? Is it ethical to add more Medi-Cal patients since Medi-Cal is paid out of taxes?

## **CLAIMS SETTLEMENT AND ADJUSTING**

Ethics at time of application has been pretty well covered, so the next time that the insured normally has contact with the insurer (and when ethics questions may arise) is at time of claim.

Ethics in claims investigation has been discussed, but claims settlement goes much further. It must be remembered that in claims settlement,



**Each claim is individual and unique, so they are negotiated.**

With some products, "negotiation" is rare and claim processing is simple. For instance in life insurance, it is normally quite cut-and-dried. Just the opposite would be true in many commercial liability policy claims. If it is a matter of replacement of a damaged insured object—such as paying a bill covered under the policy—then there is no need for negotiation. The majority of claims negotiations occur when intangibles are involved.

Negotiations in claims settlement can create ethical problems, particularly if the parties involved are unequal or when one party attempts to intimidate the other party. The claims adjuster is in a rather difficult situation at times, as the insured and any other claimants will often assume that the adjuster knows more about the insured values than they do—which may not be the case. Conversely, the insured or claimant that receives the settlement offer may also have little understanding of the values—often the insurer unintentionally intimidates them.



**Mostly, claimants just want adequate compensation for their loss, but very often has no idea as to what that might be.**

Some claims adjusters attempt to intimidate the claimant into settling for an amount that is much less than the actual value, and some act as if it is a "feather in their cap" if they save the insurer money that actually should be paid to a claimant. Unfortunately, some insurers may feel that is the principal job of an adjuster.

### ***EDUCATION OF THE CLAIMANT***

COVERAGE should be explained to the insured as the first step—immediately after normal pleasantries have been exchanged. The entire tone of the settlement is established here as the insured either has the coverage that they expected, or the coverage is much better than they expected—or not. Insurance terminology is not always fully understood by the insured (undersatement) so both the adjuster and the insured should be on the same page. After all,



**if the claimant and/or the adjuster do not understand the coverage, then how can they agree on a settlement?**

In the same vein, policy exclusions, limitations, provisions and conditions must be fully explained. When coverage is not definitive and is questionable, then a reservation of rights letter should be immediately issued, or the parties should enter into a non-waiver agreement. If a third party is involved and there is no contractual agreement between the third party and the insurer, then the coverage must also be explained. However, it is not considered by many to be ethical to inform the third party of the maximum coverage of the insured's policy. On the other hand, if the claim is very serious and the coverage will not provide enough to settle the claim, then this amount would, of course, be disclosed to the third party with the knowledge of the insured.



**Once coverage is explained and is known by all parties, and then there must be complete agreement as to how the coverage applies to the claim.**

If negotiations continue when there is not complete understanding and agreement on coverage, then this would be unethical as the situation is out of balance—one party does not have the good-faith requirement of understanding the facts.

### ***CLAIMS LIABILITY***

The establishing of liability follows the claims investigation as the next logical step. This can be the most difficult part of any claims settlement and some adjusters or claims representatives will attempt to use negligence as the only settlement issue. However, claim liability is a legal action, which can include not only contract law (understanding the policy and coverage) but also tort and statutory law. Statutory law is particularly applicable in no-fault insurance situations, and local statutes can certainly affect the settlement value.

Detailed settlement practices and procedures are not within the scope of this text, but one fact emerges that affects ethical standards:



**If the investigation is not adequate or complete, then any settlement thereof shall, by its nature, be inequitable (and unethical).**

Cutting-corners or the use of intimidation can greatly limit the ability of the parties to negotiate liability—generally to the advantage of the insurer because of superior knowledge and expertise. If, for some reason, certain facts just are not obtainable that are necessary to complete the investigation—and this happens frequently—then an ethical solution must be in favor of the insured if there are any questions whatsoever. Actually, a court would undoubtedly rule in favor of the insured if litigation between parties ensued, therefore it is not only ethical to err on the side of the insured; it can also be a wise business decision.

### ***DAMAGES***

After the claims settlement phase, damages must be addressed. Damages are not only "punitive" damages as there are many kinds of damages—some are covered and some are not. Usually they relate to damage/loss of (tangible) property, bodily/personal injury, or financial loss. What is covered and how much is determined by the policy and the controlling liability.

In auto insurance, liability will cover property damage and bodily injury but not personal injury or any loss that is strictly financial. The insured is insured for specific liability and liability for the actions of the insured *outside* of the policy provisions, are not covered. However, one area where ethics enters the picture in respect to damages is in the use of after-market auto parts used as repairs on insured's automobile instead of "factory" parts, which are more expensive. Using substandard parts is an ethical question but there has been much litigation in this respect to the point where there have been some large (outrageous, some say) awards given by courts against insurers who have used these parts.

There are also bodily injury (BI) claims that raise ethical questions, on both sides of the issue. BI claims are of two types, those that are covered under the policy (called "special damages") and can be proven by receipts or similar documentation—and those that are intangible but also covered. Medical expenses relating to a BI claim can be well documented, but other ethical considerations may be involved. In this area, rather uniquely, there can be a collateral source rule, which allows the victim to receive compensation from another insurer and these payments are not offset by a claim against the party responsible for the tort. This may go against insurance principles, but is a fact of life in some jurisdictions. Could it be considered ethical to receive

money for compensation from two sources? Even if it is unethical; suffice it to say that an injured party would rarely turn down the additional funds.

A claims representative has a problem sometimes when legal counsel represents the third-party claimants, as the claims representative cannot contact the third party without the approval of their attorney. This can make it difficult to build a good relationship to settle a claim legally and ethically. Even if there is a policy provision permitting the insurer to require a physical examination of the insured, the examination can be subject to questionable ethics. There are doctors who only do independent medical examinations and many of them usually render reports that are favorable to the insurance companies but unfavorable to claimants. After all, they get a lot more money from examinations requested by an insurance company than an occasional examination requested by an individual. Sometimes ethics of both the insurer and the physician can be questioned.

In attempts to lower claims costs, some insurers use paper reviews of the medical records of a claimant's medical records. An outside firm on a fee basis and affording considerable savings in time and money usually offers this service. However, one of the television news programs attacked this practice by showing that the reports were many times conducted by non-medical persons and often were drawn from a standardized format without much actual evaluation of the medical information provided. The question can be raised whether this is unethical practices, or is it a good business practice that saves money? Or, is it unethical *not* to take advantage of a cost-savings device?

When questions like this arise, there is always one thing to keep in mind: insurers must take all legal and ethical steps necessary to reduce their costs in order to stay in business. Additional costs in operation are reflected in increases in premiums; therefore, it follows that any action that reduces their costs would be reflected in stability and/or lowering of premiums.

### ***WHISTLE-BLOWING***

This is a difficult problem for agents, insurers, and businesses as a whole. The ethical position of a firm in response to someone who publicly reveals proprietary information that leads to civil litigation, and in some cases, criminal prosecution, is interesting and generally revealing.

The area of claims settlement often involves "whistle-blowers," however the subject of whistle-blowing affects more than just claims personnel, and in actual practice, can involve many lines of insurance just on a business basis. While whistle-blowing is generally used in an employee-employer relationship, it applies just as well between an insurance agent and a client. It applies primarily in an employer-employee environment and would apply to those who are employees of an insurance company. Claims representatives and adjusters come to mind, as do salaried agents.



**"Whistle-blowing" is a term used in business ethics, which connotes an employee who knows that a fellow employee or the employer is engaged in activities, which cause unnecessary harm, violate human rights, are illegal, do not follow the defined purpose of the company or institution, or otherwise are immoral. The employee then notifies superiors, professional organizations, the public and/or some governmental agency.**

When is whistle-blowing acceptable? To some, it may never be, and that is a problem. People just do not like being known as a "fink," "rat," "tattle-tale," or such. The term itself

comes from sports idiom referring to an official (referee or umpire usually) who detects and penalizes the unsportsmanlike behavior or violation of rules, but, it is noted, it is NOT the function of another player to make these calls on a member of his own team. This would leave one with the impression that whistle-blowing is *never* accepted. Of course, this is not true as there are times when it is absolutely the right thing to do.

First, the reason for whistle blowing must be **legitimate** and for the "right" moral reason – not just a move in order to get ahead in the organization, for instance. There must be an illegal or immoral action involved.

Secondly, and perhaps the most importantly there must be **evidence** available that would persuade a reasonable (at least) person. Get the ducks in a row.

The next recommended step is **self-analyses**—mentally review the entire situation again (and again and again if needed). How serious is the problem? Many times problems will stop there when it is analyzed. When is the violation going to happen, if it hasn't already? One should make sure not to "jump on their horse and ride off in all directions." And very importantly, is the charge upon which the whistle blowing is based, *specific*? Generalities will not suffice. A handy tool for self-analysis is to imagine being on a witness stand undergoing a tough cross-examination.

Lastly, it is imperative that **all internal channels have been exhausted** before the information is revealed to the public. If there are others in the organization whose duties it is to report such activities, and you report the problems to that person, then you have done your job. However, if such a person ignores your information, or worse, attempts to cover it up, then one has no recourse but to become a whistle blower.

It must be kept in mind in this discussion, that under some circumstances, **it a moral obligation to prevent harm**. Everyone has to look at themselves in the mirror in the morning, and live with themselves the remainder of the day. It is so much easier to overlook the actions of those that you know and work with every day, even though you know they are committing illicit, immoral or even illegal acts, than it is to make enemies of those that you have considered as friends, in favor of faceless stockholders. Sometimes it is difficult to be a **professional**.



**Ethics are heavily involved with the understanding of all applicable parties, which then creates a relationship based upon accurate information and proper action by all parties.**

A related actual situation providing an exercise in proper/ethical action was where a reinsurer of a small casualty insurance company sends its auditors to the company in order to determine the worth of the block of business being reinsured because the company's vice president of claims was concerned that the company may be in jeopardy of losing their reinsurance. Because of the increase in claims, the insurer had already filed for a rate increase with the Insurance Department to be effective the following year. Based upon the concern of the company's vice president, the reinsurer determined that more exact loss information was needed in order to continue its reinsurance treaty. The reinsurance auditors soon realized that the claims data had not been recorded correctly because of a technical error, and further, there really had been no increase in claims cost.

The insurance company's vice-president of claims had been terminated about 2 months earlier for failing to contain the claims costs. The vice president had depended upon the expertise of a claims accounting supervisor who had moved on to another company. So, ethically, what should the insurance company do? Rehire the VP with possibility of wrongful termination lawsuit? Should the reinsurance company inform the VP of what had happened, particularly since the VP was responsible for the reinsurer to get involved in this situation which, based upon the information available at that time, was entirely proper and ethical?

## CONFLICT OF INTEREST



**Conflict of interest can be the most serious of ethic breaches and is considered by most as the most serious of legal breaches also.**

Conflict of interest is of major interest to the legal profession as there probably are more situations where a conflict of interest arising when attorneys are involved, starting from the simple situation of representing one client in a matter than involved another client, to more serious matters involving the court and judge and jury. There are many television programs that depict attorneys and law firms, and in nearly many episodes, there is at least one situation or mention of conflict of interest.

Attorneys are not the only ones that face conflicts of interest. Even doctors have been known to prescribe certain drugs from pharmaceutical houses in which they have an investment. At first glance, it does not seem to be a problem in the field of insurance because of the workings of the insurance business. A broker who sells a policy that does not fit the needs of the client but is sold because of a higher commission, breaches the conflict of interest ethics rules because the broker supposedly represents the client.

Several years ago, the Actuarial Vice President of a small life insurance company set up a "dummy" consulting actuarial firm, using a post office box address. The company President was aware that since the company could not afford a full actuarial staff at this stage of their growth, that the actuary would farm out certain actuarial duties. The actuary was given free rein to contract with whatever actuarial firm he felt was the most qualified. The actuary contracted with his dummy firm, in effect, contracting with himself.

When this was discovered, the VP-Actuary was terminated. His only defense was that he did the work and did it properly on *his own time*. He did not have time during normal working hours, and he was not on an hourly basis, so since he had to give up his own free time, he should be paid for it.

How about conflict-of-interest between an employee and himself? The company President when he terminated the actuary (actually one of his best friends also) stated that there would be no legal action taken as his ethics would be forever questioned and that was punishment enough for a professional. Was the company unethical by "overworking" the actuary? True story

### CONFLICT OF INTEREST IN CLAIMS PROCESSING, ADJUSTING AND SETTLEMENT

If an insurance company institutes very strict and limiting claims processes for the purpose of limiting claims so their shareholders will be happy, this is a conflict of interest. A claims adjuster faces more situations involving a conflict of interest than most insurance personnel do as they

could be in a situation where they are adjusting a claim of a friend or relative, or to refer work to a firm in which they hold some interest. It is also a conflict of interest for a claims representative to receive a "referral fee" from a law firm for business referred to them.

### THIRD PARTY ADMINISTRATORS

One of the areas in which there are ample opportunities to create conflict of interest in claims administration is where there is a Third Party Administrator (TPA) involved. A TPA may at any time represent

- the insurance company,
- the insurance company's reinsurer,
- the insured's excess carriers, and
- any additional insured's that are protected by the policy

It would be fair to ask, "Who are all these people?" A claims administrator may be in a position where it is necessary (and ethical) to disclose all of the principals, and how can they do this if they do not know who the principals are? In a third-party claim, the failure to include a person or entity whose interest is protected by the policy can easily result in litigation—and an Errors and Omissions (E&O) claim.

### *E&O EXPOSURE*

In most E&O claims within the insurance industry, **an ethical breach or lapse is the principal reason that a claim is filed.** An agent or broker could follow the law precisely, but still not handle a situation ethically, with the result that there is an E&O claim. Also, it is true that



**many E&O claims arise because the agent has not understood the risk.**

It is the ethical duty of an agent or a broker to identify any potential exposures and at least identify them to the client. Remember the financial planner who neglected to mention the availability of Long Term Care Insurance?

There are many a slip between the cup and the lip—in a complicated commercial insurance transaction it is relatively easy for misunderstanding or misinterpretation. There have been cases where the contents of a business for fire insurance were drastically underinsured when a claim arose. In a commercial situation, those making insurance decisions for the business entity are usually not the owners, but an officer of the firm. This means that if the contents were underinsured, in case of a total loss, the officer stands a good chance of losing his job. The natural inclination would be to blame it all on the agent, while maintaining that the proper amounts had been provided to the agent, who evidently ignored it or misunderstood. An E&O claim can arise.

In similar cases some courts have ruled that the policyholder has an obligation to read the policy. Other courts have not been too generous in this respect, and will consider all types of situations in ruling against the insurer/agent. In some situations where an agent is replacing a policy, if the new policy does not provide at least as much coverage as the previous nonrenewed policy, courts have not been lenient if a claim arises because the new policy did not cover the loss. Sometimes and in some jurisdictions, it does not seem to make much difference if the insured has even read the policy.

These are legal points, but ethics plays an important part in these situations. If the agent or broker had taken the time to analyze the exposures, asked all the questions that he would be expected to ask—even if he had sought expert advice if there were a question in his mind that he would be expected to ask—then he would have fulfilled an important ethical duty, and maybe avoided an E&O claim.

### *INSOLVENCY*

There have been lawsuits involving an insurer becoming insolvent and therefore not in a position to honor the promises of the insurance contract. As was mentioned earlier, the question of ethics arises when an agent has some information that an insurer may be suffering financially. One of the problems in this situation is that if an agent "bad-mouths" an insurance company, the agent could lose his license for making slanderous remarks. Of course, the best defense against slander is the truth, but it is very difficult for an agent or broker to know with certainty that an insurance company is having financial difficulties. Often it is not even known to the Department of Insurance until the company is insolvent.

Legally, most courts have found that the agent owes no duty to the insured in such a situation. Ethically, the agent should notify customers when an insurer with whom he has placed insurance, does become insolvent. This can be advantageous to an agent as it gives him an opportunity to replace the coverage.

There are times when an agent or broker has received unofficial information regarding the financial condition of an insurance company. It might seem to be ethical that an agent would want to point this out to potential clients who are thinking of purchasing insurance from the company. This is a real slippery slope—if word gets back to the supposedly troubled company that an agent has been talking about them to potential customers, this could easily be a lost license and stiff action by the slandered insurer. Remember, ethics starts with good sense.

To carry this a little further, if a company does become insolvent, it seems that at that instant the customers of the insolvent company is fair game. However, the Department of Insurance will usually put the company into receivership and take steps to sell the company and/or the business in order to protect the existing policyholders. They will not take it kindly if someone is replacing the policies in the company that they are attempting to rehabilitate.

If the policyholder of the insolvent company approaches an agent so as to obtain coverage with a more financially sound company, the rule is that the "customer rules." If the agent can provide coverage the same as they had previously, there would be little chance of anyone complaining. But what if the company were insolvent because of their too-liberal policy coverages? It happens. Then a policy with identical coverage of the old policy may not be possible. Here is where ethics are important.



**The agent/broker *must* make sure that the applicant fully understands that they are not going to have the same coverage as under the old policy if such is the case.**

Recently, in this situation, agents of some of the replacing companies were instructed to get a signed statement from the applicant stating that they understood that they would not have the exact same coverage that they previously had.

Sometimes, when one insurer has purchased the business of another insurer, whether the former insurer was financially sound or not, the assuming insurer has instructed their agents to contact all of the assumed policyholders and to fully explain the coverage that they have. This is certainly ethical, especially since it costs the insurer extra money to reimburse their agents for their time, but it is also a good business decision as the assuming insurer had a minimum of lapses of the business they had acquired.

Interesting how many times an ethical action results in a good business decision.

### **AGENTS ATTEMPTING TO CHANGE POLICY PROVISIONS**

Life, Annuity and Health Insurance policies are very explicit regarding the agent waiving or changing a policy provision. The general rule and with the most legal support at this time, prohibits the company from rescinding the insurance in case of a violation of the policy when an agent who has either actual or apparent authority has waived any policy provision, whether such "waiver" was orally or in writing. This also applies to the insurance company's attempting to rescind.

Secondly, the company is prohibited from rescinding the insurance because of a policy violation in a situation where the company attempts to defend based upon a violation of the terms of the contract, because of some knowledge or acts on its part or on the part of the agent. The courts do not, as a rule, accept oral evidence to alter the terms of a written document.

Therefore,



**an agent's actions in respect to waiving a policy provision, affects not only the agent, but also the company.**

The company's instructions nearly always are abundantly clear, so any misconduct of the agent makes him personally liable to the company for any damages as a result of his actions (enter E&O coverage). This stems from the law of agency wherein the agent must indemnify any loss or damage to the principal.

These actions can be an agent exceeding specific authority; binding unacceptable risks; failure to provide the insurance company with information regarding risks (such as health history, or present health condition); making incorrect statements about the applicant; failing to send funds that were collected to the insurer—such as premium payments or claims payments intended for an insured; and failing to follow explicit instructions from the insurer. These are all, obviously, serious breaches of ethics.

In nearly all cases, however, these situations are resolved by the agent being fired and his license revoked.

### ***LIFE INSURANCE AND POLICY ILLUSTRATIONS***

Ethical considerations and (violations of these ethics) vary little by most types of insurance—such as not transmitting accurate information to the underwriting department, not properly disbursing funds, misrepresentation, etc.—but the Life Insurance industry, in particular, has in recent years in respect to interest-sensitive life insurance policies, undergone considerable criticisms from policyholders and state insurance departments. This started as an ethical problem, but has now graduated into regulations, rules and laws (and litigation). Many agents who were involved in sales of these products still feel that they have done nothing wrong, and to a certain

extent, they are correct. Many, if not most, of the projections that caused the problems later were legal at that time and were performed under the supervision of and instructions from the insurance company. Indeed, computer programs were provided from the marketing department of the insurer and in many cases, laptop computers were also furnished. Company-sponsored seminars on policy illustrations were frequently held and attendance was often mandatory.

## **BACKGROUND**

For years life insurance suffered because permanent life insurance contained cash values that was touted as a savings device, or "forced savings," but the interest rate attributed to the policy was much less than with other investments. Disregarding the technical details, the problem was solved in the 1970s with the introduction of Universal Life and other interest-sensitive plans, which, for the first time (in this country) the cash value, could fluctuate and represent the increase in interest earnings of the insurer. Marketing material was developed that showed the increase in cash values as the interest rate increased.

Soon there were many other variations of these interest-sensitive products, and people were looking with renewed interest at the possibility of using life insurance as an investment vehicle. There were certain additional tax advantages of using life insurance in this way, plus the investments were "guaranteed" by the assets of the insurance company. Win-win situation too many

## **THE VANISHING PREMIUM POLICY**

An example of policies developed at that time was the "*vanishing premium*" policy—or when sold as an option to another policy, a "*vanish pay*" provision. As the name indicates, the policyholder would not have to pay more than (usually) five or seven annual premiums, because of the high interest rate attributed to the cash-value buildup of the policy. At this time in history, even CDs were getting as much as 14% (maybe even higher with offshore banks). The internally generated interest in the form of dividends and/or excess interest credits would be sufficient after the initial premium-paying period to keep the policy in force. In the projections of cash values, the interest rate of 12% was commonly used.

One of the "ethical" problems that arose was that many policyholders of older policies were convinced by illustrated policy values that were based on these (inflated) interest assumptions, that they should replace their older policy with this (miracle) policy.

Insurance companies made the usual disclaimers on their policy illustrations, but these were often at the bottom of the page, sometimes as footnotes, with the obvious result that they were ignored or not read to the applicant, simply erased before presentation, or were proclaimed as irrelevant. If the question was raised to the agent as to how such high interest rates could be forecast, many agents referred to the past where such disclaimers were used by insurers but dividends nearly always exceeded that of those illustrated.

It was no surprise that when interest rates dropped, many policyholders received premium notices of premiums due, even after the policy had been in force for the 5 or 7 year period. Many policyholders, at first, thought this was just technical insurance talk and nothing would happen. But many, who thought that their policy should even be paid up, or at least the premiums would not be due, found that the reality was that they owed premiums or the policies would lapse. This was not a good time to be in the marketing or customer relations department of a life insurance company that sold these plans.

The next step, obviously, was litigation, charging deceptive sales practices, fraudulent inducement and representation and intentionally misrepresenting the policy. Some of the insurers responded that the policyholder had been put on notice by the disclaimer, or the illustration was not part of the contract, or the problems had been caused by a handful of rogue agents.

In some areas, insurers have been successful with their defense, but not successful in other jurisdictions. One reason that some courts ruled in favor of the policy holder was that some companies had stated in their disclaimer that the interest values used in the illustration was what the company was experiencing at that time—which was shown to not be true.

The final result of this situation has not as yet been resolved, but thousands of cases have been settled with insurers paying millions of dollars in fines, judgments and legal fees and these types of policies have been removed from the market. This is a massive illustration of how important it is for insurers to get correct and complete information to its customers. This is an ethical point as much as it is legal, and raises the question as to whether it was ethical to present an illustration using inflated interest rates. It is difficult to not consider it unethical, as very few agents apprised their policyholders that they may have to pay premiums again during the time that the stock market and interest rates tumbled. There were some professionals who worked diligently to make their clients aware of what was happening as soon as they became aware of the lowering of interest rates, and in some cases, they were able to exchange the policy for one more suitable for their needs—saving their commissions and probably stopping some litigation in the process.

Universal Life Insurance and its offshoots, of which there are many, rely heavily upon illustrations. Because of overzealous agents and their illustrations using unrealistic assumptions, there have been problems similar to the vanishing-premium plans. As expected, because of the unethical behavior of agents and companies in providing illustrations, there are now very strict laws, rules and regulations in respect to illustrations.

### ***ETHICS CAN BE GOOD BUSINESS***

In a somewhat related situation that illustrates that an ethical act can be wise in a business sense also—several years ago when the interest rates were starting to climb, one life insurance company whose principal market was annuities, decided that they would offer every annuitant a new policy that would reflect the higher interest rate, and allow a 100% rollover with no penalties even though it would probably mean that they would lose considerable business. This was not considered for ethical reasons solely, as they thought that they would not only lose business when their customers were made aware that they could get higher interest, but they would probably lose more if they had to pay the annuity values at a much higher rate when it was annuitized.

Interestingly—to some, it seemed unbelievable—their offer to all of their annuitants was accepted by about 20% of the annuitants with no noticeable change in persistency on the entire block. In other words, 80% of the annuitants just decided to keep the original annuity. As time passed after this and subsequent similar offers, the company reported just normal attrition.

### ***INSURANCE MARKETPLACE STANDARDS ASSOCIATION (IMSA)***

Obviously, insurers have had ethics problems. Insurers have tried to improve their image by stressing ethical behavior in training, improving their agent's training programs, completely changed the illustration process and numbers, and other such related items directly addressing

the problems. One result of all of this turmoil was the formation of the Insurance Marketplace Standards Association (IMSA) in 1996.

This is a voluntary association, which encourages life insurers to maintain high standards of **ethical** behavior in the sales and marketing of individual life insurance and annuities by becoming members. These standards only apply to selling and marketing, and not to other areas (such as claims, underwriting, policyholder service, etc.).

Insurers voluntarily adopt the Principles of Ethical Market Conduct and then create programs and change existing programs to comply. Insurers do a self-assessment, and make changes accordingly. But perhaps most importantly, the company must secure a favorable opinion by an independent assessor of the company's policies and procedures before they can advertise as being a member of IMSA.

### PRINCIPLES OF IMSA

"Each IMSA member pledges to comply with the following principles in all matters affecting the marketing and sale of individually issued life insurance and annuity products:

- To conduct business according to high standards of honesty and fairness and to render that service to its customers, which, in the same circumstances, it would apply to or demand for itself.
- To provide competent and customer-focused sales and service.
- To engage in active and fair competition.
- To provide advertising and sales materials that is clear as to purpose and honest and fair as to content.
- To provide fair and expeditious handling of customer complaints and disputes.
- To maintain a system of supervision and review that is reasonably designed to achieve compliance with this *Principle of Ethical Market Conduct*.

### STUDY QUESTIONS

1. A claims investigation is ethical if
  - A. the insured is aware that such an investigation is being conducted.
  - B. the investigation is relative and pertinent to the claim.
  - C. the expense of investigation is paid by both the insured and the insurer.
  - D. the investigation is conducted by an independent investigator.
2. In order to assure the suitability of a product, it is the ethical duty of the agent
  - A. to explain fully and completely, the various options to their clients.
  - B. to have home office personnel explain the client's options under the policy.
  - C. to decline any commissions.
  - D. to compare the plan with every other similar plan sold in that state.

3. Since as a rule, every claim is individual and unique, therefore
  - A. they are all declined initially.
  - B. they are negotiated.
  - C. they nearly always end up in court.
  - D. the face amount of the claim is paid immediately following legal action always following.
  
4. When an insurance claim is made, and once the coverage is explained and known by all parties, then
  - A. the insurer automatically declines all settlement amounts.
  - B. an arbitrator assigned by the insure, enters the picture.
  - C. a copy of all documents are filed with the Department of Insurance, who determines the final settlement.
  - D. there must be complete agreement as to how the coverage applies to the claim.
  
5. A settlement is automatically unethical if
  - A. a private investigator is involved.
  - B. if the claimant is required to get an attorney for his own benefit.
  - C. if the investigation is not adequate or complete.
  - D. the full amount of the policy is paid to the claimant immediately after claim.
  
6. The most serious of ethical breaches, which may also be the most serious of legal breaches, is
  - A. placing an insurance policy with a company that is not the highest rated.
  - B. for an agent to suggest that professional legal or accounting assistance be used.
  - C. for an agent to attempt to replace a policy when the original carrier is in receivership.
  - D. conflict of interest.
  
7. Many times Errors and Omissions (E&O) claims arise in insurance transactions because
  - A. a claimant has made a claim of prejudice in claim investigation procedure.
  - B. the agent has not understood the risk.
  - C. an insurer wants to get risk of an agent but cannot prosecute them legally.
  - D. of request of the Department of Insurance.
  
8. If a company becomes insolvent and the policyholder approaches his agent to obtain coverage with a more financially sound company, and the agent is able to do so except that an automatic renewal provision is not available under the new policy, then the agent
  - A. does not need to tell the client about that as that would insult the client as can easily read it himself in the policy.
  - B. cannot accept any commission from the insurer.
  - C. must make sure that the client fully understands the difference and that they are not going to have the same coverage they had before.
  - D. can force the new insurer to duplicate the original coverage.

9. When an agent tries to waive a policy provision
- A. he is only doing what the client expects him to do.
  - B. usually he is allowed to do so, within limitations, and under the provision that he will receive no compensation for the sale of the policy.
  - C. that is a criminal act and is a felony with a \$5,000 fine.
  - D. his actions affects not only the agent but also the company.
- 10..A life insurance policy, no longer sold, that was later considered as very unethical not only in its sales but in its composition, was the
- A. Universal Life Insurance policy.
  - B. a mutual whole life permanent insurance policy.
  - C. annual renewable term (ART) policy.
  - D. the Vanishing Premium policy.

**ANSWERS TO STUDY QUESTIONS**

1B 2A 3B 4D 5C 6D 7B 8C 9D 10D



## CHAPTER FOUR – ILLUSTRATIVE CODES OF ETHICS

The explanations and illustrations of ethical behavior has been explained and discussed. As indicated earlier, there are many organizations in the insurance industry and they each have a Code of Ethics (or "Canons") that pertains to the business of their members. It would take many pages to go through even the majority of such Codes, therefore the professional codes for those who hold designations awarded by the American College, a representative Code for CLU designates, and a summary of the Code of Ethics for the Chartered Property and Casualty Underwriters are presented. Since this text will be used primarily by agents for Continuing Education purposes, these Codes should provide a good base for ethical behavior.

The American College of Life Underwriters maintains Standards of Ethics for those who hold the Huebner School Designations (CLU, ChFC, RHU, REBC, or CLF) consisting of the Professional Pledge and eight Canons.

### ***THE PROFESSIONAL PLEDGE:***

**"In all my professional relationships, I pledge myself to the following rule of ethical conduct and I shall, in light of all conditions surrounding those I serve, which I shall make every conscious effort to ascertain and understand, render that service which, in the same circumstances, I would apply to myself."**

This pledge could be made as a standard for all lines of insurance. While this may sound at first blush as just a repetition of the "Golden Rule," it is noteworthy that it instructs that every effort shall be made to "ascertain and understand" *all condition surrounding* "those I serve." To reiterate and to satisfy ethical standards, one must not only know all of the conditions of the situation, but they must also understand these conditions. The only other addition to this pledge that comes to mind might be that this information must be transmitted accurately, fully and timely to the insurer or their proper representatives. Technically though, that would be a legal requirement and covered under an agent's contract anyway.

### **THE CANONS**

1. Conduct yourself at all times with honor and dignity.
2. Avoid practices that would bring dishonor upon your profession or the American College.
3. Publicize your achievements in ways that enhance the integrity of your profession.
4. Continue your studies throughout your working life so as to maintain a high level of professional competence.
5. Do your utmost to attain a distinguished record of professional service.

6. Support the established institutions and organizations concerned with the integrity of your profession.
7. Participate in building your profession by encouraging and providing appropriate assistance to qualified persons pursuing professional studies.
8. Comply with all laws and regulations, particularly as they relate to professional and business activities.

### **COMMENTS**

The Canons are "standards for judgment" which are as they should be, but it should be pointed out that specificity is not part of the Canons.

Those that are engaged in various aspects of the insurance industry will have such ethical "Canons" or Code of Ethics that relate to their profession/occupation specifically. For the purpose of this educational institution, the Canons are more of a continuation of the Professional Pledge. After all, the purpose of the American College and its designations is to create professionals in the insurance industry.

### **CODE OF ETHICS – AMERICAN SOCIETY OF CHARTERED LIFE UNDERWRITERS**

(The Center for the Study of Ethics in the Professions, Illinois Institute of Technology, has presented this Code of Ethics online at

<http://www.iit.edu/departments/csep/PublicWWW/codes/coe/ascllu-a.html> )

This Code is preceded by the statement:



**To competently advise and serve the client . . .**

It has been suggested that perhaps all Codes of Ethics for those in the insurance industry should precede their Code with this statement. Couldn't hurt

#### **1. A MEMBER SHALL PROVIDE ADVICE AND SERVICE WHICH ARE IN THE CLIENT'S BEST INTEREST.**

What this is saying is that a person who possesses a specific body of information and knowledge which is not possessed by the general public, has an obligation to use that knowledge for the benefit of the client and to avoid taking advantage of that knowledge to the detriment of the client.

If an agent has knowledge that a particular insurance company is considering moving out of state because of adverse experience, then it is the duty of the agent to report this to the client. Of course, care must be taken as the agent cannot be guilty of slander – which could cause him to

lose his license – so the information must be published or this information must be corroborated by independent sources. This can be tough sometime, as in case it hasn't been noticed; the insurance industry is always full of rumors.

If a company has notified its agents of a rate increase effective at a later date, it is the agent's responsibility to pass this to a new client or to a client changing benefits when this would be important. Too often agents may "forget" about a newly announced rate increase, as they are confident that once they have sold the policy, they can save the policy when new rates are enacted. (Anyway, they will receive production credit during sales contests so they can worry about lapses later.)

Sometimes an agent may represent more than one company, and discover that he could place a policy with a company that pays high commissions but the premium is a little higher; or he could place it with another company at lower premiums that pays lower commissions. Obviously, in a conflict of interest situation, the interest of the CLIENT is paramount. What if the premiums were the same but the company paying lower commissions was an AAA+ rated company, compared to the other company which was new and was unrated? Just because a company is unrated does not *necessarily* mean that it will become insolvent, but should you, as the agent, take the chance? In any event, it would seem ethical (at least) to make the client aware of the situation – although it is difficult with the facts as stated, why there would even be a choice!

An agent **must** give due courtesy and consideration to those who are engaged in related professions who are also serving the client. For life and health agents, the first thing that comes to mind is *a doctor!* Policies cannot be written, agents cannot be paid, and applicants are more open to sales pitches from competitors if it takes too long to issue a policy because the attending physician's office is slow in making and submitting copies of medical records. In estate and financial planning, the thorn in the side of an agent can be an accountant or attorney, but in either event, their approval and their providing of information **MUST** be obtained. In some cases, they may not be a "friend" of the agent, but there is nothing that can be done except a lot of tongue biting and crow-eating. But if a good job is done for the client, then it is worth it, and who knows, you may have made a new accountant or attorney friend that can (ethically) refer business to you.

This particular Code states that "an (agent) is to give due regard to any agent principal relationship, which may exist between the (agent), and such companies as he may represent." What this emphasizes is that an agent must be loyal to those companies that he represents. If, for instance, he has agreed to an exclusive agreement with a company to sell a particular product, then he must live up to that agreement, even if it means that he can get more commission from placing the business with another company as a broker. Ethical behavior is not exclusively between an agent and a client, but also between an agent and the agency and company he represents. Another situation could be where an agent places a policy directly with a company, bypassing the agency. This rarely happens, of course, but occasionally there can be, for instance, large groups that an agent "controls" and can logically bypass the agency.

## **2. A MEMBER SHALL RESPECT THE CONFIDENTIAL RELATIONSHIP EXISTING BETWEEN CLIENT AND MEMBER.**

Apropos to the entire insurance industry, in order to give competent advice and service, it is often necessary to obtain confidential and personal information from the client; such information is to be held (highly) confidential unless this obligation is released by the client (and no one else).

**3. A MEMBER SHALL CONTINUE HIS PROFESSIONAL EDUCATION THROUGHOUT HIS PROFESSIONAL LIFE.**

A fact well known by the Insurance Departments, it is necessary to continue studying in order to not only improve his professional abilities, but also just to keep up with changes. This, of course, is one of the reasons for Continuing Education.

Continuing Education does not just educate and add to the knowledge or the practice of the profession, but also it must keep the member abreast of changing economic conditions and legislative conditions, which can affect the financial plans of the insuring public. The recent changes in the tax laws, 401(k), taxation of Long Term Care Insurance, and many other legislative changes emphasize the necessity of keeping abreast of more than what may be found in textbooks. "Professional Education" may be formal, informal, and/or professional experiences.

**4. A MEMBER SHALL RENDER CONTINUING ADVICE AND SERVICES**

Conditions and circumstances of clients change for a variety of reasons and it is the responsibility for the member to keep abreast of these changes. A client with whom the member has an "active professional relationship" must be informed of any changes (economic or legislative) that could affect that relationship.



**To enhance the public's regard for professional designations and allied professional degrees held by members...**

**5. A MEMBER SHALL OBEY ALL LAWS GOVERNING HIS BUSINESS OR PROFESSIONAL ACTIVITIES.**

"Activities" are considered as business activities outside of the life insurance industry, and professional activities would then be non-personal activities within the life insurance industry.

**6. A MEMBER SHALL AVOID ACTIVITIES WHICH DETRACT FROM THE INTEGRITY AND PROFESSIONALISM OF THE CHARTERED LIFE UNDERWRITER DESIGNATION, THE CHARTERED FINANCIAL CONSULTANT**

**DESIGNATION, OR ANY OTHER ALLIED PROFESSIONAL DEGREE OR DESIGNATION HELD BY MEMBERS.**

This includes all personal, business and professional activity within the scope of this statement. There are activities which could present a violation of this statement, such as:

1. A member's failure to obey a law unrelated to the member's business or professional activities.
2. A member impairing the reputation of another practitioner.
3. A member unfairly competing with another practitioner.
4. Actions which result in the member discrediting his own reputation.
5. A member discrediting life underwriting as a profession, the institution of life insurance or the American Society of CLU and ChFC.
6. A member advertising the Chartered Life Underwriter or Chartered Financial Consultant designation or membership in the American Society in an undignified manner or in a manner prohibited by the Bylaws of the American Society.

**7. A MEMBER SHALL ENCOURAGE OTHERS TO ATTAIN THE CHARTERED LIFE UNDERWRITER AND/OR THE CHARTERED FINANCIAL CONSULTANT DESIGNATIONS.**

Since this Code is that of those who have achieved these designations, it follows that they should also encourage others to do the same. CLUs and ChFCs want more people in the industry with those designations, as that will then enhance the public regard for these professionals. Attend your local CLU chapter function and see how much effort is made to recruit new members and the great support given to those who are presently involved in the program. This is one of the requirements for a "professional."

**8. A MEMBER SHALL AVOID USING THE CLU OR CHFC DESIGNATION IN A FALSE OR MISLEADING MANNER.**

This would be a direct violation of the American College professional requirements. As an example, an agency could be owned or managed by a CLU, who would then encourage his agents who do not have this designation, to represent themselves as also having this designation. Further, the designation shall not be used in a name that would reasonably lead others to believe that someone other than the member held the designation. There are two examples offered:

John C. Jones, CLU and Associates—this is OK.

John C. Jones and Associates, Chartered Financial Consultants—not allowed (unless, of course, all of the associates are ChFCs).

## **CODE OF ETHICS OF THE CHARTERED PROPERTY AND CASUALTY UNDERWRITERS**

### ***ABOUT THE CODE OF PROFESSIONAL ETHICS***

**This is a brief summary of information appearing in greater detail in the Code of Professional Ethics, which is among the CPCU -1 study materials.**

All CPCU candidates and CPCUs are bound by the Code of Professional Ethics of the American Institute for CPCU. The Code describes both high goals and minimum standards of conduct.

1. The high goals described in the Canons challenge all CPCUs and CPCU candidates to aspire to the highest level of ethical performance in all of their professional activities.
2. The minimum standards of conduct, described in the Rules, maintain the integrity of the CPCU designation. CPCUs and CPCU candidates are obligated to at least meet the minimum standards in the Rules, and failure to do so may subject a CPCU—or a CPCU candidate—to disciplinary measures.

CPCU candidates study the Code and are tested in CPCU 1 to ensure that all CPCUs understand their ethical obligations. The ultimate goal of the Code is to foster highly ethical conduct on the part of all CPCUs.

### **THE CANONS AND RULES OF THE CODE OF PROFESSIONAL ETHICS FOR CHARTERED PROPERTY AND CASUALTY UNDERWRITERS**

**Canon 1-CPCUs should endeavor at all times to place the public interest above their own.**

Rule R1. 1-A CPCU has a duty to understand and abide by all *Rules* of conduct, which are prescribed in the *Code of Professional Ethics of the American Institute*.

Rule R1.2-A CPCU shall not advocate, sanction, participate in, cause to be accomplished, otherwise carry out through another, or condone any act which the CPCU is prohibited from performing by the *Rules* of this *Code*.

**Canon 2-CPCUs should seek continually to maintain and improve their professional knowledge, skills, and competence.**

Rule R2. 1-A CPCU shall keep informed on those technical matters that are essential to the maintenance of the CPCU's professional competence in insurance, risk management, or related fields.

**Canon 3-CPCUs should obey all laws and regulations, and should avoid any conduct or activity, which would cause unjust harm to others.**

Rule R3.1-In the conduct of business or professional activities, a CPCU shall not engage in any act or omission of a dishonest, deceitful, or fraudulent nature.

Rule R3.2-A CPCU shall not allow the pursuit of financial gain or other personal benefit to interfere with the exercise of sound professional judgment and skills.

Rule R3.3-A CPCU shall not violate any law or regulation relating to professional activities or commit any felony.

**Canon 4-CPCUs should be diligent in the performance of their occupational duties and should continually strive to improve the functioning of the insurance mechanism.**

Rule R4. 1-A CPCU shall competently and consistently discharge his or her occupational duties.

Rule R4.2-A CPCU shall support efforts to effect such improvements in claims settlement, contract design, investment, marketing, pricing, reinsurance, safety engineering, underwriting, and other insurance operations as will both inure to the benefit of the public and improve the overall efficiency with which the insurance mechanism functions.

**Canon 5-CPCUs should assist in maintaining and raising professional standards in the insurance business.**

Rule R5. 1-A CPCU shall support personnel policies and practices which will attract qualified individuals to the insurance business, provide them with ample and equal opportunities for advancement, and encourage them to aspire to the highest levels of professional competence and achievement.

Rule R5.2-A CPCU shall encourage and assist qualified individuals who wish to pursue CPCU or other studies, which will enhance their professional competence.

Rule R5.3-A CPCU shall support the development, improvement, and enforcement of such laws, regulations, and codes as will foster competence and ethical conduct on the part of all insurance practitioners and inure to the benefit of the public.

Rule R5.4-A CPCU shall not withhold information or assistance officially requested by appropriate regulatory authorities who are investigating or prosecuting any alleged violation of the laws or regulations governing the qualifications or conduct of insurance practitioners.

**Canon 6-CPCUs should strive to establish and maintain dignified and honorable relationships with those whom they serve, with fellow insurance practitioners, and with members of other professions.**

Rule R6. 1-A CPCU shall keep informed on the legal limitations imposed upon the scope of his or her professional activities.

Rule R6.2-A CPCU shall not disclose to another person any confidential information entrusted to, or obtained by, the CPCU in the course of the CPCU's business or professional activities, unless a disclosure of such information is required by law or is made to a person who necessarily must have the information in order to discharge legitimate occupational or professional duties.

Rule R6.3-In rendering or proposing to render professional services for others, a CPCU shall not knowingly misrepresent or conceal any limitations on the CPCU's ability to provide the quantity or quality of professional services required by the circumstances.

**Canon 7-CPCUs should assist in improving the public understanding of insurance and risk management.**

Rule R7. 1-A CPCU shall support efforts to provide members of the public with objective information concerning their risk management and insurance needs and the products, services, and techniques which are available to meet their needs.

Rule R7.2-A CPCU shall not misrepresent the benefits, costs, or limitations of any risk management technique or any product or service of an insurer.

**Canon 8-CPCUs should honor the integrity of the CPCU designation and respect the limitations placed on its use.**

Rule R8. 1-A CPCU shall use the CPCU designation and the CPCU key only in accordance with the relevant *Guidelines* promulgated by the American Institute.

Rule R8.2-A CPCU shall not attribute to the mere possession of the designation, depth or scope of knowledge, skills, and professional capabilities greater than those demonstrated by successful completion of the CPCU program.

Rule R8.3-A CPCU shall not make unfair comparisons between a person whom holds the CPCU designation and one who does not.

Rule R8.4-A CPCU shall not write, speak, or act in such a way as to lead another to reasonably believe the CPCU is officially representing the American Institute, unless the CPCU has been duly authorized to do so by the American Institute.

**Canon 9-CPCUs should assist in maintaining the integrity of the Code of Professional Ethics.**

Rule R9. 1-A CPCU shall not initiate or support the CPCU candidacy of any individual known by the CPCU to engage in business practices which violate the ethical standards prescribed by this *Code*.

Rule R9.2-A CPCU possessing unprivileged information concerning an alleged violation of this *Code* shall, upon request, reveal such information to the tribunal or other authority empowered by the American Institute to investigate or act upon the alleged violation.

Rule R9.3-A CPCU shall report promptly to the American Institute any information concerning the use of the CPCU designation by an unauthorized person.

## **CERTIFICATION FOR EXCELLENCE IN INSURANCE SALES**

### **Code of Ethics**

1. The agent must always act in a professional manner.
2. The agent must ascertain and understand all relevant matters surrounding the client.
3. The agent must give due consideration to other professionals serving the client.
4. The agent must not disparage or belittle another agent.
5. The agent must provide advice to meet the needs of the client.
6. The agent must honor the confidential relationship that exists between the client and the agent.
7. The agent must continue their professional education throughout their career
8. The agent must obey all laws pertaining to their profession.
9. The agent must conduct their business in such a way as to enhance the insurance industry.

### **STUDY QUESTIONS**

1. The Professional Pledge of the American College of Life Underwriters states that "every effort shall be made to ascertain and understand
  - A. the publications of the insurers represented."
  - B. all of the examinations of the American College."
  - C. all conditions surrounding those I serve."
  - D. what I, as an agent, can offer, even without technical knowledge of the coverages."
2. The Canons of the American College states that you should conduct yourself at all times
  - A. as if you knew all the details of the insurance product being sold.
  - B. in manner of dress and appearance, with tie & suit or blouse & skirt.
  - C. as if you the client's buddy, and agree with all of his premises.
  - D. with honor and dignity.
3. The Canons encourage those in the profession to
  - A. discourage others from joining the profession.
  - B. discourage others from taking insurance courses from any other educational institution.

- C. encourage and to provide assistance to those qualified persons pursuing professional studies.
  - D. actively screen those in the industry who are not professionals, and do not do business with them.
4. The Code of Ethics of the American Society of Chartered Life Underwriters is preceded by a statement
- A. "To competently advise and serve the client . . ."
  - B. "In order to wear the professional jewelry proudly . . ."
  - C. "To maximize commissions . . ."
  - D. "The following Code should be used only by those with a CLU or ChFC designation."
5. The first Canon states that "A Member shall provide advice and service
- A. to his clients, including legal advice."
  - B. only to those who will totally accept the Member's suggestions."
  - C. which are in the client's best interest."
  - D. to clients only after they have signed the application."
6. In the Code of Professional Ethics as contained in the CPCU study materials, failure to meet the minimum standards of the rules
- A. will make it mandatory that the CPCU give up his insurance license.
  - B. automatically requires a CPCU to take Examination 5 over again.
  - C. shall have no particular consequences.
  - D. may subject the CPCU to disciplinary measures.

7. The Canons of the CPCU state that CPCUs should endeavor at all times to
  - A. place the public interest above their own.
  - B. create a working climate conducive to accelerated earnings.
  - C. protect their designation and professional organization against any outside action.
  - D. discourage CPCU candidates so that the profession shall remain elite.
  
8. CPCUs should obey all laws and **avoid** any conduct or activity
  - A. encouraging new CPCU candidates.
  - B. that brings their profession into the public eye.
  - C. that could benefit a client to the detriment of the CPCU.
  - D. which would cause unjust harm to others.
  
9. Relative to the insurance business, CPCUs should
  - A. strive to require an added commission bonus to those with the designation.
  - B. encourage the AFL, CIO or other unions, to become stronger in the industry.
  - C. assist in maintaining and raising professional standards in the industry.
  - D. never display their CPCU jewelry in public.
  
10. CPCUs should assist in improving
  - A. their commissions schedules.
  - B. their amount of sales.
  - C. relationships between the races.
  - D. the public understanding of insurance and risk management.

## ANSWERS TO STUDY QUESTIONS

1C 2D 3C 4A 5C 6D 7A 8D 9C 10D



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## CONSUMER INFORMATION

California Department of Insurance and other state contacts:

### CONSUMER INFORMATION

Joel Laucher, Chief Consumer Services Division  
California Department of Insurance  
Ronald Reagan Building  
300 South Spring Street 213-897-8921  
Los Angeles, California 90013 800-927-4357

### DEPARTMENT OF INSURANCE

<http://www.insurance.ca.gov>

Consumer Assistance  
800-927-HELP (4357)  
[www.insurance.ca.gov/0100-consumers](http://www.insurance.ca.gov/0100-consumers)

### CONSUMER ACTION

221 Main St., Suite 480  
San Francisco, CA 94105  
(415) 777-9635

### AGENT/BROKER LICENSED?

[www.consumer-action.org/links/articles/california\\_department\\_of\\_insurance/](http://www.consumer-action.org/links/articles/california_department_of_insurance/)

