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## PUBLISHER'S NOTE

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## CHAPTER 1: CONSUMER PROTECTION

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### REGULATING INSURANCE

In most states, the insurance business is regulated on the state, rather than the federal, level. Until 1944 insurance was not considered as commerce and as such was not subject to federal jurisdiction. Each state regulated policy language and rates. A landmark case in 1944 forced a reversal in the insurance industry and the Supreme Court ruled that insurance was indeed commerce and subject to federal jurisdiction. However, by that time each state had already implemented programs and policies for governing insurance on the state level, and leaders of the federal government were reluctant to step in and overtake the process.

In 1945, Congress passed the McCarran-Ferguson Act, which turned over control of the insurance business to the state, rather than the federal, authorities. The federal government would only intervene in insurance matters if a state's governing regulations were proved to be inadequate.

Today, the role of the state is still to oversee the insurance industry. From time to time state regulations are challenged by proponents of a federally-controlled system. Those who want the insurance industry to be controlled by the federal government point to a level of overall uniformity that could be achieved by bringing all the regulations under one governing body, instead of 50 individual bodies.

Proponents of the state-regulated industry counter this thinking with the arguments that:

- Individual states may be more responsive to the needs of their own citizens;
- Although state regulations do differ from state to state, most follow the guidelines set out for all state governments and their respective insurance commissions. As such, the differences between the state regulations are minor in detail.
- There may be great upset caused to the individual if a switch over from the state-governed system to a federally-governed system were to ensue.

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### WHY REGULATE?

State regulations governing the insurance industry are designed primarily to (1) protect the consumer from abuses and (2) promote fair competition among the insurers. Not all consumer abuses are the direct result of fraud or willful intent. In many cases, increased competition drives a business environment to move too quickly and incompetence results. So, the regulations also include guidelines for how an insurance practice should be operated to maintain a minimum standard of competence.

There are several specific areas where the state regulates practices in the insurance industry:

- Financial condition of the insurer;
- Standard provisions in contracts;
- Licensing; and
- Rates.

#### *Financial Condition*

An insurer's financial stability is of great importance, as its financial strength indicates how viable the company is, and indicates a proven track record of performance and service to its customers. All insurance companies must meet basic requirements to continue to do business. For example, insurers are required to keep reserves of funds to be used to pay future claims. These funds are earmarked for future use and cannot be part of the assets of the company.

Handling assets is also regulated. Most states do not allow insurers to invest in risky investment vehicles, such as certain types of securities. Instead, the insurers are required to invest in conservative financial vehicles.

Insurers are required to report their financial condition to the state annually. The state systematically audits each insurer on a regular basis.

#### *Standard Provisions in Contracts*

To establish a small measure of uniformity, many states require standard provisions in contracts, or may have a standard policy format that is to be followed. Terms that are used and defined will be the same from provision to provision, to further ensure uniformity. Many states have "readability standards" that require that policies, provisions and contracts are worded in the most simple, easy to understand terms.

Before an insurance policy may be sold in a state, it must be filed with the state insurance department, where it is reviewed to make sure it meets all the requirements of the state. If it does not, the state may reject the policy and not allow it to be sold by the insurer.

### ***Licensing***

Licensing relates to the power of the insurance department to:

- Issue licenses;
- Renew licenses;
- Suspend licenses; and
- Revoke licenses.

Both individuals and companies must be licensed to participate in the insurance industry in a state. Companies must have a license to do business in the state. Agents must hold a valid license to sell insurance in the state, and many states now require insurance adjusters to be licensed.

Licensing regulations ensure that the state insurance department can (1) maintain the standards it has set for individuals and companies alike, and (2) allows the department to have an avenue for removal of any individuals or companies from the state insurance industry if they are found to violate the regulations. In this way, the insurance department can stop fraud, consumer abuses and remove individuals who are unscrupulous or unethical in their dealings within the insurance industry.

### ***Rates***

The amount each consumer pays for his insurance policy is known as the insurance rate, and competition among insurance companies to provide the lowest rates to consumer's fuels the marketplace. The insurance department in the state governs how the rates are determined and applied, and further outlines that insurance companies must provide their rate structure to the insurance department for review and compliance with all state regulations.

There are specific areas where rates must be scrutinized. The state stipulates that rates must NOT be:

- ***Excessive.***  
Rates may not be too high and consumers may not be overcharged for insurance.
- ***Inadequate.***  
Although consumer concerns are considered, insurance companies must be able to charge a high enough rate to cover the insurance company's losses and exposures.
- ***Discriminatory.***  
The main issue of discrimination in insurance rates relates to the assumption of parties of risk. It does not mean that all consumers should pay the same amount for insurance. The very nature of the business indicates that certain factors, such as age, sex and physical status, determine lower or higher rates. However, rates cannot discriminate in that certain members of one group cannot be charged a higher rate to subsidize lower rates for other members of the same group.

### **FOCUS POINTS:**

- In most states, the insurance business is regulated on the state, rather than the federal, level.
- Until 1944 insurance was not considered as commerce and as such was not subject to federal jurisdiction.
- A landmark case in 1944 forced a reversal in the insurance industry and the Supreme Court ruled that insurance was indeed commerce and subject to federal jurisdiction.
- Because by 1944 each state had already implemented programs and policies for governing insurance on the state level, the federal government became reluctant to step in and overtake the process.
- In 1945, Congress passed the McCarran-Ferguson Act, which turned over control of the insurance business to the state, rather than the federal, authorities.
- The federal government would only intervene in insurance matters if a state's governing regulations were proved to be inadequate.
- Today, the role of the state is still to oversee the insurance industry.

- o Proponents of the state-regulated industry counter this thinking with the arguments that:
- o Although state regulations do differ from state to state, most follow the guidelines set out for all state governments and their respective insurance commissions. As such, the differences between the state regulations are minor in detail.
- o State regulations governing the insurance industry are designed primarily to (1) protect the consumer from abuses and (2) promote fair competition among the insurers.
- o The regulations also include guidelines for how an insurance practice should be operated to maintain a minimum standard of competence.
- o The areas where the state regulates practices in the insurance industry include Financial condition of the insurer; Standard provisions in contracts; Licensing; and Rates.
- o All insurance companies must meet basic requirements to continue to do business. For example, insurers are required to keep reserves of funds to be used to pay future claims. These funds are earmarked for future use and cannot be part of the assets of the company.
- o Handling assets is also regulated. Most states do not allow insurers to invest in risky investment vehicles. Insurers are required to invest in conservative financial vehicles.
- o Insurers are required to report their financial condition to the state annually. T
- o The state systematically audits each insurer on a regular basis.
- o To establish a small measure of uniformity, many states require standard provisions in contracts, or may have a standard policy format that is to be followed.
- o Terms that are used and defined will be the same from provision to provision, to further ensure uniformity.
- o Many states have "readability standards" that require that policies, provisions and contracts are worded in the most simple, easy to understand terms.
- o Before an insurance policy may be sold in a state, it must be filed with the state insurance department, where it is reviewed to make sure it meets all the requirements of the state.
- o Licensing relates to the power of the insurance department to Issue licenses; Renew licenses; Suspend licenses; and Revoke licenses.
- o Both individuals and companies must be licensed to participate in the insurance industry in a state.
- o Companies must have a license to do business in the state.
- o Agents must hold a valid license to sell insurance in the state, and many states now require insurance adjusters to be licensed.
- o Licensing regulations ensure that the state insurance department can (1) maintain the standards it has set for individuals and companies alike, and (2) allows the department to have an avenue for removal of any individuals or companies found to violate the regulations
- o The amount each consumer pays for his insurance policy is known as the insurance rate, and competition among insurance companies to provide the lowest rates to consumers fuels the marketplace.
- o The insurance department in the state governs how the rates are determined and applied.
- o Insurance companies must provide their rate structure to the insurance department for review and compliance with all state regulations.
- o Rates must NOT be excessive, inadequate, or discriminatory

## CHAPTER 2: EXPLORING ETHICS

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### BUSINESS ETHICS

Simply put, ethics involves learning what is right or wrong, and then doing the right thing. But, the "right thing" is not nearly as straightforward as conveyed in a great deal of insurance ethics literature. Most ethical dilemmas in the workplace are not simply a matter of "should Bob steal from Jack?" or "should Jack lie to his boss?" There are two schools of thought on ethics—one group of industry analysts believes that there is always a right thing to do based on moral principal. Others believe that the right thing to do depends on the situation, and that ultimately it is up to the individual.

Philosophers consider ethics to be the "science of conduct", that ethics are the fundamental ground rules by which all people live their lives. Philosophers have been discussing ethics for at least 2,500 years, since the time of Socrates and Plato. Many ethicists consider emerging ethical beliefs to be state-of-the-art legal matters. What becomes an ethical guideline today is often translated to a law, regulation, or rule tomorrow. Values, which represent how an individual should behave, are considered moral values, such as respect, honesty, fairness and responsibility. Statements around how these values are applied are sometimes called moral or ethical principals.

The concept of business ethics has come to mean various things to various people. Generally, it is coming to know what is right or wrong in the workplace and doing what is right—this is in regard to effects of products and services and in relationships with stakeholders. Attention to business ethics is critical during times of fundamental change. In times of fundamental change, values that were previously taken for granted are questioned. Many values are no longer followed, and then there is no clear moral compass to guide leaders through complex dilemmas about what is right or wrong.

Attention to ethics in the workplace sensitizes leaders and agents to how they should act. Perhaps most important, attention to ethics in the workplace helps ensure that when leaders and managers are struggling in time of crises and confusion, they retain a strong moral compass. However, attention to business ethics provides numerous other benefits as well.

#### ***A Serious Matter***

Many people react that business ethics, with its continuing attention to "doing the right thing" only asserts the obvious ("be good," "don't lie", etc.), and so these people do not take business ethics seriously. For many people, the principles of the obvious can go right out the door during times of stress. Alternatively, applying a strict code of ethics can be strong preventative medicine.

Ethics came to the forefront during the birth of social responsibility in the 1960's. In that decade, social awareness movements raised expectations of businesses to use their massive financial and social influence to address social problems such as poverty, crime, environmental protection, equal rights, public health and improving education. An increasing number of people assert that because businesses were making a profit from using the country's resources, businesses owed it to work to improve society.

The emergence of business ethics can be related to leaders' realization that they needed to manage a more positive image to the public—something insurance leaders have encompassed. As commerce becomes more complicated and dynamic, insurance leaders realize they need more guidance to ensure their dealings support the common good and do not harm others.

Ethics in the business environment—any business, including insurance—is about prioritizing moral values and ensuring that individuals' behavior are aligned with those values.

#### ***Recognizing an Ethical Dilemma***

Most of the ethical dilemmas faced in the workplace are highly complex. Typically, a serious ethical conflict exists when there is the presence of:

1. A significant value conflict among differing interests;
2. Real alternatives that are equally justifiable; and
3. Significant consequences on "stakeholders" in the situation.

Resolving issues can be difficult. Most people are quick to invoke the "golden rules" of honesty and courtesy, but, when presented with complex business transactions, they realize there is a wide gray area in applying these principles.

#### ***Is a Code of Ethics Effective?***

Many people react that codes of ethics, or lists of ethical values to which the organization aspires, are rather superfluous because they represent values to which everyone naturally should aspire. However, the value of a code of ethics to an organization is its priority and focus regarding certain ethical values in that workplace. For example, it is obvious that it is desirable for all people to be honest. However, if an organization is struggling around continuing occasions of deceit in its



industry, a priority on honesty is very timely, and honesty should be listed in that organization's code of ethics. A code of ethics is an organic instrument, and often changes with the needs of society and the organization.

For representative examples of industry codes of ethics, please see also **Chapter 10, "Codes of Ethics: Samples"** in this book.

### ***Regulating Morality***

Everyone realizes that good people can take bad actions, particularly when stressed or confused. However, stress and confusion are not excuses for unethical actions, they are reasons. Agents must realize that working in the industry includes all parties working together to help each other remain ethical and to work through confusing and stressful ethical dilemmas.

The definition of the discipline of ethics in business should include:

1. An application of ethics to the corporate community;
2. A way to determine responsibility in business dealings;
3. The identification of important business and social issues; and
4. A critique of business.

Items number 3 and number 4 are often matters of *social* responsibility, that relate directly back the individual on a personal level.

### ***"Boiling the Frog"***

An individual can often be unethical, yet operate within the limits of the law. For example, an individual could withhold information, "fudge" financial data, complain about or berate competitors and co-workers, etc. However, breaking the law often starts with unethical behavior that has gone unnoticed.

The "boil the frog" phenomena is a useful parable to illustrate this:

If a frog is put in hot water, it immediately jumps out. However, if you put a frog in cool water and slowly heat up the water, it is possible to eventually boil the frog. The frog does not seem to notice the adverse change in the environment.

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## **APPLYING ETHICS BENEFITS THE INDUSTRY**

There are many obvious moral benefits to adhering to ethical standards, but there are other benefits of ensuring that ethics are followed in the industry and in the workplace:

1. ***Attention to business ethics has substantially improved society.*** A number of decades ago, children in our country worked 16-hour days. Workers' limbs were torn off and disabled workers were condemned to poverty and often starvation. Trusts controlled some markets to the extent that prices were fixed and small businesses were choked out. Price fixing crippled normal market forces. Employees were terminated based on personalities. Influence was applied through intimidation and harassment. Then society reacted and demanded that businesses place high value on fairness and equal rights. Anti-trust laws were instituted. Government agencies were established. Unions were organized. Laws and regulations were established.
2. ***Ethics programs help maintain a moral course in turbulent times.*** As noted previously, attention to business ethics is critical during times of fundamental changes. During times of change, there is often no clear moral compass to guide leaders through complex conflicts about what is right or wrong. Continuing attention to ethics in the workplace sensitizes leaders and staff to how to act — consistently.
3. ***Ethics cultivate strong teamwork and productivity.*** Attention to ethics align employee behaviors with those top priority ethical values preferred by leaders of the industry. Usually, the small office or organization finds surprising disparity between the preferred values of the industry and the actual values in the day-to-day business transactions. Ongoing attention to the values and ethics builds openness, integrity and a sense of community for the individual—critical ingredients of a strong leader in the industry.
4. ***Ethics standards support individual growth.*** Attention to ethics in the industry helps an agent face reality, both good and bad, in the industry and in himself. In this regard, an agent may feel full confidence and can admit and deal with whatever comes his way.
5. ***Ethics programs are an insurance policy—they help ensure that policies are legal.*** There is an increasing number of lawsuits in regard to the effects of services or products on the consumer. Attention to ethics ensures highly ethical policies and procedures in the workplace. Analysts believe it is far better to incur the cost of mechanisms to ensure ethical practices now than incur the costs of litigation later.

6. ***Ethics standards help avoid criminal acts of omission and can lower fines.*** Ethics standards, such as an insurance agent's code of ethics, tend to detect ethical issues and violations early on so they can be addressed. In some cases, when an organization is aware of an actual or potential violation and does not report it to the appropriate authorities, it can be considered a criminal act. However, ethics guidelines adopted on an industry-wide basis potentially lower fines if an organization or individual has clearly made an effort to operate ethically.
7. ***Ethics standards help manage values associated with quality management, strategic planning and diversity management.*** Ethics programs identify preferred values and ensure that the individual's behavior is aligned with those values. This effort includes recording the values, developing policies and procedures to align behavior with preferred standards, and then training personnel about the policies and procedures. Ethics standards are highly useful for managing strategic values, such as expanding market shares, reducing costs, and managing diversity. Diversity is much more than the color of a person's skin—it is acknowledging different values and perspectives.
8. ***Ethics standards promote a strong public image.*** Attention to ethics is also a strong public relations tool. Admittedly, managing ethics should not be done primarily to the reason of public relations. But, the fact that an organization regularly gives attention to ethics can portray a strong, positive image to the public. People see those organizations as valuing people more than profit, as striving to operate with the utmost of integrity and honor. Aligning behavior with values is critical to effective marketing and public relations programs.
9. ***The bottom line.*** Applying ethical standards legitimizes managerial actions, strengthens the coherence and balance of the industry, improves trust in relationships between individuals and groups and supports greater consistency in standards and qualities of products.

### ***Qualities of the Highly Ethical Individual***

There are four basic principles of a highly ethical individual (or organization):

1. The individual is at ease interacting with diverse internal and external groups, i.e., consumers. The "good of the consumer" is part of the individual's own philosophy and own good.
2. The individual is obsessed with fairness. The individual's ground rules emphasize that the other person's interests count as much as his own.
3. The individual assumes personal responsibility for his actions, and he is responsible to himself first and then to his organization.
4. The individual sees his activities in terms of purpose. This purpose is a way of operating that members of the industry or organization highly value. Purpose ties the individual to the organization, and the organization to the environment.

### ***Qualities of the Highly Ethical Industry***

The following are characteristics of the highly ethical organization or industry:

1. There exists a clear vision and picture of integrity throughout the industry;
2. The vision is owned and embodied by top management in the industry, over time.
3. The reward system is aligned with the vision of integrity.
4. Policies and practices of the industry are aligned with the vision; no mixed messages.
5. It is understood that every significant decision has ethical value dimensions.
6. Everyone in the industry is expected to work through conflicting value perspectives.

FOCUS POINTS:

- o Ethics involves learning what is right or wrong, and then doing the right thing.
- o One group of industry analysts believes that there is always a right thing to do based on moral principal.
- o Some believe that the right thing to do depends on the situation, and that ultimately it is up to the individual.
- o Philosophers consider ethics to be the "science of conduct", that ethics are the fundamental ground rules by which all people live their lives.

- What becomes an ethical guideline today is often translated to a law, regulation, or rule tomorrow.
- Values which represent how an individual should behave are considered moral values, such as respect, honesty, fairness and responsibility. Statements around how these values are applied are sometimes called moral or ethical principals.
- The concept of business ethics generally is coming to know what is right or wrong in the workplace and doing what is right.
- Attention to business ethics is critical during times of fundamental change. In times of fundamental change, values that were previously taken for granted are questioned.
- Attention to ethics in the workplace sensitizes leaders and agents to how they should act.
- Attention to ethics in the workplace helps ensure that when leaders and managers are struggling in time of crises and confusion, they retain a strong moral compass.
- For many people, the basic principles of the obvious can go right out the door during times of stress. Alternatively, applying a strict code of ethics can be strong preventative medicine.
- Ethics came to the forefront during the birth of social responsibility in the 1960's. In that decade, social awareness movements raised expectations of businesses to use their massive financial and social influence to address social problems such as poverty, crime, environmental protection, equal rights, public health and improving education.
- An increasing number of people assert that because businesses were making a profit from using the country's resources, businesses owed it to work to improve society.
- The emergence of business ethics can be related to leaders' realization that they needed to manage a more positive image to the public—something insurance leaders have encompassed.
- As commerce becomes more complicated and dynamic, insurance leaders realize they need more guidance to ensure their dealings support the common good and do not harm others.
- Any business, including insurance—is about prioritizing moral values and ensuring that individuals' behavior are aligned with those values.
- Most of the ethical dilemmas faced in the workplace are highly complex. Typically, a serious ethical conflict exists when there is the presence of: a significant value conflict among differing interests; real alternatives that are equally justifiable; and significant consequences on "stakeholders" in the situation.
- Resolving issues can be difficult. Most people are quick to invoke the "golden rules" of honesty and courtesy, but, when presented with complex business transactions, they realize there is a wide gray area in applying these principles.
- The value of a code of ethics to an organization is its priority and focus regarding certain ethical values in that workplace. For example, it is obvious that it is desirable for all people to be honest.
- A code of ethics is an organic instrument, and often changes with the needs of society and the organization.
- Good people sometimes can take bad actions, particularly when stressed or confused.
- Stress and confusion are not excuses for unethical actions.
- Agents must realize that working in the industry includes all parties working together to help each other remain ethical and to work through confusing and stressful ethical dilemmas.
- An individual can often be unethical, yet operate within the limits of the law. For example, an individual could withhold information, "fudge" financial data, complain about or berate competitors and co-workers, etc.
- Breaking the law often starts with unethical behavior that has gone unnoticed.

- There are many obvious moral benefits to adhering to ethical standards, but there are other benefits of ensuring that ethics are followed in the industry and in the workplace.
- *Attention to business ethics has substantially improved society.*
- *Ethics programs help maintain a moral course in turbulent times.*
- *Ethics cultivate strong teamwork and productivity.*
- Attention to ethics aligns employee behaviors with those top priority ethical values preferred by leaders of the industry.
- Usually, the small office or organization finds surprising disparity between the preferred values of the industry and the actual values in the day-to-day business transactions.
- Ongoing attention to values and ethics builds openness, integrity and a sense of community for the individual—critical ingredients of a strong leader in the industry.
- *Ethics standards support individual growth.*
- *Ethics programs are an insurance policy—they help ensure that policies are legal.*
- Analysts believe it is far better to incur the cost of mechanisms to ensure ethical practices now than incur the costs of litigation later.
- *Ethics standards help avoid criminal acts of omission and can lower fines.*
- *Ethics standards help manage values associated with quality management, strategic planning and diversity management.*
- Ethics programs identify preferred values and ensure that the individual's behavior is aligned with those values.
- Ethics standards are highly useful for managing strategic values, such as expanding market shares, reducing costs, and managing diversity.
- Diversity is much more than the color of a person's skin—it is acknowledging different values and perspectives.
- *Ethics standards promote a strong public image.*
- Attention to ethics is also a strong public relations tool.
- Applying ethical standards legitimizes managerial actions, strengthens the coherence and balance of the industry, improves trust in relationships between individuals and groups and supports greater consistency in standards and qualities of products.
- The highly ethical individual is at ease interacting with diverse internal and external groups, i.e., consumers. The "good of the consumer" is part of the individual's own philosophy and own good.
- The highly ethical individual is obsessed with fairness. The individual's ground rules emphasize that the other person's interests count as much as his own.
- The highly ethical individual assumes personal responsibility for his actions, and he is responsible to himself first and then to his organization.
- The highly ethical individual sees his activities in terms of purpose. This purpose is a way of operating that members of the industry or organization highly value. Purpose ties the individual to the organization, and the organization to the environment.
- Qualities of the Highly Ethical Industry
- In a highly ethical industry there is a clear vision and picture of integrity throughout the industry.

- o In a highly ethical industry the vision is owned and embodied by top management in the industry, over time.
- o In a highly ethical industry the reward system is aligned with the vision of integrity.
- o In a highly ethical industry policies and practices of the industry are aligned with the vision; no mixed messages.
- o In a highly ethical industry it is understood that every significant decision has ethical value dimensions.
- o In a highly ethical industry everyone in the industry is expected to work through conflicting value perspectives.

## CHAPTER 3: TRADE PRACTICES

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### PROTECTING THE CONSUMER

Trade practices can be defined simply as the manner in which an agent conducts his day-to-day business in the insurance industry, and how he handles his insurance consumers. Agents should strive to maintain business practice standards that are far above the minimum requirements set out by their states. There are serious penalties for circumventing these requirements.

There are several specific areas where the insurance industry regulates the behavior of the individual agent as well as the insurer, in the form of prohibited activities. The following list is not all-inclusive, and agents must be certain to follow the spirit, as well as the letter, of the law. There are other areas where an agent may run afoul of common practices, and it is the responsibility of each agent to maintain high standards.

### PROHIBITED ACTIVITIES

Agents are required to follow the ethical standards established in their states, and must not engage in the following prohibited activities:

- Misrepresentation;
- Altering applications;
- Premium theft;
- Unlicensed sales;
- Forgery or "Windowing";
- Misleading sales techniques;
- Illegal rebates;
- Untruthful Policy Replacement coverage;
- Discrimination; and
- Untruths in advertising.

#### *Misrepresentation*

In the normal course of a discussion with a potential client, an insurance agent may say something inadvertently, or make an error in representation about the insurance product that he is presenting. Such omissions or errors are not committed intentionally, and the insurance agent does not intend to defraud the consumer. Without malicious intent, such misrepresentations are not fraudulent, although they are still subject to penalties.

It is the responsibility of the agent to make sure he is well versed about the products he offers. If there is any uncertainty about provisions or features, it is incumbent upon the agent to research the issue before providing erroneous information to the client.

A few examples of misrepresentation:

- Advising a client that an auto policy will cover liability when it is only for collision;
- Telling a prospective client that dividends are guaranteed when they are not;
- An agent telling prospects that he represents several companies when in fact he represents only one; and

- Talking about a term life insurance policy in such a way to lead the prospective customer to believe that it will have cash value accumulation.

### ***Altering Applications***

Altering applications, for any purpose, is not permitted. It is illegal and insurance agents must not engage in altering applications.

In the past, applications have been altered for a number of fraudulent reasons, such as to:

- Change underwriting information to get a more favorable premium rate, or
- Switch the type of coverage applied for, or
- Add additional zeroes to the amount of coverage applied for.

### ***Premium Theft***

Of all the prohibited activities, premium theft ranks among the worst offense an insurance agent can commit. In addition to the outright theft of the premium money, failure to turn over a premium on a policy prevents the policy from going into effect. The consumer believes he is insured, but in fact, his application was never submitted to the insurance company. These situations are quickly discovered if the prospective insured or the insurance company makes any inquiry.

Every state insurance department rigorously punishes premium theft.

### ***Unlicensed Sales***

As mentioned previously, license regulations help protect the general public and allow the insurance department to maintain standards of uniformity. By licensing individual agents, the state can provide some level of assurance to the consumer that an individual capable of offering guidance and competency will meet their needs. Each member of the insurance industry strives to maintain the standards established: those who do not may tarnish the reputations of the other members of the industry.

Agents must be licensed properly to see insurance in the jurisdictions where they do business. A resident license is required for selling within the state where the agent resides; should an agent sell in another state, he must obtain a non-resident's license to do so. In many states, additional licenses may be required to sell variable products, such as variable annuities or variable life. The sale of products other than life insurance, such as property and casualty or investments, also requires a separate license.

It is the responsibility of every agent to comply fully with the state regulations regarding his licensing requirements for all activities in which he engages.

### ***Forgery***

Like theft of premium funds, forgery is an act that is not tolerated and which is punished severely by the insurance department. Tracing over an authentic signature on one form onto another form is known as 'windowing' and is illegal. Windowing has been used to obtain an illegal policy loan, or to obtain a change of dividend option.

In addition to punishment by the insurance department, forgery is also subject to criminal penalties.

### ***Misleading Sales Techniques***

Misleading sales techniques violate the consumer's trust and harm the industry by offering a product that the agent does not actually intend to sell. Sometimes known as a 'bait and switch' tactic, a misleading sales tactic often involves offering one product that looks almost too good to be true, and then offering in its place a similar or substandard product. In most cases, the "too good to be true" product was never available in the first place.

An ethical insurance agent is always careful never to make a promise, or offer a product, which cannot be delivered.

### ***Illegal Rebate***

In all but two states (Florida and California) rebating is illegal. Rebating offers buyers of larger policies more leverage for financial incentives, and harms buyers of smaller policies. The buyers of the smaller policies, in effect, end up paying more for their policies. In the two states that allow rebating, their insurance departments heavily regulate it.

Examples of rebating:

- Giving anything of value to the customer for buying insurance;
- Giving back the premium, in whole or in part, to the customer;
- Advising the customer of benefits or funds that will be received, but they are not specified in the contract.

### ***Untruthful Policy Replacements***

Also known as *twisting*, this situation occurs when an agent advises a policyholder to let his current policy lapse, or to surrender it, so that a new policy can be purchased. Although this is not always a misleading situation, in some cases an unscrupulous agent may convince the policyholder to let a valid policy lapse just to purchase a new one on which the agent will reap commission.

For replacement of coverage to be legal, there must be proof that the policyholder will be better off with the new policy. To use the offer of a replacement policy just as a sales technique, however, is unethical.

There are specific procedures regarding when an agent can replace a life insurance policy; these procedures are regulated by most states. Among these procedures is the requirements that the policyholder must be provided a written explanation of exactly what the replacement means, as well as notification of the insurance company that the policy is to be replaced.

Determining the best interest of the policyholder always should be foremost in an agent's list of priorities. If a policy has been in effect for a long time, the policyholder may not be eligible for the same coverage and rate on a new policy. Policies that have been building cash value may be undermined by replacement with a new policy that will take many years to accumulate the same level of cash value.

### ***Discrimination***

It is against the law to discriminate against individuals in the same class regarding the availability, terms, benefits, premiums, rates, or dividends pertaining to any policy of life, health, or property-casualty insurance.

### ***Untruths in Advertising***

An advertisement generally includes any printed or published material intended for the general public. Advertisements and sales materials used with the public have direct impact on an agent's sales and sales practices.

Advertising regulations differ from state to state, but the following list encompasses the rules most commonly applied by the states:

- Advertisements must be truthful, and must not have the "sin of omission", or failure to include information in an attempt to mislead the consumer.
- It must be clear that insurance is the subject of the ad.
- Ads that tout unusually high claims settlements are usually considered misleading unless the ad specifically states that the amount is unusual. Ads may not imply that claims settlements will be generous beyond the terms of the policy, or that a policyowner will receive special treatment that is not specified in the policy.
- Technical terms and illustration may not be used if their meaning is not clearly understandable to the individuals who might purchase the product. Required disclosures must be set out in plain language.
- If using statistics in an ad, they must be relevant and factual. The source of the statistics must be identified in the ad.
- Ads may not offer anything that is in violation of public policy or law.
- Ads may not offer anything of value that is outside the express terms of the policy advertised.
- It is not allowable to make unfair comparisons of policies or any of their terms.
- Testimonials from third parties must really reflect the true opinion of the third party and must relate to the exact policy that is being advertised.
- Premium amounts stated in an ad must be for the exact coverage described in the ad.
- Ads may not create the impression that the advertiser or a policy is being recommended or backed by any state or federal government agency. If an ad refers to policy approval by state authorities, it must also disclose that all legitimate insurance policies receive such approval.

### **FOCUS POINTS:**

- Trade practices can be defined simply as the manner in which an agent conducts his day-to-day business in the insurance industry, and how he handles his insurance consumers.

- Agents should strive to maintain business practice standards that are far above the minimum requirements set out by their states.
- Agents are required to follow the ethical standards established in their states, and must not engage in misrepresentation, altering applications, premium theft, unlicensed sales, forgery or "Windowing", misleading sales techniques, illegal rebates, untruthful policy, replacement coverage, discrimination, and untruths in advertising.
- In the normal course of a discussion with a potential client, an insurance agent may say something inadvertently, or make an error in representation about the insurance product that he is presenting. Such omissions without malicious intent, such misrepresentations are not fraudulent, although they are still subject to penalties.
- It is the responsibility of the agent to make sure he is well-versed about the products he offers
- Altering applications, for any purpose, is not ethical and illegal.
- Of all the prohibited activities, premium theft ranks among the worst offense an insurance agent can commit.
- Failure to turn over a premium on a policy prevents the policy from going into effect. And the consumer believes he is insured, but in fact, his application was never submitted to the insurance company.
- Every state insurance department rigorously punishes premium theft.
- It is the responsibility of every agent to comply fully with the state regulations regarding his licensing requirements for all activities in which he engages.
- Forgery is an act that is not tolerated and which is punished severely by the insurance department.
- Tracing over an authentic signature on one form onto another form is known as 'windowing' and is illegal.
- Windowing has been used to obtain an illegal policy loan, or to obtain a change of dividend option.
- In addition to punishment by the insurance department, forgery is also subject to criminal penalties.
- Misleading sales techniques violate the consumer's trust and harm the industry by offering a product that the agent does not actually intend to sell.
- Sometimes known as a 'bait and switch' tactic, a misleading sales tactic often involves offering one product that looks almost too good to be true, and then offering in its place a similar or substandard product.
- An ethical insurance agent is always careful never to make a promise, or offer a product, which cannot be delivered.
- In all but two states (Florida and California) rebating is illegal.
- Rebating offers buyers of larger policies more leverage for financial incentives, and harms buyers of smaller policies.
- In the two states that allow rebating, it is heavily regulated by their insurance departments.
- Rebating is giving anything of value to the customer for buying insurance.
- Rebating is giving back the premium, in whole or in part, to the customer.
- Also known as *twisting*, this situation occurs when an agent advises a policyholder to let his current policy lapse, or to surrender it, so that a new policy can be purchased.
- Some times an unscrupulous agent may convince the policyholder to let a valid policy lapse just to purchase a new one on which the agent will reap commission. This is unethical and illegal.



- For replacement of coverage to be legal, there must be proof that the policyholder will be better off with the new policy.
- To use the offer of a replacement policy just as a sales technique is unethical.
- There are specific procedures regarding when an agent can replace a life insurance policy; these procedures are regulated by most states.
- Among the specific procedures regarding replacement is the requirements that the policyholder must be provided a written explanation of exactly what the replacement means, as well as notification of the insurance company that the policy is to be replaced.
- Determining the best interest of the policyholder always should be foremost in an agent's list of priorities. I
- f a policy has been in effect for a long time, the policyholder may not be eligible for the same coverage and rate on a new policy.
- Policies that have been building cash value may be undermined by replacement with a new policy that will take many years to accumulate the same level of cash value.
- It is against the law to discriminate against individuals in the same class regarding the availability, terms, benefits, premiums, rates, or dividends pertaining to any policy of life, health, or property-casualty insurance.
- An advertisement generally includes any printed or published material intended for the general public.
- Advertisements and sales materials used with the public have direct impact on an agent's sales and sales practices.
- Advertising regulations differ from state to state.
- Advertisements must be truthful, and must not have the "sin of omission", or failure to include information in an attempt to mislead the consumer.
- Advertisements must be clear that insurance is the subject of the ad.
- Ads that tout unusually high claims settlements are usually considered misleading unless the ad specifically states that the amount is unusual. Ads may not imply that claims settlements will be generous beyond the terms of the policy, or that a policy owner will receive special treatment that is not specified in the policy.
- Technical terms and illustration may not be used if their meaning is not clearly understandable to the individuals who might purchase the product.
- Required disclosures must be set out in plain language.
- If using statistics in an ad, they must be relevant and factual. The source of the statistics must be identified in the ad.
- Ads may not offer anything that is in violation of public policy or law.
- Ads may not offer anything of value that is outside the express terms of the policy advertised.
- It is not allowable to make unfair comparisons of policies or any of their terms.
- Testimonials from third parties must really reflect the true opinion of the third party and must relate to the exact policy that is being advertised.
- Premium amounts stated in an ad must be for the exact coverage described in the ad.
- Ads may not create the impression that the advertiser or a policy is being recommended or backed by any state or federal government agency.
- If an ad refers to policy approval by state authorities, it must also disclose that all legitimate insurance policies receive such approval.

## CHAPTER 4: RESOLVING ETHICAL DILEMMAS

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### METHODOLOGY

The following three methods can be utilized to address ethical dilemmas. Methods include:

- An ethical checklist;
- A ten-step method; and
- A list of key questions.

#### *The Ethical Checklist*

Use the ethical checklist<sup>1</sup> to evaluate the situation. Using the list, which follows, answer the questions and circle the appropriate answer on the scale. A response of "1" = not at all; a response of "5" =you are in total agreement with the statement/question.

After circling the appropriate responses, add up the total of all numbers circled to determine your ethical quotient.

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<sup>1</sup> Used with permission from copyright holders: Doug Wallace and Jon Pikel, Fulcrum Group (651) 699-3930.

## ETHICAL CHECKLIST

1.	<b>Relevant Information Test.</b> Have I/we obtained as much information as possible to make an informed decisions and action plan for this situation?	1	2	3	4	5
2.	<b>Involvement Test.</b> Have I/we involved all who have a right to have input and/or to be involved in making this decision and action plan?	1	2	3	4	5
3.	<b>Consequential Test.</b> Have I/we anticipated and attempted to accommodate for the consequences of this decisions and action plan on any who are significantly effected by it?	1	2	3	4	5
4.	<b>Fairness Test.</b> If I/we were assigned to take the place of any one of the clients in this situation, would I/we perceive this decisions and action plan to be essentially fair, given all of the circumstances?	1	2	3	4	5
5.	<b>Enduring Values Test.</b> Does this decisions and action plan uphold my/our priority enduring values that are relevant to this situation?	1	2	3	4	5
6.	<b>Universality Test.</b> Would I/we want this decision and action plan to become a universal law applicable to all similar situations, even to myself?	1	2	3	4	5
7.	<b>Light-of-Day Test.</b> How would I/we feel and be regarding by others in my industry if the details of this decision and action plan were disclosed for all to know?	1	2	3	4	5
8.	<b>Total Ethical Analysis Confidence Score.</b> Enter the total of all circled numbers here.					

### TOTAL SCORE

7-14

15-21

22-28

29-35

### EVALUATION

Not very confident.

Somewhat confident.

Quite confident.

Very confident.

### ***The Ten-Step Method***

Use the following ten-step method<sup>2</sup> to improve decision making abilities:

1. What are the facts in the situation?
2. Who are the key stakeholders, what do they value and what are their desired outcomes?
3. What are the underlying drivers causing the situation?
4. In priority order, what ethical principles or operating values should be upheld in this situation?
5. Who should have input to, or be involved in, making this decision?
6. List any alternative and action plans that would:
  - a. Prevent or minimize harm to the stakeholders
  - b. Uphold the priority values for this situation
  - c. Be a good solution to the situation
7. Build a worst-case scenario for a preferred alternative to see how it affects the stakeholders. Rethink and revise the preferred alternative if necessary.
8. Add a preventative ethics component to the action plan that deals with the underlying drivers causing the situation listed in Step 3.
9. Evaluate the chosen decision and action plan against the Ethics Checklist.
10. Decide upon and build an action plan, and implement and monitor it.

### ***Key Questions to Address Ethical Dilemmas***

Use these 12 questions<sup>3</sup> to address ethical dilemmas:

1. Have you defined the problem accurately?
2. How would you define the problem if you stood on the other side of the fence?
3. How did this situation occur in the first place?
4. To whom and to what do you give your loyalty as a person and as a member of the corporation?
5. What is your intention in making this decision?
6. How does this intention compare with the probable results?
7. Whom could your decision or action injure?
8. Can you discuss the problem with the affected parties before you make your decision?
9. Are you confident that your position will be as valid over a long period of time as it seems now?
10. Could you disclose without qualm your decision or action to your boss, your CEO, the board of directors, your family, society as a whole?
11. What is the symbolic potential of your action if understood? Misunderstood?  
Under what conditions would you allow exceptions to your stand?

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<sup>2</sup> Used with permission from copyright holders: Doug Wallace and Jon Pekel, Fulcrum Group (651) 699-3930.

<sup>3</sup> Excerpted from: Nash, L (1981). Ethics Without the Sermon. Harvard Business Review, (59)).

## CHAPTER 5: THE INSURANCE PROFESSIONAL

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### ETHICS ARE NUMBER ONE PRIORITY

The work of an insurance professional plays an important, though sometimes unrecognized, role. The insurance professional is part of the insurance industry's public relations team. The agent meets the public every day, and the way an agent conducts his business leaves a lasting impression, and relates to the insurance industry as a whole.

Insurance agents must maintain a level of professionalism in their attitudes toward their competitors. An agent must avoid criticizing other agents; it harms the competitor, puts the critical agent in a bad light, and leaves a bad impression of the insurance industry in general with the prospective client. If unchecked, misleading or harmful criticism of another in the industry may lead to revocation of the license of the agent who is guilty.

#### *Lofty Goals*

A professional in the insurance industry must set lofty goals, and adhere to a set of high personal ethical standards, as well as complying with the minimum legal standards established by the state. These minimum legal standards create safeguards to protect the consumer, but professionalism requires more than just meeting these standards—it means exceeding these standards. An insurance professional achieves this goal by putting his clients' interests ahead of his own.

Maintaining high ethical standards is beneficial for the client and the agent. Put simply, people like to do business with people they trust. An agent who maintains high standards is going to have more success in business than the agent who does not maintain those same high standards. Genuine respect and concern for the client motivates the professional agent to act ethically. Agents who are tempted by an individual or find themselves in a situation in which they are pressured to act in an unethical matter must consider the long-term results of those actions, and the result it may have on the agent's career.

Some industry leaders advise that in perhaps no other industry is the element of trust as important as it is in the insurance business.

#### *Making a Difference*

Just why that element of trust is crucial to an insurance agent's professional role is evidenced by the services an agent performs. Consider some of the following areas where an insurance agent serves the client:

- An insurance agent may provide the financial planning tools that enable a child to go to college by assisting his parents with trusts, or life insurance.
- An agent may assist business partners in designing a buy-sell agreement or business continuance plan that will save the company in the event of a partner's death, or casualty to the business.
- An agent may assist a couple plan their retirement years, and give them the tools to spend a worry-free retirement.
- An agent may provide a comfortable lifestyle for survivors of a policyholder, by providing a product to the policyholder that was designed to enable them to remain in their home, and continue their normal standard of living.

Insurance agents clearly present an essential service in our society.

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### THE RIGHT STUFF

In addition to maintaining personal ethical standards, there is a responsibility on the agent to be as well-informed as possible about the products and advice he presents to the consumer.

The agent must:

- Understand how each product works.
- Analyze the needs of the consumer and make proper recommendations.
- Motivate people to take action.
- Understand how insurance companies work.
- Know how to support the policyholder.
- Understand contractual obligations.

Changes in situations, rules, regulations and products make it critical for an agent to keep on top of his profession. This is a career that demands constant study, awareness and dedication, all of which result in success.

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## **A CODE OF CONDUCT**

While not a "hard and fast" list of rules, the following may serve as guidelines for ethical conduct:

1. Place the interests of the customers first.
2. Strive for a high level of personal integrity.
3. Strive to constantly improve your professional skills and knowledge in the industry.
4. Maintain a professional level of conduct with business associates and others in the insurance industry.
5. Make it your personal responsibility to know the laws and rules that regulate the insurance business, and follow them in both spirit and letter of the law.
6. Do not make claims you cannot support, or make untrue or exaggerated statements.
7. Be aware of the factors that influence your customers, and provide them with the same service, advice, compassion and skill with which you would serve your own family.

### ***Liability***

Even the best-intentioned agent may sometimes find himself exposed to risk or liability related to a mistake he has made. No one is perfect; if a mistake is made an agent must assume responsibility for it, and make every effort to rectify the situation.

There are a few ways that an insurance professional may protect himself from liability exposure:

- Be aware of the applicable laws and insurance regulations, and observe them.
- Be aware of company standards and procedures.
- Perform activities such as needs analysis, policy delivery, service to the policyowner, claims investigations and the like with extreme care and due diligence.
- Keep the lines of communication open between customers and the company, and respond quickly to their needs.
- Take measures to continuously improve knowledge and skill in the field.

There are a few areas that are regular pitfalls for agents; areas where an agent is most likely to encounter problems with errors and omissions liability. These are:

- (1) Failing to obtain the correct coverage for a client;
- (2) Failing to obtain adequate coverage for a client; and
- (3) Failing to maintain coverage for a client.

Potential legal liability for errors and omissions is just one of the reasons an agent must strive to maintain high ethical and professional standards.

If an agent is up to date on current products and procedures, has analyzed the needs of the customer, and follows through with the proper service in the customer's situation, these problems are not likely to occur.

### ***Agents, Not Attorneys***

Agents must always be careful not to make legal representations. Agents are not attorneys and must avoid an unauthorized practice of law. There is a fine line in many instances where the advice provided by an agent crosses into legalities. The following guidelines should be reviewed for clarification on what an agent may or may not do:

- Agents should avoid appearing to give legal advice. Questions from a client about how specific legal concepts affect the client must be referred to the client's attorney.
- Agents must not draft legal documents such as wills or trusts, or even make addenda or notes on such documents.
- Agents may gather information about their clients and discuss general principles of law, but they should not try to apply law to their clients situation.

### ***Clients for Life***

The responsibility of the agent to his client does not end when the sale is made and the financial transaction is complete. An agent has the responsibility to service his client not only during his time of need, but in general, over his lifetime. To meet this expectation an agent must commit himself to providing ongoing service.

In addition to being part of the ethical process of an agent, providing ongoing service is also a wise business decision, as opportunities for additional business often result from an agent's longtime contact with his clients.

Ongoing service to a client may encompass simple tasks such as assisting a client with a change of beneficiary, or periodic review of the client's policies to make sure he is adequately covered for his current needs. If the need for additional coverage is discovered, the agent who has provided the ongoing service will be the individual to draft the new coverage.

Building a relationship with each client results in goodwill and a satisfied client; satisfied clients are the ones who make referrals.

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### **FEES AND COMMISSION**

There is a marked difference between an agent, who earns commission on the sale of specific insurance products, and an insurance counselor, who makes recommendations about many products and collects a fee for his general advice.

Because a commission is the reward for making a sale, an agent must be careful not to unduly influence a client toward a certain product. Most agents recommend their own company's products when the products are suitable for the client. There is no need to provide consulting services, too, and charge the client an unnecessary additional fee.

Many states prohibit agents from charging fees at all, and some states prohibit charging fees and collecting a commission from the same policy. There are states that allow collection of both a fee and commission, but these states have strict guidelines governing how the monies must be handled, such as:

- Agents have a duty to serve the client's best interest and are required to make objective recommendations and analyses; and
- If an agent receives both a commission and a fee from the same policy, the agent has a responsibility to make sure that the value the client received from the policy includes services above just the sale of the policy.

#### **FOCUS POINTS:**

- The insurance professional is part of the insurance industry's public relations team.
- The agent meets the public every day, and the way an agent conducts his business leaves a lasting impression, and relates to the insurance industry as a whole.
- Insurance agents must maintain a level of professionalism in their attitudes toward their competitors.
- An agent must avoid criticizing other agents; it harms the competitor, puts the critical agent in a bad light, and leaves a bad impression of the insurance industry in general with the prospective client.
- If unchecked, misleading or harmful criticism of another in the industry may lead to revocation of the license of the agent who is guilty.
- A professional in the insurance industry must set loft goals, and adhere to a set of high personal ethical standards, as well as complying with the minimum legal standards established by the state.
- Minimum legal standards create safeguards to protect the consumer, but professionalism requires more than just meeting these standards—it means exceeding these standards. An insurance professional achieves this goal by putting his clients' interests ahead of his own.
- Maintaining high ethical standards is beneficial for the client and the agent.
- People like to do business with people they trust.
- An agent who maintains high standards is going to have more success in business than the agent who does not maintain those same high standards.

- Genuine respect and concern for the client motivates the professional agent to act ethically.
- Agents who are tempted by an individual or find themselves in a situation in which they are pressured to act in an unethical matter must consider the long-term results of those actions, and the result it may have on the agent's career.
- An insurance agent provides the financial planning tools that enable a child to go to college by assisting his parents with trusts, or life insurance.
- An agent assists business partners in designing a buy-sell agreement or business continuance plan that will save the company in the event of a partner's death, or casualty to the business.
- An agent assists a couple plan their retirement years, and give them the tools to spend a worry-free retirement.
- An agents provide a comfortable lifestyle for survivors of a policyholder, by providing a product to the policyholder that was designed to enable them to remain in their home, and continue their normal standard of living.
- Insurance agents clearly present an essential service in our society.
- In addition to maintaining personal ethical standards, there is a responsibility on the agent to be as well-informed as possible about the products and advice he presents to the consumer.
- The agent must: understand how each product works.
- An agent must analyze the needs of the consumer and make proper recommendations.
- An agent motivates people to take action.
- An agent must understand how insurance companies work.
- An agent must know how to support the policyholder.
- An agent must understand contractual obligations.
- Changes in situations, rules, regulations and products make it critical for an agent to keep on top of his profession.
- A Code of Conduct requires that an agent place the interests of the customers first.
- A Code of Conduct requires that an agent strive for a high level of personal integrity.
- A Code of Conduct requires that an agent strive to constantly improve their professional skills and knowledge in the industry.
- A Code of Conduct requires that an agent maintain a professional level of conduct with business associates and others in the insurance industry.
- A Code of Conduct requires that an agent make it their personal responsibility to know the laws and rules that regulate the insurance business, and follow them in both spirit and letter of the law.
- A Code of Conduct requires that an agent not make claims they cannot support, or make untrue or exaggerated statements.
- A Code of Conduct requires that an agent be aware of the factors that influence their customers, and provide them with the same service, advice, compassion and skill with which they would serve their own family.
- If a mistake is made an agent must assume responsibility for it, and make every effort to rectify the situation.
- An insurance agent may protect him or herself from liability exposure by being aware of the applicable laws and insurance regulations, and observe them.



- o An insurance agent may protect himself or herself from liability exposure by being aware of company standards and procedures.
- o An insurance agent may protect himself or herself from liability exposure by performing activities such as needs analysis, policy delivery, service to the policy owner, claims investigations and the like with extreme care and due diligence.
- o An insurance agent may protect himself or herself from liability exposure by being keeping the lines of communication open between customers and the company, and respond quickly to their needs.
- o An insurance agent may protect himself or herself from liability exposure by taking measures to continuously improve knowledge and skill in the field.
- o Areas where an agent is most likely to encounter problems with errors and omissions liability include failing to obtain the correct coverage for a client; failing to obtain adequate coverage for a client; and failing to maintain coverage for a client.
- o Potential legal liability for errors and omissions is just one of the reasons an agent must strive to maintain high ethical and professional standards.
- o Agents must always be careful not to make legal representations.
- o Agents are not attorneys and must avoid an unauthorized practice of law.
- o There is a fine line in many instances where the advice provided by an agent crosses into legalities.
- o Agents should avoid appearing to give legal advice.
- o Questions from a client about how specific legal concepts affect the client must be referred to the client's attorney.
- o Agents must not draft legal documents such as wills or trusts, or even make addenda or notes on such documents.
- o The responsibility of the agent to his client does not end when the sale is made and the financial transaction is complete.
- o An agent has the responsibility to service his client not only during his time of need, but in general, over his lifetime. To meet this expectation an agent must commit himself to providing ongoing service.
- o In addition to being part of the ethical process of an agent, providing ongoing service is also a wise business decision.
- o Ongoing service to a client may encompass simple tasks such as assisting a client with a change of beneficiary, or periodic review of the client's policies to make sure he is adequately covered for his current needs. I
- o f the need for additional coverage is discovered, the agent who has provided the ongoing service will be the individual to draft the new coverage.
- o Building a relationship with each client results in goodwill and a satisfied client; satisfied clients are the ones who make referrals.
- o There is a marked difference between an agent, who earns commission on the sale of specific insurance products, and an insurance counselor, who makes recommendations about many products and collects a fee for his general advice.
- o Because a commission is the reward for making a sale, an agent must be careful not to unduly influence a client toward a certain product.
- o Many states prohibit agents from charging fees at all, and some states prohibit charging fees and collecting a commission from the same policy.
- o There are states that allow collection of both a fee and commission, but these states have strict guidelines governing how the monies must be handled.

- o Agents have a duty to serve the client's best interest and are required to make objective recommendations and analyses.
- o If an agent receives both a commission and a fee from the same policy, the agent has a responsibility to make sure that the value the client received from the policy includes services above just the sale of the policy.

## CHAPTER 6: THE AGENCY RELATIONSHIP

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### AGENCY

A new agent concerned with the every day requirements of his company often forgets the legal and ethical requirements of his new undertaking. These expectations fall under an area known as AGENCY.

Agency is a legal term that describes the relationship between two parties. The first party (the principal) authorizes the second party (the agent) to perform certain legally binding acts on behalf of the principal.

In the case of an agent and his employing firm this relationship exists because the agent is acting on behalf of his insurance company and entering into legal contracts on behalf of his firm with consumers. The agent's ethical behavior is of utmost concern in carrying out the principal's instructions.

Agents are often charged by their principals with the actions of collecting premiums, entering into contractual agreements on behalf of their principals, making representations on behalf of their principals and in general promoting the products offered by their principals. The law holds the agent as responsible for his behavior as it holds the principal for the same.

By establishing an agency relationship the company is entrusting the agent to represent its every interest in a transaction.

#### *How is Agency Created?*

Agency can be created in three ways, by:

- Appointment;
- Estoppel; and
- Ratification.

#### *Agency by Appointment*

Agency by appointment results by written contract between the principal and the agent. The contract specifically outlines the duties and obligations of each and often carries specific direction and duties.

#### *Agency by Estoppel*

Agency by estoppel is an implied agency. When a principal allows an agent to behave in such a manner that a third party might interpret the agent's actions to be those of the principal than an agency by estoppel is established between the principal and the agent.

Agency by estoppel requires three elements in order to be established. These three elements are:

1. The principal must act in a manner that allows the agent to lead a third party to believe that a relationship exists between the agent and the principal;
2. An innocent third party must be misled by the principal's actions; and
3. The third party must be harmed by the principal's behavior.

An example of this might be where an agent's contractual commitment to a principal has been terminated and the agent continues to use the business cards and contracts of his principal and binds consumers to these agreements. By failing to confiscate their forms and identification documents from their prior agent, should a third party be harmed by the actions of the agent, the company (the principal) would be liable for the actions of the prior agent. This does not free the agent from being held accountable from unethical conduct.

#### *Agency by Ratification*

Agency by ratification occurs when an individual represents to be authorized by a principal but in reality is not. When the principal eventually authorizes the actions of the agent, he, the principal has now ratified the authority and thus binding the commitments of that agent.

An example of this might be where an agent knows that he can book a certain type of coverage with an insurance company, and leads the client to believe that he already has a relationship with that firm and books the coverage. Later, the agent presents the contract to the insurance company and the company accepts the coverage and thus ratifies the agent's authority. The ratification can be solely limited to that transaction, or extended to all future transactions. Failing to notify the insured that the authority is strictly transactional would create the potential of an agency by estoppel with the insured.

### ***How the Authority of an Agent is Create***

The authority of an agent is created by contract. This is how an insurer grants an agent the right to act on their behalf in their relationship with a third party, the insured.

The power or authority of an agent is defined in the contractual agreement between himself and the principal. The ranges of authority vary and can be either very broad or very limited. The authority granted the agent must be very specific as to avoid an agent acting on behalf of the principal in matters not authorized. Since the agent acts on behalf of the principal the legal and ethical repercussions to the principal can be far-reaching and extremely libelous if the authority is not well defined.

The agent's authority to act on behalf of the principal is created in three different ways:

- Expressed consent;
- Implied consent; and
- Apparent consent.

### ***Expressed Consent***

Expressed consent is usually granted either verbally or in writing and spells out what an agent can or cannot do on behalf of the principal. This form of consent is usually granted in the agency contract and often spells out the agent's ability to solicit, initiates applications and collect the initial premiums due on a new policy.

### ***Implied Consent***

Implied consent is granted as a result of those actions, which must be taken to carry out the authority granted to an agent in expressed consent. This authority is granted to an agent in a non-written or verbalized manner. In other words these are actions that must be carried out in order to help achieve the end goal of the principal in employing the agent.

An example of this might be the "binding" authority an agent has prior to the issuance of an actual policy.

### ***APPARENT CONSENT***

This form of authority occurs whenever a principal permits an agent to act on their behalf without either expressed or implied authority.

An example of this type of authority would be where an agent has territorial restrictions by the principal and yet the principal accepts business from the agent outside these boundaries, then by accepting this business the principal has established apparent consent of the agent's actions. The agent's authority is in most cases limited and even though he may make decisions on behalf of the principal, often these decisions have limitations and are subject to the principal's review.

Examples of limitations on an agent's authority are:

- The inability to adjust premium rates;
- The final decision to accept the risk involved; and
- The inability to waive exclusions (unless specifically authorized).

For an agent to step beyond the authority granted creates serious legal and ethical issues with both the principal and the consumer.

Because an agent is licensed by the state his conduct is monitored not only in respect to meeting obligations with the employing principal, but also in maintaining an honest and ethical relationship with the consumer as the insured.

In essence the agent is held to the highest level of trust and ethical conduct by the principal, the consumer and the state licensing authority.

The agent thus becomes a fiduciary.

### ***The Agent as a Fiduciary***

A fiduciary is an individual whose position or responsibility involves having the highest degree of trust and confidence. Trustees of estates, guardians of individuals, and executors are all individuals that fall in this category. An agent in the same manner when he under takes an employment with an insurer is held to the same degree of trust and fair play and responsibility.

An agent owes his principal:

- Loyalty;
- Skill;
- Disclosure;
- Timeliness;
- Accountability of funds;
- Sole interest;
- Diligence in Solicitation of Business; and
- Competitive Fair Play.

### ***Loyalty***

An agent must always act on behalf of the insurer's best interest and must put the insurer's needs even ahead of his own needs. This is the role a fiduciary takes in entering into an agreement with a principal.

An agent unless authorized to do so cannot represent more than the interest of one principal. Often independent agents represent the interest of more than one insurer. This is proper and ethical as long as there is full knowledge and consent of all the parties.

An agent must stay within the confines and conditions of his agency contract with the principal. An agent cannot receive personal financial gain other than that specified in his agency agreement.

### ***Skill and Care***

In representing his principal the agent has been entrusted with the ability to handle his principal's needs in a skillful and diligent manner. The agent must use every skill at his disposal to make sure that the principal's goals are reached in the most effective and efficient manner possible. The agent represents the company to the public, and, therefore, must present that principal to the highest competency. If the agent should encounter a consumer demand that he is not skilled to handle, he should refer the client to another source to insure the principal's best representation.

### ***Disclosure***

It is the agent's obligation to the insurer to make sure that all questions on applications are answered truthfully and nothing is omitted. To induce the insurer to enter into a risk that is not sound is both unethical and in conflict with the agent's fiduciary obligation to the insurer.

Full disclosure is critical in both the application and claim handling process.

Agents should also disclose to clients any hidden conflicts of interest that could inadvertently affect the recommendations of the agent. When such conflicts of interest are disclosed, the client has the opportunity to evaluate the agent's recommendation in depth before accepting any proposal. Any time a conflict of interest is hidden purposefully while an agent is making a recommendation, it casts the agent's motive in doubt.

### ***Timeliness***

Submitting all paperwork on a timely basis is imperative to the principal's business success and risk. The insurer has obligations to the consumer based on time schedules. Not meeting these obligations due to delays caused by an agent not acting in an expedient manner causes the company to be at risk for longer periods of time in the case of an insured that will be denied, or delays the underwriting procedure for one that will be accepted.

### ***Accountability of Funds***

Under the law, delivering premiums to an agent is the same as delivering them to the insurer. Therefore, delivering those funds to the insurer by the agent as quickly as possible is of utmost importance.

Premiums collected from the insured parties are usually held in premium funds trust accounts for no more than 90 days or other date specified in the agent's contract with the insurer. Funds held by agents are required to be held in these special trust accounts by most states. In submitting funds from these accounts to the insurer it is most commonly permitted for agents to retain their portions of commissions earned prior to submitting the premiums to the insurer.

### ***Sole Interest***

An agent must act in all transactions to avoid any potential conflict of interest between him, the insurer or the insured. An agent has an obligation to the insurer to represent the product in a skillful and honest manner. Should there be any misrepresentation wherein the insured makes a decision based on the misrepresentation, intentional or otherwise, the agent is liable for losses to either the insurer, the insured, or both.

In the event an agent receives compensation in a transaction for performing related services in the same transaction the insurer must be made aware of this compensation and must in no way conflict with the agent's contractual obligation with the principal.

### ***Diligence in Solicitation of Business***

It is the obligation of an agent to solicit business that represents the risk element that his insurer is willing to take. To solicit higher risk business and omit or alter the application in an effort to conceal the risk factor is unethical and not in keeping with the fiduciary responsibility owed the principal.

### ***Competitive Fair Play***

In the insurance industry it is accepted practice that when the issue of a competing firm is brought up that it is in the best interest of the industry not to defame a competitor but stick to issues of one product verses another.

#### **FOCUS POINTS:**

- o Agency is a legal term that describes the relationship between two parties. The first party (the principal) authorizes the second party (the agent) to perform certain legally binding acts on behalf of the principal.
- o In the case of an agent and his employing firm this relationship exists because the agent is acting on behalf of his insurance company and entering into legal contracts on behalf of his firm with consumers.
- o Agents are often charged by their principals with the actions of collecting premiums, entering into contractual agreements on behalf of their principals, making representations on behalf of their principals and in general promoting the products offered by their principals.
- o The law holds the agent as responsible for his behavior as it holds the principal for the same.
- o By establishing an agency relationship the company is entrusting the agent to represent its every interest in a transaction.
- o Agency can be created in three ways, by: Appointment; Estoppel; and Ratification.
- o Agency by appointment results by written contract between the principal and the agent.
- o Agency by estoppel is an implied agency.
- o Agency by estoppel requires three elements in order to be established. These three elements are:
  - o The principal must act in a manner that allows the agent to lead a third party to believe that a relationship exists between the agent and the principal.
  - o Agency by ratification occurs when an individual represents to be authorized by a principal but in reality is not.
  - o The authority of an agent is created by contract. This is how an insurer grants an agent the right to act on their behalf in their relationship with a third party, the insured.
  - o The power or authority of an agent is defined in the contractual agreement between himself and the principal.
  - o The ranges of authority vary and can be either very broad or very limited.
  - o The authority granted the agent must be very specific as to avoid an agent acting on behalf of the principal in matters not authorized.
  - o Since the agent acts on behalf of the principal the legal and ethical repercussions to the principal can be far-reaching and extremely libelous if the authority is not well defined.

- The agent's authority to act on behalf of the principal is created in three different ways: expressed consent; implied consent; and apparent consent.
- Expressed consent is usually granted either verbally or in writing and spells out what an agent can or cannot do on behalf of the principal.
- Implied consent is granted as a result of those actions, which must be taken to carry out the authority granted to an agent in expressed consent. This authority is granted to an agent in a non-written or verbalized manner
- Apparent consent occurs whenever a principal permits an agent to act on their behalf without either expressed or implied authority.
- For an agent to step beyond the authority granted creates serious legal and ethical issues with both the principal and the consumer.
- An agent is held to the highest level of trust and ethical conduct by the principal, the consumer and the state licensing authority.
- An agent is considered a fiduciary.
- A fiduciary is an individual whose position or responsibility involves having the highest degree of trust and confidence.
- An agent owes his principal: Loyalty; Skill; Disclosure; Timeliness; Accountability of funds; Sole interest; Diligence in Solicitation of Business; and Competitive Fair Play.
- An agent must always act on behalf of the insurer's best interest and must put the insurer's needs even ahead of his own needs.
- An agent unless authorized to do so cannot represent more than the interest of one principal.
- Often independent agents represent the interest of more than one insurer. This is proper and ethical as long as there is full knowledge and consent of all the parties.
- An agent must stay within the confines and conditions of his agency contract with the principal.
- An agent cannot receive personal financial gain other than that specified in his agency agreement.
- In representing his principal the agent has been entrusted with the ability to handle his principal's needs in a skillful and diligent manner.
- It is the agent's obligation to the insurer to make sure that all questions on applications are answered truthfully and nothing is omitted.
- To induce the insurer to enter into a risk that is not sound is both unethical and in conflict with the agent's fiduciary obligation to the insurer.
- Full disclosure is critical in both the application and claim handling process.
- Agents should disclose to clients any hidden conflicts of interest that could inadvertently affect the recommendations of the agent.
- Submitting all paperwork on a timely basis is imperative to the principal's business success and risk.
- The insurer has obligations to the consumer based on time schedules.
- Under the law, delivering premiums to an agent is the same as delivering them to the insurer.
- Premiums collected from the insured parties are usually held in premium funds trust accounts for no more than 90 days or other date specified in the agent's contract with the insurer.
- Funds held by agents are required to be held in these special trust accounts by most states.

- o In submitting funds from these accounts to the insurer it is most commonly permitted for agents to retain their portions of commissions earned prior to submitting the premiums to the insurer.
- o An agent must act in all transactions to avoid any potential conflict of interest between him, the insurer or the insured.
- o An agent has an obligation to the insurer to represent the product in a skillful and honest manner.
- o In the event an agent receives compensation in a transaction for performing related services in the same transaction the insurer must be made aware of this compensation and must in no way conflict with the agent's contractual obligation with the principal.
- o It is the obligation of an agent to solicit business that represents the risk element that his insurer is willing to take.
- o In the insurance industry it is accepted practice that when the issue of a competing firm is brought up that it is in the best interest of the industry not to defame a competitor but stick to issues of one product verses another.

## CHAPTER 7: CAPTIVE VS. INDEPENDENT AGENTS

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### TYPES OF AGENTS

#### *Captive Agent*

An agent who has signed an exclusive contract with one or more companies is considered a captive agent. He must represent the interest of those companies as their fiduciary in the highest and most reputable manner.

It would be unethical for this type of agent to represent more than one insurance company selling the same or similar policies.

The insurer owns and maintains control of all accounts serviced by the agent and in return the agent is paid a salary and /or commissions.

The agent has an obligation to disclose to the insurer his interest in any similar business or service that he renders regardless of whether he receives compensation. It is then up to the principal to determine whether there exists a conflict of interest.

#### *Independent Agents*

Independent agents most often represent several companies and are paid on commission.

The agents own all of the clients and typically shop the best premium for that insured.

If an independent agent severs his relationship with a company the agent may rewrite the insured with a different company, provided that it is with the consent and permission of the insured.

Because independent agents must often meet quotas by insurance companies in order to maintain their writing ability with that company, the ethical issues this type of agent often faces, is the dilemma of getting the best deal for his consumer, verses meeting his quota, or perhaps receiving the highest commission.

To avoid these conflicts and potential ethical violations, the independent agent must follow the guidelines set forth for dual agency.

Under these guidelines the agent represents:

1. His client only during the process of helping the client select the insurance plan best suited to the client's needs. It is up to the agent to see that the insurance policy is written properly to meet the clients needs and intent.
2. The insurance company when the insurance is being applied for and when it is in process of being underwritten, in record keeping, in claims settlement or other insurer-related activities.

Dual agency, when practiced ethically, can serve both the insurer and the client without conflict.

### ***Principal's Obligations to the Agent***

Because the principal is obligated and responsible for the actions of his agents it is imperative that the principal choose individuals of the highest caliber of ethical conduct. The obligations of both the principal and agent are spelled out in an employment agreement.

The principal has three major duties to the agent:

- Employment;
- Compensation; and
- Indemnification.

### ***The Employment Agreement***

The employment agreement covers the following elements:

- Length of time;
- Minimum production standards;
- Lines of business that may be written;
- Method of compensation; and
- Principal's recourse for non performance.

### ***The Principal's Obligation of Compensation***

In exchange for representation the principal compensates the agent based on the terms of the employment agreement. Compensation is broken down depending on the nature of the business and whether it is new business or renewal business. The most common break down is as follows:

- Different rates for different lines of insurance;
- Higher rate of commission on new business; and
- Lower rate of commission on renewal business.

Because of this structure sometimes agents shift policyholders from one company to another at renewal time. An ethical agent must never do this at the expense of the insured.

### ***Indemnification of Agent***

Unless the agent is found guilty of breach of duty or is lacking in due diligence, the principal indemnifies the agent from all costs and claims made against him in the carrying out of his duties under his agency relationship with the principal.

This ever-challenging conflict must be met with the utmost of integrity in order to serve both the insurer and the insured.

Falling to meet this obligation in this fashion can only result in a potential lawsuit and or disciplinary action.

### **FOCUS POINTS:**

- An agent who has signed an exclusive contract with one or more companies is considered a captive agent.
- A captive agent, who has signed an exclusive contract, must represent the interest of those companies as their fiduciary in the highest and most reputable manner.
- It would be unethical for a captive agent to represent more than one insurance company selling the same or similar policies.
- The insurer owns and maintains control of all accounts serviced by a captive agent and in return the agent is paid a salary and /or commissions.
- A captive agent has an obligation to disclose to the insurer his interest in any similar business or service that he renders regardless of whether he receives compensation. It is then up to the principal to determine whether there exists a conflict of interest.
- Independent agents most often represent several companies and are paid on commission.
- The independent agent owns all of the clients and typically shops the best premium for that insured.
- If an independent agent severs his relationship with a company the agent may rewrite the insured with a different company, provided that it is with the consent and permission of the insured.



- o The ethical issues often facing an independent agent is the dilemma of getting the best deal for his consumer, verses meeting his quota, or perhaps receiving the highest commission.
- o To avoid conflicts and potential ethical violations, the independent agent must follow the guidelines set forth for dual agency.
- o Dual agency, when practiced ethically, can serve both the insurer and the client without conflict.
- o The obligations of both the principal and agent are spelled out in an employment agreement.
- o The principal has three major duties to the agent: Employment; Compensation; and Indemnification.
- o The employment agreement covers the following elements: Length of time; Minimum production standards; Lines of business that may be written; Method of compensation; and Principal's recourse for non-performance.
- o In exchange for representation the principal compensates the agent based on the terms of the employment agreement.
- o Unless the agent is found guilty of breach of duty or is lacking in due diligence, the principal indemnifies the agent from all costs and claims made against him in the carrying out of his duties under his agency relationship with the principal.

## CHAPTER 8: POLICY ILLUSTRATIONS

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### ETHICAL PRACTICES REGARDING POLICY ILLUSTRATION

How can prospects evaluate non-guaranteed values in policy illustrations? The figures are based on a mathematical formula. If all the assumptions upon which the illustration is based hold, the policy will pay the values shown. However, if the illustration is based on many different assumptions, than it is highly likely that actual experience will differ in some respect. The figures in an illustration relating to non-guaranteed values are not at all certain.

It is not always appropriate to use a policy illustration. It is appropriate to use life insurance policy illustrations, assuming that proper disclosure has been made, to:

Explain how certain concepts work; and  
 Demonstrate how a particular product works.

It is not appropriate to predict future values or compare competing proposals with a policy illustration.

#### *Disclosure*

Agents must be certain that prospective clients have an accurate understanding of what the figures in the policy illustration mean, in an effort to avoid misleading the client. The agent must fully understand the illustration in order to present the illustration properly to the client. In addition to understanding the illustration, it is incumbent upon the agent to communicate all the nuances of the illustration to the client

There are some areas where an agent must be well versed in explaining the facets of the illustration:

- Interest rates;
- Returns;
- Dividends;
- Mortality;
- Expenses; and
- Vanishing premiums.
- Interest Rates in Policy Illustrations

The interest rate connected to cash values is changeable, and a prospective client must be made aware of those factors that influence the interest rate. Some of the factors that influence the interest rates are:

External indices: the interest rate may be tied to an average rate paid on certain treasury bills, or the average rate of corporate bonds. The rate in this case is known as an 'indexed' rate.

Rates declared by the company: the interest rate is dependent on the insurance company's investment experience. In some cases lower rates may be used in offsetting operating expenses or mortality expenses of the company.

How often the rates change: an agent must advise the prospective client how often the rates may change.

Returns: Methods of Crediting

There are three basic methods of crediting a return on an insurance policy:

- Portfolio method;
- New Money method; and
- Combination method.

In the portfolio method, long-term investments are emphasized. Companies using the portfolio method own various investments that earn different rates of return. They blend all these returns together to establish one single rate of return that will be disbursed to all policies. Highs and lows in the marketplace may increase or decrease the return.

The new money method uses short term investing practices. The interest tends to rise and fall at the rate of investment returns in the financial marketplace. Returns credited under the new money method can be expected to fluctuate more widely and more frequently than in the portfolio method.

The combination method combines aspects of both the portfolio and new money method. Policies are divided into blocks using the criteria of the time period in which the policy was issued. Each block begins with the rate that was current at the time the policy was issued. However, over time, this rate is blended with the rates that are current as new premiums are received or as those initial investments mature and is reinvested. In this manner, each block eventually ends up with a portfolio-type rate.

### **Dividend**

Distributing surplus earnings on policies that pay dividends must be addressed with the prospective client.

The majority of insurance companies use the "contribution" principle to distribute these funds. In the contribution principle, surplus is divided and distributed to classes of policy owners on a pro rata formula equal to the contribution each class made to the surplus. For example, if 55% of divisible surplus came from policies owned more than 25 years, then 55% of divisible surplus would have to be distributed to the owners of those policies.

The agent should advise a prospective client if the insurer under consideration uses the contribution of another method of distributing surplus earnings.

### **Mortality**

Illustrations include mortality charges, and the prospective client must be advised as to whether or not these charges are based on actual current experience or improvements in current experience.

### **Expenses**

Certain types of policies have more associated expenses than other policies, and an agent must explain these differences to the prospective client.

### **Vanishing Premiums**

As most agents are aware, "vanishing" premiums do not actually vanish. Premiums continue to come due, but, under the illustration and the formula upon which it is based, it is projected that dividends and other cash values will pay those premiums without further out-of-pocket expenses on the part of the policyholder.

It is helpful to prepare two or three different illustrations, each with a different vanish year, to assist prospective clients with this topic. It is also helpful to create an illustration that will show the vanishing premium "re-appearing" under certain circumstances, to make sure this issue is fully understood by the prospective client.

#### **FOCUS POINTS:**

- Ethical Practices Regarding Policy Illustrations
- Figures in policy illustrations are based on a mathematical formula. If all the assumptions upon which the illustration is based hold, the policy will pay the values shown.
- It is not always appropriate to use a policy illustration. It is appropriate to use life insurance policy illustrations, assuming that proper disclosure has been made, to:
  - Explain how certain concepts work; and demonstrate how a particular product works.
- It is not appropriate to predict future values or compare competing proposals with a policy illustration.
- Agents must be certain that prospective clients have an accurate understanding of what the figures in the policy illustration mean, in an effort to avoid misleading the client.
- The agent must fully understand the illustration in order to present the illustration properly to the client. I
- It is incumbent upon the agent to communicate all the nuances of the illustration to the client.

- o The interest rate connected to cash values is changeable, and a prospective client must be made aware of those factors that influence the interest rate.
- o An agent must advise the prospective client how often the rates may change.
- o Returns: Methods of Crediting
- o There are three basic methods of crediting a return on an insurance policy: portfolio method, New Money method; and Combination method.
- o In the portfolio method, long-term investments are emphasized.
- o The new money method uses short term investing practices.
- o The combination method combines aspects of both the portfolio and new money method
- o Distributing surplus earnings on policies that pay dividends must be addressed with the prospective client.
- o The majority of insurance companies use the "contribution" principle to distribute dividends.
- o In the contribution principle, surplus is divided and distributed to classes of policy owners on a pro rata formula equal to the contribution each class made to the surplus.
- o Illustrations include mortality charges, and the prospective client must be advised as to whether or not these charges are based on actual current experience or improvements in current experience.
- o Certain types of policies have more associated expenses than other policies, and an agent must explain these differences to the prospective client.
- o As most agents are aware, "vanishing" premiums do not actually vanish. Premiums continue to come due, but, under the illustration and the formula upon which it is based, it is projected that dividends and other cash values will pay those premiums without further out-of-pocket expenses on the part of the policyholder.

## CHAPTER 9: CODES OF ETHICS

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### ABOUT CODES OF ETHICS

A credo generally describes the highest values to which the company or industry aspires to operate. It contains the 'thou shalt's'. A code of ethics specifies the ethical rules of operation. It is the 'thou shalt not's'. More than 76% of companies surveyed by The Conference Board, a leading business membership organization, have a code of ethics.

Some business ethicists disagree that codes have any value. Usually they explain that too much focus is put on the codes themselves, and that codes themselves are not influential in managing ethics in the workplace. Many ethicists note that it is the developing and continuing dialogue around the code's values that is most important.

Occasionally, members of an organization react to codes with suspicion, believing that values are like "motherhood and apple pie" and codes are for window dressing. But, when managing a complex issue, especially in a crisis, having a code is critical.

Some organizations update and continue to develop their codes of ethics in challenge meetings. They ask each individual "do we still believe this?" and, if fine-tuning is needed, the codes are amended. In most cases, only minor points are fine tuned — the values underlying the code are not amended.

#### *Developing a Code of Ethics*

There are some guidelines employed by most organizations when developing a code of ethics:

**Relevant laws and regulations are reviewed**—this ensures the organization is not breaking any relevant laws or regulations.

**Values which produce the top three or four traits of a highly ethical and successful service or product in the industry are reviewed**—Objectivity, confidentiality, accuracy, etc. Values are identified that produce behaviors that exhibit these traits.

**Values needed to address current issues in the industry are identified—descriptions of major issues in the workplace or industry are collected.** Then descriptions of the behaviors that produce those issues are defined and reviewed for those which are ethical in nature, e.g., issues in regard to respect, fairness and honesty. The behaviors that are needed to resolve these issues are defined, and the values that generate these preferred behaviors are listed. There may be values included that some people would not deem as moral or ethical values, (team-building, promptness, etc.), but these special values may add utility to a code of ethics.

**Evaluate the industry's SWOT**—Strengths, weaknesses, opportunities and threats. Determine what behaviors are needed to build on strengths, shore up weaknesses, take advantage of opportunities and guard against threats.

**Top ethical values that might be prized by the consumer are considered**—for example, the expectations of clients and customers, underwriters, agencies, the community, etc.

**The top five to ten ethical values which are high priorities in the industry are collected**—examples of ethical values might include some of the following:

**Trustworthiness:** honesty, integrity, promise-keeping, loyalty.

**Respect:** autonomy, privacy, dignity, courtesy, tolerance, acceptance.

**Responsibility:** accountability, pursuit of excellence.

**Caring:** compassion, consideration, giving, sharing, kindness, loving.

**Justice and fairness:** procedural fairness, impartiality, consistency, equity, equality, due process.

**Civic virtue and citizenship:** law abiding, community service, protection of business environment.

**Behaviors are associated with values**—critics of codes of ethics assert the codes may seem vacuous because many only list ethical values by do not clarify these values by associating examples of behaviors.

**Input from members of the industry is solicited**—ideas and input from as many leaders of the industry as possible are included.

**The code is reviewed regularly**—The most important aspect of the code of ethics is in its development; the code should be reviewed every year for relevance. Continued dialogue and reflection around ethical values produces ethical sensitivity and consensus.

**Goals are refined**—It is not possible to include in a code of ethics every value and preferred behavior for every possible ethical dilemma that might arise. The goal is to focus on top ethical values needed in your organization and avoid potential ethical dilemmas that seem most likely to occur.

### Codes of Conduct

Codes of **conduct** specify *actions* and codes of ethics are general guides to *decisions about those actions*. The following steps are employed to develop a code of conduct:

Identify key behaviors needed to adhere to the ethical values proclaimed in the code of ethics, including ethical values derived from review of key laws and regulations, ethical behaviors needed in your product or service area, behaviors to address current issues in the workplace, and behaviors needed to reach strategic goals.

Include wording that indicates that all members of the organization are expected to conform to the behaviors specified in the code of conduct.

Obtain review from key members of the organization.

Announce and distribute the code of conduct.

Include examples of topics typically addressed by codes of conduct, such as:

Illegal drugs

Reliability

Confidentiality

Not accepting personal gifts from clients as a result of company role

Avoiding sexual or racial discrimination

Avoiding conflicts of interest

Complying with laws and regulations

Not using the organization's property for personal use

Reporting illegal or questionable activities.

## CHAPTER 9: SAMPLE CODES OF ETHICS

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### ASSOCIATION OF LIFE AND FINANCIAL UNDERWRITERS

## Code of Ethics

### Preamble

Those engaged in offering insurance and other related financial services occupy the unique position of liaison between the purchasers and the suppliers of insurance and closely related financial products. Inherent in this role is the combination of professional duty to the client and to the company as well. Ethical balance is required to avoid any conflict between these two obligations.

Therefore, I Believe It To Be My Responsibility:

To hold my profession in high esteem and strive to enhance its prestige.

To fulfill the needs of my clients to the best of my ability.

To maintain my clients' confidences.

To render exemplary service to my clients and their beneficiaries.

To adhere to professional standards of conduct in helping my clients to protect insurable obligations and attain their financial security objectives.

To present accurately and honestly all facts essential to my clients' decisions.

To perfect my skills and increase my knowledge through continuing education.

To conduct my business in such ways that my example might help raise the professional standards of those in my profession.

To keep informed with respect to applicable laws and regulations and to observe them in the practice of my profession.

To cooperate with others whose services are constructively related to meeting the needs of my clients.

#### Code Of Ethics

Those engaged in life underwriting occupy the unique position of liaison between the purchasers and the suppliers of life and health insurance and closely related financial products. Inherent in this role is the combination of professional duty to the client, and to the company as well. Ethical balance is required to avoid any conflict between these two obligations. Therefore,

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### **ASSOCIATION OF HEALTH UNDERWRITERS**

#### *NAHU Code of Ethics*

- To hold the selling, service and administration of health insurance and related products and services as a professional and public trust and do all in my power to maintain its prestige.
- To keep paramount the needs of those whom I serve.
- To respect my clients' trust in me, and to never do anything, which would betray their trust or confidence.
- To give all service possible when service is needed.
- To present policies factually and accurately, providing all information necessary for the issuance of sound insurance coverage to the public I serve.
- To use no advertising which I know may be false or misleading.
- To consider the sale, service and administration of health insurance and related products and services as a career, to know and abide by the laws of any jurisdiction Federal and State in which I practice and seek constantly to increase my knowledge and improve my ability to meet the needs of my clients.
- To be fair and just to my competitors, and to engage in no practices which may reflect unfavorably on my industry or myself.
- To treat prospects, clients and companies fairly by submitting applications which reveal all available information pertinent to underwriting a policy.

- To extend honest and professional conduct to my clients, associates, fellow agents and brokers, and the company or companies whose products I represent.

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## THE AMERICAN SOCIETY OF CLU AND CHFC

The purpose of the Code is to give further force to the Pledge taken by all holders of the CLU and ChFC designations and to provide a series of standards by which those involved in providing insurance and financial planning and economic security may conduct themselves in a professional manner. The Code is founded upon the two ethical imperatives of competent advice and service to the client and enhancement of the public regard for the CLU and ChFC designations.

Competent advice and service to the client is at the very essence of any professional calling. Enhancement of the public regard for professional designations gives voice to the concept that in accepting Society membership, an obligation is also accepted to all other holders of similar and allied professional designations and degrees.

In its design, the Code presents the two ethical imperatives, supported by Guides, which give specificity to the Imperatives, and interpretive comment, which is intended to aid in a uniform understanding of the Guides.

A violation of the Code would expose a member to sanctions, which range from reprimand to revocation of membership in the American Society. A member is in violation of the Code when a final judgment is made that the member has breached an ethical imperative through failure to adhere to one or more of the Guides.

Men and women who have chosen to enter into membership in the American Society voluntarily bind themselves to this the Code of Ethics of their professional organization.

### *CLU & ChFC Code of Ethics*

#### *First Imperative: To competently advise and serve the client . . .*

##### **Guide 1.1:**

A member shall provide advice and service, which are in the client's best interest.

##### **Guide 1.2:**

A member shall respect the confidential relationship existing between client and member.

##### **Guide 1.3:**

A member shall continue his education throughout his professional life.

##### **Guide 1.4:**

A member shall render continuing advice and service.

#### *Second Imperative: To enhance the public regard for professional designations and allied professional degrees held by members . . .*

##### **Guide 2.1:**

A member shall obey all laws governing his business or professional activities.

##### **Guide 2.2:**

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.

##### **Guide 2.3:**

A member shall encourage others to attain the Chartered Life Underwriter and/or the Chartered Financial Consultant designations.

##### **Guide 2.4:**

A member shall avoid using the Chartered Life Underwriter or Chartered Financial Consultant designation in a false or misleading manner.

**MDRT Code of Ethics**

Members of the Million Dollar Round Table should be ever mindful that complete compliance with and observance of the Code of Ethics of the Million Dollar Round Table shall serve to promote the highest quality standards of membership. These standards will be beneficial to the public and the life insurance industry, and its related financial products. Therefore, members shall:

- I. Always place the best interests of their clients above their own direct or indirect interests.
- II. Maintain the highest standards of professional competence and give the best possible advice to clients by seeking to maintain and improve professional knowledge, skills and competence.
- III. Hold in the strictest confidence, and consider as privileged, all business and personal information pertaining to their clients' affairs.
- IV. Make full and adequate disclosure of all facts necessary to enable their clients to make informed decisions.
- V. Maintain personal conduct, which will reflect favorably on the life insurance industry and the Million Dollar Round Table.
- VI. Determine that any replacement of a life insurance or financial product must be beneficial for the client.
- VII. Abide by and conform to all provisions of the laws and regulations in the jurisdictions in which they do business.

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**GENERAL AGENTS AND MANAGERS ASSOCIATION (GAMA)**

**Statement of Principles**

BECAUSE the institution of life insurance renders an economic and social service that is unique and of great benefit to society, because it is a trusteeship that requires constant service, and because matters that affect its progress are of vital concern to all, and because the representatives of life insurance constitute its most important liaison with the public which it serves; and because it is of the utmost importance to maintain the high ethical standards of the institution of life insurance;

THEREFORE, I believe it to be my responsibility:

To select my sales associates and managers carefully, using the best available techniques, so that only the qualified shall be placed under contract.

To build a sales organization by recruiting people new to the business who intend to make life insurance, in one or more of its branches, their full-time career.

To provide adequate training and supervision, using the best available methods and materials, so that the sales associates placed under contract give sound advice, render quality service to policyholders, and achieve financial success at the earliest possible moment.

To encourage my associates to continue their development with sound self-improvement programs from year to year, such as LUTC, CLU, and other similar courses, to the end that they may reach the highest level of proficiency, and achieve prestige and maximum satisfaction in their work.

To encourage membership in and support the local Association of Life Underwriters by attendance and participation in meetings and activities and to follow their rules of conduct.

To present fairly and honestly, and without exaggeration, all facts which a prospective sales associate or manager should have in determining whether to accept a contract with my field organization.

To urge any sales associate or manager with whom I am discussing potential employment to review the sales associate's or manager's current employment situation with the sales associate's present general sales associate or manager before reaching a decision.

To take a leadership role in advocacy of the field organization distribution system and in the fundamental belief that life and disability insurance are upon death, disability, old age and during emergencies the best products to provide cash and income when most needed by my fellow citizens who seek self-determination and personal freedom.

In general, I shall endeavor and encourage others to practice the "Golden Rule" in all aspects of our professional lives and, in so doing, strive to gain the respect of our contemporaries and lift our profession to the highest level of public esteem.

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## **ASSOCIATION OF PROFESSIONAL INSURANCE ADJUSTERS**

### Rules Of Professional Conduct and Ethics

The following Rules of Professional Conduct and Ethics are applicable to all members of the Association.

1. The members shall conduct themselves in a spirit of fairness and justice to their clients, the Insurance Companies, and the public.
2. Members shall refrain from improper solicitation.
3. No misrepresentation of any kind shall be made to an assured or to the Insurance Companies.
4. Commission rates shall be fair and equitable, and strictly in accordance with the prevailing custom in the locality, and must, where laws or regulations of insurance departments exist, comply fully with such laws or regulations.
5. Members shall conduct themselves so as to command respect and confidence. They shall work in harmony with one another, with their clients, and the Insurance Companies' representatives, so as to foster a cordial and harmonious relationship with all branches of the insurance business, and with the general public.
6. Members must be fitted, by knowledge and experience, for the work they undertake. They must not endanger the interests of the public adjusting profession, or risk injustice to assureds or to the Insurance Companies, by attempting to handle losses or claims for which they are not qualified, and for which they cannot find competent technical assistance.
7. Members shall not engage in the unauthorized practice of law.
8. Members shall not acquire any interest in salvaged property or participate in any way, directly or indirectly, in the reconstruction, repair or restoration of damaged property, except with the knowledge consent and permission of the assured.
9. Members shall be cooperative and assist one another in every possible way.
10. Members shall not disseminate or use any form of agreement, advertising, or any printed matter that is harmful to the profession of public adjusting, or which does not comply with the rules and regulations of the Insurance Department of the state in which such member is professionally engaged, or which might subject public adjusting and public adjusters to criticism or disrespect.

***END OF COURSE***