

Part II

The Environment

The Ethical Environment

The most comprehensive study of the status of ethics among insurance professionals was conducted 10 years ago by The Insurance Center at Drake University and the American Society of CLU & ChFC (now the Society of Financial Service Professionals)*.

This survey of 1200 professionals in sales, management and home office positions rated 32 perceived ethical issues, sources of potential help and areas of potential challenge. It was prepared in response to the various industry scandals during the previous few years and apparently has never been replicated.

The CLUs and ChFCs responding rated six ethical issues as most significant to them. In descending order these were:

1. False or misleading representations of products or services in marketing, advertising or sales.
2. Failure to identify the customer's needs and to recommend products and services that meet those needs.
3. Lack of knowledge or skills to competently perform one's duties.
4. Conflicts between opportunities for personal financial gain (or other personal benefits) and proper performance of one's responsibilities.
5. Misrepresenting or concealing limitations in one's abilities to provide services.
6. Making disparaging remarks about competitors, their products or their employees or agents.

Even if you assume the average agent is "honest", that is someone who does not steal or would not lie under oath, this is still a rather discouraging portrait of the industry's business behavior.

Furthermore, the surveyed agents also identified the major ethical challenges they themselves faced. Again, the top six were:

1. Intense competition in the insurance industry, which forces owners, managers and others to focus on the bottom line and not on business ethics.
2. Competition encountered in business activities.
3. Performance based upon quotas such as amounts of insurance sold, cases underwritten or claims processed.
4. Measuring employee performance on the basis of end results without also considering how ethical the means were to achieve those results.

5. Unethical demands made by clients or customers.
6. Managers who are only concerned with their own personal gain and not ethics.

That these ethical challenges could be applied to many other businesses should not be comforting to insurance professionals. Fortunately, many companies have adopted internal policies to control these in the wake of this widely circulated survey. And, as we shall see, so have regulatory authorities.

Finally, and positively, the respondents also cited 15 sources of potential help for responding to ethical challenges. The top seven all relate specifically to the most common challenges. These are:

1. Your own personal moral values and standards.
2. Your family and friends who provide support and insight in resolving ethical conflicts.
3. The fact that your immediate boss does not pressure you into compromising your ethical standards.
4. A company environment which does not encourage you to compromise your ethical values to achieve organizational goals.
5. A company management philosophy which emphasizes ethics in business operations.
6. The professional code of ethics of The American College and the American Society (now the Society of Financial Service Professionals).
7. Clear communication of appropriate ethical behavior by company management.

In other words an honest, ethical agent representing an honest, ethical company will still face challenges, but will have the fortitude and support to avoid ethical transgressions.

Lastly, the survey never defined "ethics", assuming apparently the Greek concept of an idealized set of instructions for a well-ordered society.

* (The complete survey and an explanation of its methodology can be found in the September, 1991, edition of the "Journal of the American Society of CLU & ChFC"--Robert W. Cooper, PhD, & Garry L. Frank, PhD, "Ethics in the Life Insurance Industry: The Issues, Helps and Hindrances".)

The Legal Environment

The most important legal consideration for the ethical agent is his relationship with the companies he represents.

This relationship is governed by the Law of Agency, a series of common-law precedents. The Law of Agency establishes the insurance company as the principal responsible for the actions of its agents, including their proper licensing and marketing conduct. This relationship exists regardless of the agent's employment status: anyone who represents a

principal in a transaction with a third party is an agent by law, whether he is an employee or independent contractor.

Furthermore, the Law of Agency applies even if the agent only represents the principal sporadically, or even for a single transaction. A business agreement does not have to be permanent nor exclusive to create a principal-agent relationship. Any time an agent acts within the parameters of his authority, the Law of Agency assumes that the agent's actions are those of the principal, and therefore binding on the principal.

Although most agents would disagree, by law life insurance agents do not represent their clients in a transaction. The Law of Agency does not draw distinctions between acting as an "agent" or acting as a "broker", regardless of how one might be licensed in a particular state.

(We will discuss the various levels of agent authority within the Law of Agency in next section of this course.)

In response to the industry scandals and the ethics survey, and with an eye to the Law of Agency, most states have adopted increasingly strict licensing and conduct requirements for agents, and are holding admitted companies responsible for enforcing these rules.

Some are purely punitive, intended as retribution for egregious violations of the law. These punishments include banning from the profession (license suspension or revocation), fines and directed reimbursements and prison sentences. Many states now publish list of violators. These make interesting, and instructive, reading.

But many of the new requirements are reflective of a legalistic solution to perceived ethical lapses through the control of entry into the profession to those considered most qualified. Examples are the rapidly increasing fees for license renewals, especially non-resident license renewals; the almost-universal expectation of the "40-hour" instructional courses for new license applicants; and the expansion of continuing education requirements, including specific fiats for courses in ethics.

Finally, the various codes of ethics of industry professional societies are also essential elements of the legal environment surrounding the agent.

Insurance agents, including this agent, often refer to our occupation as a "profession", on a plane with law, medicine and education. To be a profession, however, an occupation must meet certain tests: it must have educational or licensing standards; it must require continuing adherence to these standards; and it must abide by a strict code of ethics. Insurance today certainly meets the first two requirements; members of those professional societies which enforce a code of ethics can also claim that they meet the third. They are professionals.

The Social Environment

There are also ethical challenges for the conscientious agent in the social environment.

First, public perceptions of insurance agents as a class remain low, in the depths with attorneys and Congressmen. And recent surveys seem to indicate that these perceptions are sinking further, perhaps a result of the public's aversion to telemarketing, and the agent's need to make appointments on the telephone.

However, many studies have revealed a curious distinction between the public's view of agents as a group and individual's opinion of their own agent. It appears that conscientious professionals are recognized for their own merits. Similar opinions have also been revealed in surveys about attorneys, accountants and doctors. "I don't like _____ but I sure like my own _____. He's different."

At least most of us aren't Congressmen!

Ironically, the professional agent often must struggle for equal recognition by professionals he regards as his peers--attorneys and accountants. Both often seem to have an aversion to those who sell for a living, although their professional societies make no such distinction. We will examine the issue of agents and related professions in a later section.

This reputation--a distasteful profession but an admirable professional--may result from many agents' reluctance to recognize that they are frequently on public display, that every action can be subject to scrutiny.

One professional society, the Houston Association of Life Underwriters, has attempted to address this issue with an extraordinarily helpful pamphlet, "Are You in Compliance?"**

Placing the agent at the intersection of Scrupulous & Principled Avenue and Iniquitous & Negligent Circle, the Association admitted the industry suffered from a poor public perception. But it stated that "some of the problems--maybe not all, but perhaps most--caused by sales representatives were the result of ignorance, not improper intentions."

Consequently, the group created the booklet to educate well-meaning agents about changes in regulations and requirements in several critical areas: advertising; commissions and rebating; market conduct and proper representation; replacement and illustration integrity; record keeping and confidentiality; underwriting; and the complaint process. We will examine the some of these in more detail in this section and the next.

The practical advice focuses on those areas where states have enacted model laws or acted in concert to correct abuses. Thus, the advice is applicable in almost any jurisdiction.

It concludes that "your personal framework as a truthful person was constructed long ago. (This booklet) can't help you with that. But it can serve as a reference whenever you have a question on the technical requirements of running a totally compliant, ethical sales practice."

The conscientious, ethical agent must actively strive to remain conscientious and ethical.

**("Are You in Compliance?" is published by LIMRA International, Inc., and available through that organization.)

Enlightened Self-Interest

A text on professional ethics emphasizes the practical: "Ethics does not have to be incompatible with capitalism; 'profit' is not a dirty word. In the long run good ethics is good business. Hard but fair competition cannot help but benefit the public."

Therefore, a conscientious and ethical agent must be a successful agent also, to continue to serve his public and to fulfill his promises to his customers.

These promises begin with his commitment to fiduciary responsibility.

A *fiduciary* is anyone who is placed in a trusted position by his profession, often involving the handling of other people's money or assets. An agent is clearly a fiduciary when handling premiums or benefit payments, and harsh penalties are assessed against those who violate that responsibility.

But an agent also acts as a fiduciary when transacting sales and processing application, since the resulting policy represents a potential payment from one party to another, neither of whom is the agent.

Consequently, the agent has the same obligations as other fiduciaries: loyalty to his principal; a professional level of competence; full disclosure of any conflicts; scrupulous handling of all money and papers.

Field underwriting--the process of selecting prospects and completing applications--is a particular trap for the unwary. "Perhaps no area pertaining to compliance and ethics deserves as much attention as field underwriting," "Are You in Compliance?" cautions.

The completed application becomes an integral element of the policy--the applicant's offer and valuable consideration. Therefore, an ethical agent must ensure that all questions are answered correctly and thoroughly. Remember, the agent represents the principal, the insurer.

Furthermore, a deliberately deceptive application will do the applicant or insured no favor, either, since life applications are usually contestable for two years and health applications are often contestable forever in cases of fraud. No commission is worth that turmoil.

However, there is one area where the agent can be at great but inadvertent risk while recognizing his primary obligation to the insurer. That is the issue of the "agent's report."

Many companies expect an agent to complete a detachable report that is not included in the signed application. This often includes open-ended questions such as: "Are you aware of any other factor that might affect the applicant's insurability?" The prudent answer is always: "No."

Why answer "no"? because any positive response will have negative consequences for the applicant and cause some damage--legal damage. By completing an adverse agent's report an agent will libel the applicant. He will willfully communicate damaging or disparaging material to a third party with financial consequences to the damaged party. The agent can be sued--and will probably lose, too.

Positive or explanatory information should be conveyed in a detailed cover letter. Otherwise, let the insurer ask the specific questions it wants answered, or conduct its own investigation. The ethical agent is not obligated to sacrifice himself. No code expects such altruism.

Everyone makes mistakes, of course, even conscientious agents.

Fortunately, there are third-party protections when those mistakes occur. The most common are liability insurance, commonly known as errors and omissions, and fidelity bonding. And mistakes are common enough that most states require licensed agents to maintain one or the other, as protections for the public.

Errors and omissions policies pay when an innocent party is damaged by the inadvertent actions of a agent, such as the failure to remit a premium in a timely manner. But the triggering actions must be inadvertent; there can be no intent to defraud or all policies are null--and the agent becomes personally liable.

Fidelity bonds protect the agent against the inadvertent mishandling of funds, commonly the misplaced check. Again, deliberate deceptions are excluded. Although some states permit licensed agents to submit either an E&O policy or a bond as requirements, in fact the two products protect against different risks. The prudent agent will provide both.

A word to the wise: E&O policies provided by your primary carrier as a service or contract requirement may not cover transactions outside that company. Read your policy carefully!

A few states also permit an agent to utilize other devices--either a letter of credit or a statement of financial responsibility. The letter of credit is an acceptable substitute for a bond, but a bond is easier to obtain. But a statement of financial responsibility is only prudent for the very wealthy agent--and that agent is probably too prudent to risk his own assets.