**ETHICS: DO NO HARM**

**Course 20W**

## 1.0. What Is Ethics?

Defining ethics is a perennial question, to which there are a host of answers. One is: Ethics is an area of academic study in which morals, values and rules of conduct are investigated theoretically. Another answer: Ethics is the study of what constitutes good and bad, right and wrong behavior, though this implies a degree of practical application of ethical values. Moving a little closer to our interests for this course, ethics can be defined as the guidelines of how we should relate to the interests of parties that have a stake in the outcome of our actions.

As you can see, definitions of ethics range from academic to practical. In this course, it is the practical *application* of ethics that concerns us.

### 1.1. Ethics versus Morals

The notion that ethics involves moral values *and* rules of conduct leads to the most basic confusion at the root of ethical dilemmas: Is an action that is ethical also one that is moral? For example, is it moral to kill another human being? Most people would say that it is not moral. Is it then immoral under all circumstances? Is it immoral in a time of war to kill an enemy bent on killing you? Is it immoral to kill someone to protect someone else?

The reality is that many ethical decisions, like the decision to go to war, to protect one's family and country, do not generate purely good, right or even morally justifiable results unless we cleave rigidly to a set of values that supports our actions, overlooks the negative impact of the decision on some affected party, or both. Rather, such ethical decisions entail complex outcomes, direct and indirect, that may actually be interpreted as good or bad, right or wrong differently by different parties to a transaction.

As the foregoing suggests, in many cases moral codes and ethical codes do not complement one another; rather, they can actually contradict one another and lead to ethical and moral confusion.

### 1.2. The Purpose of Ethical Codes

Ethical codes are designed to provide guidance for a collective group (such as a business or sports team) when individuals within the group are faced with situations that require them to make difficult, ethical choices. Unlike moral codes, which are characterized by their rigidity and frequently originate from a shared, often sacred source or document, ethical codes can be more general and can be designed by a group to address their particular situation/position.

Despite the fact that ethical codes are couched in broad terms, many of which relate to a wide range of situations, it is also true that ethical codes offer some kind of focus. This focus results from the fact that ethical codes are often developed to address more specific areas of activity. For example, a company in which all of the employees work in administrative capacities would not develop the same ethical code of conduct that a company widely engaged in sales to other businesses or consumers would develop. While the former might have a substantially broader emphasis on interpersonal relationships among office staff, the latter, while it might address interpersonal ethical conduct issues, would address sales practices the office-based code of ethics would not address.

QUESTION 1: Refer to Section 1.1, page 1

Ethical decisions always generate purely good and morally justifiable results.

Answer:

True

Response: A

Your answer is incorrect.

Answer:

False

Response: B

Your answer is correct. Ethical decisions do NOT always generate purely good and morally justifiable results.

QUESTION 2: Refer to Section 1.2, page 1

All of the following describe ethical codes, EXCEPT:

Answer:

Vary by group and/or position

Response: A

Your answer is incorrect. Ethical codes often vary by group and/or position.

Answer:

Couched in broad terms

Response: B

Your answer is incorrect. Ethical codes are often couched in broad terms.

Answer: T

Characterized by rigidity

Response: C

Your answer is correct. Ethical codes are NOT characterized by rigidity.

Answer:

Offer some kind of focus

Response: D

Your answer is incorrect. Ethical codes can offer some kind of focus.

## 2.0. Why Does a Heightened Concern About Ethics Persist?

There are a number of reasons a heightened concern about ethics persists. The reasons change as the years pass according to the current fashion for abuse. In recent years, regulators have been concerned about the incentives agents may have to recommend annuities and other products that are not in their customers' best interest, but rather are recommended because of the commissions and fees that can be earned. This concern has spawned a lot of regulatory action at the federal level by the Securities and Exchange

Commission (SEC) and the Employee Benefits Security Administration (EBSA) of the Department of Labor (DOL) and at the state level by the National Association of Insurance Commissioners (NAIC) and the individual states.

The driving force behind this regulatory activity has been the arrival of the baby boom generation at retirement age. This generation is making important financial decisions and has been looking to the financial professional for advice about rollovers from employer retirement plans to IRAs and funding of those IRAs with annuities, including complicated annuity products like variable annuities and index annuities. Complexity combined with compensation systems that created conflicts of interest for the agents have been the target of the regulatory activity. Concern has been that the consumer too often loses out in these situations—while agents and insurance companies profit from giving poor advice.

Another reason for the interest in ethics is the lingering effect of the class action lawsuits brought against a number of large insurance companies, which they lost, at the end of the 20th century. These suits principally involved the sale of life insurance policies on a short-pay basis, a practice at one time called a "vanishing premium" approach. These policies were sold at a time when interest rates and dividend earnings were high and projected to remain at those high levels. These overly optimistic projections supported life insurance ledgers that showed a limited number of premium payments as an insured's full out-of-pocket financial responsibility. After the limited number of illustrated payments were paid, the ledgers showed that any ongoing policy expenses to keep coverage in force—permanently in most cases—would be paid out of high policy cash value accumulation in universal and variable universal life policies, based on continued high interest earnings or securities market returns, respectively, or on high non-guaranteed cash values in participating whole life policies, based on continued high dividend earnings.

Several issues, including a lack of ongoing policy oversight and review by agents, reduced or stagnant market interest rates and securities market corrections and volatility, combined to leave a significant number of policyholders in a position which forced them to:

1) pay significantly higher premium payments than anticipated, or

2) face sudden notification that their policies were near lapse, and they would need to make substantially higher, and often impossibly large, premium payments just to keep their insurance coverage in force from year to year.

For those policyholders whose policies lapsed or were scheduled to lapse within a relatively short period of time, ill health or the high costs associated with keeping their coverage intact made it impossible for them to replace the coverage they had which had suddenly become so expensive. At the time of purchase, the policyholders had been assured the protection would be theirs for as long as they lived.

In addition to these class action suits, there were others that focused on inappropriate sales of annuity products, particularly to older individuals. These class action suits often cited inappropriate matching of products to client investment needs, risk tolerance or to misleading or entirely absent replacement disclosure. Each new suit served to keep those that had gone before fresh in the minds of consumers.

## The Government Bailout & Distribution of TARP Funds

Public perception of the inter-connected relationship between banking, Wall Street and insurance is broad and essentially negative. This is true for a number of reasons, not the least of which is that banks and insurance company securities are listed on all the major stock exchanges and are bought and sold by large Wall Street financial firms. More specifically, there are a number of insurance companies that own banks and market their banking services

to their customers, and there are many banks that solicit their customers for life insurance and annuity products supplied by large, well-known insurance carriers.

The degree to which banks and insurance companies participate in the economic life of the country serves to keep their financial activities and, in particular, their problems in the public eye, making them the target of negative media articles or reports. These articles or reports may address:

- the slow or inadequate medical claims-payment practices of one or more health insurers,
- the price-fixing antics of one or more property and casualty insurance companies,
- the mechanics of questionable life insurance-based tax-avoidance strategies developed at high-priced law firms and subsequently deemed illegal by the IRS, or
- the negative social policy implications of the activities of a secondary marketplace in which individual insurance policies are bought with borrowed money and then sold as investments to individual, third-party, unrelated buyers or are aggregated, securitized and sold to shareholders much the same way mutual fund shares might be sold.

Add to this the fact that in during the economic crisis at the end of the decade of the 2000s, a number of insurance carriers moved rapidly to acquire or create their own banks to facilitate the potential receipt of government bailout funds and that a number of insurance companies actually did receive such funds from the federal government—notably AIG, in which the federal government holds a very large ownership interest—insurance companies are linked in the public mind to those other mortgage and Wall Street segments of the financial services industry whose actions served to precipitate or deepen the economic impact of the crisis or who seemed to profit substantially from what was seen as the misery of unsophisticated consumers.

At the end of the 20th century, a spate of "human interest" stories appeared in newspapers and electronic media, reinforcing the idea of heartlessness and greed of all the financial institutions in the country. Mortgage foreclosures, denial of payment for medical services, escalating costs for long-term care insurance coverage, increased banking fees, the tightening of credit access, salary cuts, hiring freezes, government employee furloughs, public company layoffs, the closing of independent small businesses across the country, rising unemployment rates: All reflect badly and indiscriminately on the "fat cat" insurance, banking and financial services industries.

How to address these issues? The method of choice: Focus on ethical behavior in the marketplace to provide guidance to those working in the financial services industry and heightened protection for consumers.

**The Impact of Healthcare Reform**

The advent of healthcare reform did not help matters with respect to the perception of insurance companies. Even before passage of the medical reform legislation, many medical insurance carriers raised their rates in anticipation of what they feared was to come. Concern about medical insurance companies leaving certain market segments also arose; this happened in New York, for example, with regard to individual medical insurance coverage, when the state mandated that:

- no one who applied for it could be denied major medical insurance coverage, and
- once an individual obtained a major medical insurance policy, he or she could not be denied payment for preexisting conditions for more than twelve months.

Individual medical insurance carriers pulled out of the market one after the other, leaving a dearth of coverage choices for individuals seeking medical insurance coverage outside of their employment.

In the long and heated debate over healthcare reform, neither proponents nor opponents of healthcare reform have looked particularly kindly on insurance companies. They have, rather, been criticized and, in some cases, demonized for their opposition to certain aspects of healthcare reform.

Another pervasive perception issue is that insurance companies exist solely to pay expenses that arise when insureds are ill or injured. This is, in part, the truth, but not the whole truth. Helping individuals manage their potential healthcare costs is what medical insurance companies do, but they do not do it to simply achieve that end. If they did, they would function substantially more like charitable organizations than the entities that they are: Profit-driven corporations. This description of a medical insurance company alone can raise the hackles of many a consumer, though they might well remain indifferent or even have a positive perception of many other types of profit-driven corporations, particularly ones in which a consumer may have advantageously invested.

The nature of profit-driven corporations is that they adhere to their central mission by following tried and true practices and rules of governance that lead them to generate profits. When new rules are applied from outside the corporation, the corporation responds, not as a charitable organization to give more of itself, but as a business entity designed to preserve itself and to satisfy its stockholder-owners. Sometimes this means passing on the assumption of certain types of risks, limiting what types of coverage the company can profitably provide, or limiting available benefits to cover specified conditions. The simple fact is that no one likes to be told "no" when they are facing illness, ongoing disability or even death, accompanied by potentially financially devastating medical expenses that could wreak havoc on their own and their families' lives. When insurance companies do not step forward to save individuals in this type of situation, they are seen as withholding and avaricious.

All of these issues and perceptions combine to create what one might parlay into a portrayal of a "perfect insurance storm," the consequence of which is that the government, consumer watchdogs, consumers and—in light of our present interest—insurance companies themselves are very concerned with ethical behavior, what constitutes ethical behavior, and ensuring that ethical practices prevail in the marketplace for the protection of both consumers and insurance companies.

In every generation, there is a reason for a concern about ethics. The exact reason changes from time to time, but it's always something. Our sense of fairness demands that people in positions of trust should be trustworthy and should act in the best interest of those who depend on them.

QUESTION 1 Refer to Section 2.2, page 4

Insurance companies are typically _____ organizations.

Answer:

state-operated

Response: A

Your answer is incorrect. Insurance companies are NOT state-operated organizations.

Answer:

government-operated

Response: B

Your answer is incorrect. Insurance companies are NOT government-operated organizations.

Answer

charitable

Response: C

Your answer is incorrect. Insurance companies are NOT typically charitable organizations.

Answer: T

profit-driven

Response: D

Your answer is correct. Insurance companies are profit-driven organizations.

QUESTION 2 Refer to Section 2.1, page 4

Towards the end of the 20th century, a surge of _____ appeared in newspapers and electronic media further demonizing the financial institutions of the United States.

Answer:

advice columns

Response: A

Your answer is incorrect. Advice columns did not demonize the financial institutions of this country.

Answer: T

human interest stories

Response: B

Your answer is correct. A surge of "human interest" stories demonized the financial institutions of this country.

Answer:

competitor's advertisements

Response: C

Your answer is incorrect. A surge of competitor's advertisements did not further demonize the financial institutions.

Answer:

celebrity interviews

Response: D

Your answer is incorrect. There was no surge of celebrity interviews demonizing the financial institutions of this country.

## 3.0. Why Is Making an Ethical Decision So Difficult?

Compounding the difficulties that variables such as circumstance and relationship can lend to the decision-making process, the existence of a variety of more formalized approaches to ethical decision-making further complicates the process. Three very common approaches (approaches that many individuals apply to their ethical decision-making almost unconsciously and often inconsistently), are a *Utilitarian Approach*, a *Rules-based Approach*, and a *Relativistic Approach*.

### 3.1. The Utilitarian Approach

The Utilitarian Approach to making an ethical decision rests on the idea that the best ethical choice is the one that does the greatest good and benefits the greatest number of people. We might think of this as a quantitative or qualitative approach to ethical decision-making. From a quantitative perspective, we might see a small-town mayor attempting to determine where budget cuts will be made between:

A. An office staff who make the lives of underpaid part-time semi-volunteer public officials easier by filing reports, making photocopies, etc. or

B. A public works staff who serve the entire community providing sanitation, road clearing and repair, and snow removal services.

To make a decision, the mayor might weigh how many benefits fall under each service. One could investigate the reverse as well, still focusing on the greatest good for the greatest number, and ask: Who is hurt least as a result of choosing one option over the other?

This formal approach to ethical decision-making, like the other two, has strengths and weaknesses. One of the greatest benefits of a utilitarian decision-making approach is that it can serve the best interests of the greatest number of people. One of its **strengths** is that it is results-oriented and can derive the "best" decision from investigation of the consequences and the individuals affected. This ability to follow-up on the impact of a decision gives the utilitarian approach a sense of immediacy and clearly defined purpose, as well as rooting in the empirical world, the world we can verifiably measure.

The principal **weakness** of this type of approach is that it can, in extreme circumstances, degenerate into the notion that the end justifies the means that provide the greater good. Along with this notion is the potential problem related to perspective. History, for example, is rife with instances in which the perspective of a particular group of individuals on what constitutes the greatest good for the greatest number has led to disastrous consequences for others. The Conquistadores were convinced that the greatest good for the greatest number of individuals was supported by their efforts to convert the Incas and the Aztecs to Catholicism or annihilate them if they did not come around to the conquistadores' way of thinking. The Nazi notion that the greatest good would be served by the annihilation of Jews, Gypsies, intellectuals, homosexuals, the mentally and physically disabled and those holding political views in opposition to the Nazi Party line is another example not only of how perspective supports what many—and certainly members of those groups targeted for annihilation—would think of as unethical, but also how the greatest good for the greatest number—among whom only pure-blooded Aryans counted—can seem to justify means that are unethical: arbitrary imprisonment, torture, genocide, etc.

#### 3.1.1. The Rules-based Approach

A rules-based approach to making ethical decisions is exactly what it says. Rules are formulated to govern the behavior of individuals within a defined group.

We've all been engaged in groups in which rules gave us guidance on how to behave under certain circumstances, from kindergarten to the present. The ethical nature of those rules is not always evident, at least not in a way that we would consider those rules as ethical guidance. For example, in kindergarten, we're told to do certain things under certain circumstances: walk to the right when going down a corridor or traveling in a stairwell; wait your turn when it's cookies and milk time; wash your hands after you go to the bathroom; say *please* and *thank you*. Since we know that ethics has an eminently practical focus, these rules are designed to promote conformance to ethical standards. Walk on the right side when walking down a corridor, as opposed to walking anywhere you want to walk, forcing others to go around you or to stop as you impede their ability to move along the corridor. The ethical value here is not simply to walk on the right, since the rule could have had a young child walk as easily on the left. The ethical value is cooperation: Cooperation is good and right and appropriate behavior. Similarly, an ethical value underlies the dictum that one should wait one's turn when it's snack time. Here, the value is again cooperation, but also patience and consideration for others. Washing your hands after going to the bathroom is not solely about good hygiene, but about the *benefit* of good hygiene: good health. The ethical value is to avoid making others sick by spreading viruses and other germs. And the notion underlying the common courtesies of saying *please* and *thank you* is that each individual has the right to be treated well in the most common social situations: The rules of common courtesy are, at perhaps their most basic, standards that provide the essential support for the contention that all individuals have basic human rights.

The obvious **strength** of a rules-based approach is the fact that individuals subscribing to those rules know exactly what is expected of them to be deemed *ethical individuals*. This knowledge serves to remove doubt and ambiguity from the decision-making process. And, as is the case with the utilitarian approach, the rules approach gives the decision-making process a strong sense of purpose: Acting according to the rules is upholding values that the group deems important, whether those rules are meant to support the values of the company he or she works for or the values of a broader social order in which he or she believes.

The principal **weakness** of a rules-based decision-making process is that it is rigid. You either follow the rules or you don't. The facts and circumstances surrounding the decision-making process have no bearing on the outcome of that process. While making ethical decisions on this basis can often be useful, there are times when it might not be. For example, the HIPAA information privacy rules do not allow individuals, from doctors to receptionists in doctors' offices, to share any information with someone for whom they have not expressly been given permission to share information. This may be beneficial or not, depending on the circumstances. Let's look at just two.

**Situation number 1:**

Neil has told his partner that he would consider selling his partnership interest if his co-owner, Gary, were interested in buying. Gary does have an interest, but does not have a solid idea of how much Neil would want for his interest. Gary decides to make some inquiries. He calls friends that he and Neil have in common and asks them if Neil has said anything to them about retiring or moving on to another business venture. He learns in the course of his calls that Neil has been talking about retiring. In one conversation, he learns that Neil has made some offhand comments about a medical issue he's concerned about. Gary wonders what kind of medical issue Neil might be dealing with and what that would mean to negotiations with him. Gary decides to call Neil's doctor, who he happens to use as his personal physician as well. When Gary gets the doctor on the phone, ostensibly for another reason, Gary steers the conversation around to Neil, but is unable to persuade the doctor to give him any information on Neil's health. When all is said and done, Gary doesn't know if Neil's medical condition is serious or simply something that came up in the course of conversation with one of their friends.

Had their doctor shared information with Gary, Gary's approach to negotiating with Neil might be influenced by what he'd learned. For example, if Neil's concern was the typical kind of

concern one might have about undergoing a routine procedure, like a periodic colonoscopy, or having to undergo an endoscopy to investigate acid reflux to see if it had caused any serious esophageal damage, Gary would not likely be able to parlay that into any kind of leverage in negotiations with Neil. Had he found out instead that Neil had been diagnosed with Stage IV lung cancer and was facing the prospect of incurring substantial, extraordinary medical expenses he did not have the financial resources to manage, Gary—acting in a way that most of us would probably consider highly unethical—might be able to pressure Neil into selling his ownership interest for substantially less than its real value in light of his immediate need to turn his illiquid partnership interest into ready cash.

**Situation number 2:**

Tom has been in a serious automobile accident and is in the hospital in critical condition and not expected to survive his injuries. Tom's wife Sally received a call from the hospital shortly after the accident to come down at once, which she does after taking only a moment to call Tom's sister, Laura, who lives on the other side of the state, to let her know what's happened and to tell her where Tom is being treated. Laura calls the hospital to see if she can get any information on Tom, to find out how serious his injuries are and to determine if she should immediately come to the hospital. She is told repeatedly that no information can be provided to her because no authorization to do so has been executed. Sally, finding out that her husband is likely to die within hours from his injuries, collapses at the hospital. Laura keeps calling the hospital, explaining her relationship to Tom over and over again, but can get no information. Tom passes away during the night. It is only the following day, after Sally recovers enough emotionally to make another call to Laura that Laura learns of Tom's passing. Laura is heartbroken that she did not have the chance to be at Tom's bedside, to see him one more time, to be of any comfort to him or to be of any assistance to Sally.

In this second situation, the inability to provide any information whatsoever to Laura left her in doubt about how serious her brother's condition was and what she should do. Because of the rigidity of the HIPAA information privacy rule, Laura has suffered an emotional blow that may haunt her for the rest of her life.

### 3.1.2. The Relativistic Approach

The relativistic approach is an ethical decision-making approach that serves specifically to allow a decision-maker to take into account the facts and circumstances surrounding the situation in which he or she must make an ethical decision. Let's look at a simple example in which the facts and circumstances make all the difference.

Sarah is a third-grader. She's working on a math problem that she's having a great deal of trouble figuring out. She wants some help and asks for it. The question is: Is it ethical to give it to her?

**Situation 1:**

Sarah is sitting at the kitchen table in her home. Her mother has just wiped her hands on her apron and is letting a stew simmer when Sarah asks, "Mom, can you help me with this homework problem I'm working on?" Is it ethical for Sarah's mom to say yes?

In this situation, most people would definitely say that it is ethical for Sarah's mom to help Sarah with her problem; that in fact, it may not only be ethical but also her responsibility as a parent.

**Situation 2:**

Sarah again asks for help with a math problem. This time, however, Sarah is taking a state-mandated math test, and the person she asks for help is the student sitting across the aisle

from her. Is it ethical for her fellow student to offer Sarah help? Is it ethical for the student to say no? The ethical decision is a reversal of the previous situation: It is ethical for the student to say no because of the circumstance in which Sarah's request is made. It is also unethical for Sarah to have asked for help because that would be cheating on her exam.

**Situation 3:**

Sarah is in math class working on a set of problems her teacher has given the class. Sarah raises her hand and her teacher walks over to Sarah's desk. Sarah says, "I've tried to do problem number seven, but I can't figure it out. Can you show me how to do it?" Is Sarah acting ethically asking for her teacher's help? Is it ethical if the teacher provides Sarah with some assistance?

In this case, it seems clear the situation presented is of a different sort than Situation 2. The problems are designed to exercise what Sarah knows and to show what she needs to review. Given this set of circumstances, it would be entirely ethical for the teacher to help Sarah solve the problem she's having difficulty answering. To teach well and effectively is an ethical responsibility every teacher shares.

## 3.2 The Inherent Conflicts in the Insurance Sales Situation

The ethical decision-making process is further complicated by a number of conflicts of interest inherent in the sale of insurance products.

### 3.2.1 Whom Does the Insurance Salesperson Represent?

One of the important questions a salesperson must answer ethically is: Whom do I represent? This question may, at first blush, seem simple to answer; but in truth, it is not, because the three parties to any insurance sale (the consumer, the salesperson, and the insurance company) all have different expectations of the manner and outcome of the sale.

### 3.2.2 The Insurance Agent

You may already have noted that this section of the course has called the person selling an insurance product a "salesperson," but he or she is also an agent of an insurance company or a broker representing a number of insurance companies. The distinction here is important because each characterization raises certain expectations in consumers, the company or companies being represented, and the salesperson.

#### 3.2.2.1 Insurance Company Expectations of an Agent

An insurance company that has taken on an individual for representation has a clear and reasonable expectation that its agent will work in the interests of the company at all times and in all employment-related transactions into which the agent enters. This means that an agent will always act to present the company in a positive light. It means that agents will endeavor to present themselves in a positive light as well, since how they are seen can directly influence how individuals in the marketplace perceive the company. Representing the insurance carrier well means the agent will develop a broad and deep understanding of the insurance company's administrative and personnel policies, company operations and employment, and the sales practices and provisions of the insurance policies offered for sale to consumers by the company.

Insurance companies expect their agents:

- to be loyal,
- to present their products well, regardless of whether they are the least expensive in the marketplace, and

- to develop the value proposition supporting purchase of the product suggested to address a particular prospect's or client's needs, but to be able to address the products and services being offered in the marketplace by a company's competitors.

In general, insurance companies expect competence from their field representatives in all areas, as well as those collateral to the sales work being done: the germane tax, legal or accounting knowledge appropriate to the work the agent is doing; as well as the awareness and clear understanding that he or she cannot offer prospects and clients advice that can and should be offered only by individuals licensed to provide that advice, such as attorneys or certified public accountants. Insurance companies also expect their field agents to act as the first line of defense for the company against adverse selection in their underwriting process and against potential insurance fraud. Companies expect their agents to be honest and truthful not only in their relationships with their prospects and clients, but also in their relationship with the company. And, of course, insurance companies expect their field representatives to conform their sales practices to all relevant state and federal regulations applicable to the work they are doing.

#### 3.2.2.2. Insurance Agent Expectations of the Company

Insurance agents also have expectations of the companies they represent. They expect their companies to carry on their business activities in a legal and ethical manner so as not to prejudice consumers against purchasing the products the agents will recommend. Agents expect their companies to be run in a fiscally sound manner as well. Agents expect their companies to provide them with access to products that are competitive in the marketplace and designed to meet the needs that consumers express. They expect their insurance companies to stand behind their products and deal forthrightly with clients when they make claims under their policies. They expect their companies to provide them with support, sometimes in their field work, but more often in home offices, to provide current relevant information on tax and legal issues affecting the products the company's agents are selling, to provide adequate training with respect to product provisions and company sales practices, and to support their individual marketing efforts with company-generated marketing campaigns. Further, agents expect their companies to act within the law with respect to discrimination issues, whether related to age, gender, race, nationality, sexual orientation or political and religious affiliations.

#### 3.2.2.3. Insurance Company and Agent Expectations of Consumers

Insurance companies and the agents that represent them generally have the same expectations of consumers. Both expect consumers to be serious in their attempts to obtain insurance coverage, expecting that the work undertaken in the field--uncovering client needs, designing appropriate solutions, and engaging in the application process--and in the home office, supporting sales activities, carrying the underwriting process to a conclusion, and generating insurance coverage, will lead to placement of the insurance policies for which application was made. Collaterally, agents, though not absolutely entitled to know whether they are competing for an individual's insurance business with one or more other insurance agents or brokers, have the expectation that consumers will not use them simply to obtain information to support a decision they have already made to purchase insurance through someone else who is an unrelated competitor or an insurance agent or broker related to the prospect by blood or marriage.

Agents and insurance companies expect consumers to be forthcoming with the necessary information to make their field and home office underwriting processes function as designed. They expect the information they get from a prospect or client to be truthful, correct and complete, as, for example, when consumers provide information on medications they currently take or doctors they see or have seen in the past, or when financial information is required to substantiate eligibility for a large amount of life insurance or when tax forms or W-2s may be required to substantiate eligibility for the amount of disability income insurance coverage for which a prospect or client is applying. And, of course, insurance agents and the companies

they represent expect individuals seeking insurance coverage to be doing so for legitimate, legal reasons, as opposed to engaging in money laundering activities.

#### 3.2.2.4 Consumer Expectations of Insurance Carriers and Their Agents

Consumers who engage in insurance sales transactions have reasonable expectations that the insurance company representing itself as a financially solid entity is indeed financially solid; that its practices, both corporate and field, fall well within legal and reasonably expected ethical guidelines. Consumers also have a reasonable expectation that the information they share with insurance agents and insurance companies be handled with discretion, that their privacy be maintained, and that whatever information is provided to the insurance carrier be viewed impartially, that is, without prejudice based on illegal discriminatory practices. They have a reasonable expectation that the information they receive about the coverage being sought will be accurate and that any information related to relevant legal or tax issues is current and correct. Consumers expect the agents they work with to be honest and truthful about how policy provisions work and about policy costs, whether fixed or subject to change in the future. They expect that the agents have a marketplace knowledge base that extends beyond the products and services offered through their own companies so that statements related to the competitiveness of products being offered will be accurate. Consumers also have expectations that the agent they have chosen will work in their best interests to do his or her utmost to help them achieve their financial security objectives.

### 3.2.3 The Insurance Broker

Generally, the expectations an insurance company has of its brokers are much the same as the expectations an insurance company has of its agents. What is perhaps the primary difference is the expectation that an insurance carrier will have that a broker represent the company fairly. The notion of fair representation is in some measure different from the notions of honest and accurate representation of a company and its products. Fair representation does not take the place of honest and accurate representation, but rather adds an additional responsibility to the broker working with a prospect or client.

#### 3.2.3.1 Insurance Company Expectations of a Broker

An insurance broker is a salesperson who purports to work for the consumer, as opposed to being an agent, that is, a direct employee of an insurance company, many of whom are captive agents specifically prohibited from selling products or services of other companies. The additional burden this puts on the broker is to research the marketplace for the right products to meet a prospect's or client's needs. This effectively broadens the range of choices the broker must evaluate before making a recommendation. It presupposes that the recommendation the broker makes is in the best interest of the proposed insured. In the same way that anyone in a courtroom wants a fair hearing, an insurance company working through a broker wants a fair evaluation of its product strengths and weaknesses. The expectation, then, is that a broker will seek to meet a particular individual's insurance needs with an open and enquiring mind. It is also expected that if an insurance company product meets the individual's needs best, then its product will be the one recommended, regardless of extraneous issues such as the policy's first-year commission level, renewal payments, available perks associated with meeting specific production goals, or personal relationships at a company home office.

#### 3.2.3.2 Broker Expectations of the Company Represented

Broker expectations of the insurance companies they represent are essentially the same as those that agents have of their insurance companies. Brokers may, however, place some greater emphasis on certain expectations. For example, brokers expect the companies they represent to provide them with *highly competitive* products. This is because insurance brokers take on the potential burden of making two sales every time they set out to make one. The principal sale, of course, relates to the need the prospect or client has for insurance coverage.

The secondary sale, and often the harder one, is to convince the client that the company offering the product recommended by the broker is the one that should be used. This can be an issue for the simple reason that companies that focus solely on brokerage business don't usually market themselves to consumers. Rather, they market themselves to insurance professionals who have the knowledge and experience to judge the utility of the products the company has brought to the marketplace. And while many insurance professionals may not have the expertise to delve deeply into the financials of the company they are recommending, they do have resources to consult ratings agencies and that can provide some basic financial information on the company. Even if this is information the client does not fully appreciate, it is information that can be provided to another trusted advisor, such as an accountant, who may be able to interpret the data more fully. This secondary sale is also sometimes made more difficult because many companies that focus solely on brokerage business are substantially smaller than the financial giants of our industry, a fact that resonates with many consumers, despite the fact that most of the other businesses with which most consumers have relationships in their lives are substantially smaller than the brokerage company that may have been recommended to them.

In addition to the expectation that an insurance company focused on the brokerage market will offer highly competitive products, brokers also may have heightened expectations about service they will receive from a home office or regional company representatives, since nothing binds a broker to a company but the value of its products and the service they and their clients receive. Brokers sometimes have expectations that brokerage-focused insurance carriers will perhaps underwrite cases with a somewhat more liberal attitude toward assumption of certain risk with which the company's underwriting staff has a broad familiarity. This can be one of the reasons a broker recommends one brokerage insurance carrier rather than another.

#### 3.2.3.3 Insurance Broker and Company Expectations of Consumers

The expectations insurance brokers and the companies they represent have of consumers are virtually the same as those of agents and the companies they represent. Brokers expect their prospects and clients to be honest and truthful when it comes to the information they provide during the various phases of the sales process. They expect prospects and clients to be honest with them about their commitment to obtaining coverage and their willingness to do business with the broker.

The companies brokers represent expect the same honesty and willingness to provide information and complete whatever underwriting requirements are necessary. The companies expect the individuals who purchase insurance from them to do so for legitimate and legal reasons, as opposed to engaging in fraud or money laundering.

#### 3.2.3.4 Consumer Expectations of Brokers and the Companies They Represent

Consumer expectations of brokers and the companies brokers represent are essentially the same as those consumers have of insurance agents and the companies they represent. As with brokers and their expectations of the companies they represent, there may, however, be greater emphasis on certain consumer expectations. For example, no one seeks to purchase insurance coverage with the idea that they will be financially hurt in the transaction. Rather, what consumers expect is that they are going to be treated fairly, whether the person they are working with is identified as an agent or a broker. Someone working with a broker, however, has an expectation that the broker will engage in a broader search for the right product to recommend, than would an agent for a specific company. The assumption would be that while an agent might investigate all the products his or her company offers to consumers to see which one would work best for a client, it is a foregone conclusion the agent will sell one of

that company's products. When working with a broker, consumers expect a broker to find the very best product available in the marketplace, generally allowing only concerns about the company's financial stability, customer service, history of policy performance, and, as mentioned earlier, a special expertise to influence a recommendation.

### 3.3 Agent and Broker Expectations and Conflict With the Companies They Represent

The essential conflict between agents and brokers and the companies they represent centers around the overlap of conflicting goals. Agents and brokers—setting aside the very important fact that the work agents and brokers do with and for their clients often proves to be extremely beneficial for the people they help insure, their families, their businesses, and sometimes the charitable entities they support--are, like insurance companies, profit-driven. The selling of insurance products generates their livelihoods, and unless sales occur, agents and brokers in the vast majority of circumstances earn no income. Insurance companies, too, want sales to occur, but they, like consumers and the agents and brokers that represent them, want sales to occur on their own terms.

The desire consumers have for the very best products to meet their needs and be available at the very best (or lowest) price often comes into direct conflict with insurance companies' aim to provide adequate coverage at a price that, at least statistically, has been fixed to generate a profit. The agent, of course, wants to make the sale to please the consumer, but also wants to make a "good" sale that will please the company providing the coverage. Everyone wants to consummate insurance coverage negotiations as a winner. Very often that is possible: A potential insured qualifies for a top-notch policy at the very best rate a company can offer; the company feels confident that it has adequately and correctly underwritten the policy applied for; and the agent gets a check in the mail once the policy is in force.

This is not always the case, however. Sometimes agents will gather information from a prospective insurance buyer and believe the information they've gotten is immaterial to the underwriting of the coverage sought. That same information in the hands of an underwriter may well lead to a rating different from the one the prospective buyer and agent anticipated. At other times, logistics get in the way. When medical information is required, doctors may be away from the offices; they may require not just the insurance company's but also their own authorization to disclose their patient's medical data; they may request exorbitant fees to provide the requested records; incomplete information may be sent; recommendations in a proposed insured's medical records may indicate the need for one or more specific tests or follow-up visits not documented in the records received; proposed insureds may procrastinate in making appointments to complete company medical requirements, or in some cases, initially refuse to complete certain requirements because of the inconvenience, such as treadmill tests or full-blown medical exams. When financial information is required, proposed insureds may be reluctant or simply refuse to provide full financial disclosure because of their concerns about privacy; their accountant may require a signed authorization from a proposed insured or be deep in the midst of tax-season work when a request for financial data comes in; or, as sometimes happens, the financial information that comes in does not match the information on an application or does not support the amount of insurance coverage sought, as might be the case in an estate planning or a disability income insurance sale.

All of these issues hold up the underwriting and issue processes, and may cause an underwriter to scrutinize a case more closely than it would have had the case run more smoothly. In addition, age changes can occur that result in coverage costs higher than discussed and agreed to by the agent and proposed insured. Alternatively, backdating might be requested. Backdating requires payment of second-year premium in less than twelve months from the date a policy is actually received, which can upset some insurance buyers. There is also the potential, particularly in the current market, for products to be re-priced or even removed from the marketplace entirely in the middle of the underwriting process. Extraordinary delays may make it impossible for the insurance carrier to continue to offer the

product for which the client originally applied. In the worst case, it is possible a proposed insured's health or financial condition might change suddenly, affecting the availability of coverage for which he or she applied.

It is easy to see how the foregoing issues might create conflicts between insurance buyers, agents, brokers and the companies to which they apply for coverage, and between agents, brokers and the companies through which they attempt to address their prospect or clients' insurance needs. It is also important to note that companies themselves can be extremely unhappy with insurance buyers and agents or brokers who do not provide full and fair disclosure on the application materials they submit. In this context, an agent or broker that consistently provides incomplete or misleading information on applications will likely find that underwriters at the company come to view him or her as someone acting unethically and in an adversarial rather than a cooperative role, a view that often leads to harsher underwriting review and a decided reluctance to negotiate underwriting decisions.

## 3.4 Potential Conflicts at the Beginning of an Insurance Sales Career

Beyond the very real and important concerns that center on the inherent conflict in sales activities in which every party to the transaction wants to get a great deal, a special deal, to be *the* winner—which can lead individuals to act unethically-- other conflicts with ethical implications exist.

### 3.4.1 The Initial Focus on Family and Friends

Many new insurance salespeople are directed to develop and hone their sales skills by soliciting family and friends about their insurance needs. Theoretically, and in many cases practically, this approach to getting your feet wet in the insurance business pays off. Not only does the new agent get to practice how to approach and work with insurance prospects, but he or she is able to do so in an interpersonal environment that can be safe and embracing, an environment in which the individuals listening to the new agent's sales presentation will not be disturbed by mistakes or memory lapses. Relationships with family and friends often rest on a solid enough footing in trust or the desire to see the new agent succeed in a new occupation that, regardless of what happens, all parties involved are comfortable with one another and with the process in which they are engaged.

The inherent problem that may arise in this approach, however, is that the new agent has not only a desire to perform well when making a presentation, but also a desire to do well for his or her family and friends. This desire has the potential for ethical conflict based on all the things that can go wrong, complicated by the nature of the relationship in which they might go wrong. One can imagine a relative or friend purchasing insurance coverage from a new agent and, upon receipt of the new policy, saying something like: "Wow, this is a great policy and a great price. I am so glad you called on me to help you work on your sales presentation. You did me a really good turn." It's also easy to imagine harsh criticism: "What a rip-off your company is! You really want to work for those guys?" or "You really want to do this kind of work? Disappointing people who trust you?"

Relationships with family and friends come with baggage of one kind or another. Where that baggage lies is not always apparent at the moment a new agent walks through a friend's or a family member's front door.

### 3.4.2 Production Requirements

The imposition of production requirements also puts a lot of pressure on new agents and those that are seasoned. For new agents, the production requirements have to do with the simple fact that without production they will not be able to pay their living expenses, keep their jobs, or, when their company has made it possible for the new agent to participate in a training allowance program, meet the production requirements to keep training allowance income

coming in while they are working to establish themselves. The pressure to produce is very strong on new agents in both circumstances.

With respect to those who must sell insurance to have any income at all, lack of production has the potential to force them out of the insurance business quickly. Before it does so, however, this same lack of production may also single them out in an unpleasant way. Often supervisors will make public the sales activities of individual agents, by posting production results on a readily accessible bulletin board in the office or reviewing results publicly in regularly scheduled sales meetings. In addition, individual meetings with supervisors can place a non-producing new agent under a harsh spotlight. And, in light of the cost to bring a new insurance agent into the business, it is imperative from the employer's perspective that the new agent be a good bet to turn a profit, sooner rather than later if possible, but definitely at some reasonably foreseeable point in the future. The pressure to make a sale is intense.

The potential pressure from peers and supervisors can exacerbate problems a new agent may have acclimating to commission-based insurance sales. This kind of pressure can push individuals to cut corners or engage in unethical behavior as a means to paying their current expenses or to meet the expectations that colleagues have of them. And, of course, when an insurance company has enrolled someone in a training allowance program, it has laid out money to support the new agent that it expects to get back, and it tracks a new agent's development against the production requirements contained in the new agent's training allowance payment plan carefully.

For experienced agents, the issue is not always as simple as feeling pressure to earn enough to pay current business and living expenses. Often, the issue revolves around status and services. What producer club level will the agent qualify for? In what country and at what prestigious hotel or resort will that club meeting be held? How far will the company go to provide extra rewards to that club's members?

With respect to services, the issue is generally focused on two issues: First, how much of the usual expenses that an agent as a business person must assume—for rent and utilities, office supplies, telephone, mailing, photocopying, continuing education or compliance education requirements, secretarial or administrative services, for example—will the office in which the agent is housed or the company itself pick up? How much and what kind of services will the office or company make available to support the agent's prospecting activities—a direct mail allowance, an office-paid solicitor? What level of contributions will be made to the agent's pension or profit-sharing plan?

In addition, while it is not true of every insurance professional, many insurance professionals are highly invested in obtaining the outward signs of success:

- published industry and intra-company recognition of their achievements,
- receipt of awards and plaques,
- upgrades to their office:
    - larger office space,
    - better furniture, or
    - a corner office with wrap-around windows and a great view.

The desire for signs of achievement like these is not intrinsically a bad thing, but the desire for them at all costs may be, since those costs may range from working long hours into the evening and over weekends to the "costs" to one's moral or ethical values when closing a case merely to achieve a sales goal.

#### 3.4.2.1 Additional Pressures

This issue has been alluded to previously in noting that the production results of new agents may come under harsh scrutiny by their supervisors. This additional pressure can be brought to bear either unintentionally or intentionally. Unintentional pressure could come under the guise of "creating a little healthy competition" among new agents by publicly tracking their monthly or annual production on a bulletin board that everyone in the company passes. Intentional pressure could result if a supervisor is concerned about how a new agent's performance reflects on an agent or if a supervisor believes no other approach to getting a new agent to do what has to be done to succeed is working.

The potential for putting additional pressure on new agents to produce, and on seasoned agents as well in some cases, often derives from the fact that supervisory personnel may be judged on their ability to recruit, train and keep new agents, on their ability to support and continue to develop seasoned agents into higher-level producers, or in some cases, both. Promotions and raises in pay grade within their current position may depend on how well those they supervise perform. In other cases, the issue may have a broader impact: A supervisor's income may ultimately depend in large measure on the production of the new and seasoned agents he or she supervises, not so much in terms of incremental salary increases, but in terms of the overrides paid to the supervisor on their supervisees' production. The pressure to make that production happen can then be very strong.

### 3.4.3 Reliance on Unethical Prospecting

There is always an emphasis in insurance sales training to do a good job of providing the right product to meet a prospect's or client's needs, to provide good service following a sale, and to adhere to good ethical practices. It is ironic that many new insurance agents, and some seasoned agents, engage in essentially unethical prospecting practices.

#### 3.4.3.1 The False Referral

The false referral prospecting method works something like this:

> Lance makes an appointment to see Jill, an acquaintance, at Jill's home. Lance and Jill spend more than half an hour talking about various insurance-related issues, but in the end, Jill makes it clear to Lance that she has no interest in purchasing any insurance since she feels well covered through her employment.
>
> Back at his office, Lance gets onto his computer and starts to track down who lives in Jill's neighborhood—not too close, but close enough that the person living there might know Jill. After taking down a dozen or so names and numbers, Lance calls George, who lives down the street from Jill. The call goes as follows:
>
> **Lance**: Hi, George. My name is Lance. I got your name from a friend of yours, Jill. I'm with XYZ Insurance Company and met with Jill recently to discuss some new ideas with her. Jill thought the information I shared with her was so useful she mentioned your name and said you'd be interested in what I have to say.
>
> **George**: Jill?
>
> Lance: Yes, Jill. She said you'd met at a party and spent some time talking to one another.
>
> **George**: I don't remember doing that. You said her name was Jill? I don't recall her.
>
> **Lance**: I hope not remembering that you talked to her at the party won't stop you from giving me the chance to pass on the information Jill thought might be of use to

you. I'm going to be in your neighborhood again next Tuesday. Would it be more convenient for you to meet with me at 5:00 p.m. or would 7:00 p.m. be better?

Obviously, Lance has used the proximity of Jill and George's residences to suggest a nonexistent relationship between the two. After laying the groundwork, Lance moves on to try to set up an appointment. The main issue from an ethical perspective, of course, is that Lance's use of this technique to "break the ice" or slide past George's possible initial defenses against meeting with him is unethical. No matter how interested George turns out to be in what Lance has to say, no matter how beneficial to George and his family the work Lance does for him might be, Lance's contact with George is based on a lie. In this case, most of us would agree that Lance has acted unethically.

#### 3.4.3.2 The Letter Never Sent

Carrie hates doing the same things over and over again, so she devotes her evening to making prospecting calls using a different prospecting technique: The letter never sent.

The letter never sent conversation goes like this:

**Carrie**: Hello, Mrs. Larsen?

**Mrs. Larsen**: Yes?

**Carrie**: My name is Carrie. I'm with the XYZ Insurance Company and I'm calling you this evening to follow up on the letter I mailed you at the end of last week.

**Mrs. Larsen**: I didn't get any letter.

**Carrie**: I'm surprised to hear that. I mailed out letters to a number of people in your neighborhood all at the same time and everyone I've talked to so far has received theirs.

**Mrs. Larsen**: Well, not me.

**Carrie**: That's disturbing. I wanted to make sure you got the important information that was in it. You know, I've made an appointment for next Tuesday at 5:00 to be in your neighborhood. I really want you to have this information, so I'm willing to take the time to stop by and give it to you personally. Would 6:15 Tuesday evening be a good time for me to stop by and see you, or would 7:15 be better?

In this case, whether Carrie actually has an appointment at 5:00 in Mrs. Larsen's neighborhood is immaterial. The principal ethical issue here is that Carrie has lied. She never sent a letter to Mrs. Larsen, or to anyone else in Mrs. Larsen's neighborhood. And there is a chance that Mrs. Larsen will agree to see Carrie, believing perhaps that she inadvertently threw Carrie's letter in the trash or taking at face value Carrie's kindness in offering to meet with her.

#### 3.4.3.3 Offer From the "Expert"

This approach can take a number of forms, but often takes the form of a call in which an insurance agent offers his or her expertise to someone in this way:

**Lance**: Hello, Mr. Alexie?

**Mr. Alexie**: Yes?

**Lance**: Good evening, my name is Lance. I represent the XYZ Insurance Company. I'm calling to offer you the opportunity for a free, comprehensive insurance review that my company has developed.

**Mr. Alexie**: Thanks, but I don't want a review. Besides, I'm not interested in buying any insurance. I'm not even sure I want to keep what I've got.

**Lance**: I'm not calling to sell you insurance, Mr. Alexie. At this point I don't even know if you need insurance. But the concerns you've just expressed are great reasons to take advantage of what my company and I are offering. This kind of in-depth estate planning review can help you come to a clear decision about whether the insurance you've got is worth keeping in light of your real needs as opposed to the needs someone else might have said you have, or it can show you how you can cut your costs so that keeping the coverage you actually do need won't be so financially damaging. Either way, you've got nothing to lose and a great deal to gain—whether it's peace of mind or some extra money in your pocket. I'm going to be seeing someone in your neighborhood early next Tuesday evening. Would it be convenient for me to stop by to see you afterwards at about 6:45, or would 7:15 be better?

Another approach Lance could have taken would be to present himself as someone with a specific expertise – as an estate planner, for example. Lance's response to Mr. Alexie would then have gone more like this:

**Lance**: Good evening, Mr. Alexie. My name is Lance. I'm an estate planner working with XYZ Insurance Company. The company is reaching out to the community through its expert field staff to make sure people get the information they need to protect themselves and their families from the economic hardships that result when people don't have an adequately prepared estate plan in place. As you're probably aware, current estate planning laws are in turmoil and have left a lot of people in doubt as to what to do. This is where I, as an estate planner, can be of assistance. I'd like to stop by and see you next Tuesday when I'm in your area seeing another of my clients. Would 7:15 be a good time, or would 7:45 be better?

As many of you can readily imagine, this explanation may not lead immediately to Mr. Alexie agreeing to meet with Lance, but Lance has an arsenal of issues he can raise to attempt to disturb Mr. Alexie's sense of well-being and sway Mr. Alexie to accept an appointment. Lance could use:

- the dreaded specter of intestacy and how it could take control of Mr. Alexie's assets if he doesn't take action,
- the dreaded impact of the "death tax" that now affects so many more people on a state level than ever before,
- the havoc outstanding mortgages and other consumer debt can wreak on a spouse faced with the task of raising minor children,
- the impact of poor planning on the hopes and aspirations of children denied a college education, and so on.

The question is: Is Lance the estate planning expert he says he is? In this case, unfortunately, he is not. His "estate planning" process consists of asking a potential client some rudimentary questions about current and long-term earnings prospects, financial obligations and desires, current income and anticipated earnings growth, paying off a mortgage in the event of premature death, or guaranteeing one or more minor children with access to substantial funds for college; along with some questions about whether Mr. Alexie and his wife have wills (with no mention of any other useful documents, such as powers of

attorney or advanced care directives encompassing the provisions of a living will and a healthcare proxy, or the potential benefits of gifting or trust planning).

Once he's got his simple fact-finding completed, Lance will take it back to his office, run the data he's collected on the Alexies and their current insurance coverage through a simple computer program he's been provided by his company and present them with his "expert" estate planning advice. The Alexies can purchase an insurance policy, resulting in an increase in their current coverage or replacement of existing policies.

It is possible that the rudimentary fact-finding Lance conducts with the Alexies and his review of their life insurance policies may well offer them additional insurance protection options that serve to meet their estate planning needs. And it can be argued with a great deal of transparency not only that life insurance planning, absent any more sophisticated or broad-based considerations, is indeed estate planning, but also that often it is, in tandem with execution of the basic estate planning documents such as a will, durable powers of attorney and advanced care directives, the only additional estate planning in which many couples need to engage. What is unethical in Lance's approach, however, is his presentation of himself as an *estate planning expert* when he is not and his misrepresentation of his objective, which was to sell them new life insurance coverage, either in addition to what they already have or replacing it.

### 3.4.4 Added Pressure of a Depressed Economy

It has been noted in a wide variety of contexts that *insurance is not bought, but sold*. Certainly, this statement can be challenged when it comes to certain types of property and casualty insurance or under those circumstances in which a bank, another financial institution or a business entity requires an insurance purchase under the terms of a specific transaction, such as requiring life insurance on the principals of a firm when providing the firm with an open line of credit or when the purchase agreement for a business entity requires life insurance coverage on one or more key persons whose expertise and guidance are desirable or even necessary in effecting the beneficial transfer of the business to its new owners.

It bears noting that it is harder to sell insurance coverage, particularly life, disability, and long-term care insurance, to individuals when the general economy is in recession or depression. This is obvious to the extent that we understand that large numbers of people find themselves more hard-pressed to pay their daily living expenses in difficult economic times than in boom times when interest rates are higher or the securities markets may be more robust, when base salaries and periodic raises for salaried employees may be bigger, when credit is more readily available, and when businesses, large and small, are turning a meaningful profit. What is ironic, of course, is that it is in difficult economic times that insurance protection takes on greater importance. The premature death or protracted disability of a wage earner, with or without the need for additional long-term care services, has the potential to be more serious in difficult economic times than in times less economically stressful.

A depressed economy puts pressure on ethical values in at least two potential ways. First, there is the added pressure on brokers and agents to sell insurance products. More difficulty meeting daily living expenses focuses consumers on those expenses, rather than on the insurance protection that would make it possible to pay those expenses in the event of premature death or disability. Needs that are considered more basic than being properly insured take precedence: the need to pay a mortgage or monthly rent, the need to buy food, pay the gas, electric and phone bill, and so on. Insurance premiums somehow take on the aura of discretionary payments.

Conversely, in those situations in which individuals recognize the need for insurance protection for themselves and their families, there may be pressure due to difficult economic conditions to attempt to obtain insurance protection at the best rates by gaming the underwriting process with incomplete or misleading information, or in the case of indemnification contracts, gaming

the claims system by providing what may be substantially exaggerated or entirely false information to qualify for benefit payments. State insurance department websites and a number of insurance information and news services routinely inform us of insurance scams, from fraudulent disability claims to purchases of life insurance with the intent to do away with the insured. Difficult economic times historically tend to coincide with increases in a wide range of criminal activity, including insurance fraud.

### 3.5 Review Section

QUESTION 1: Refer to Section 3.1.1, page 7

The obvious **strength** of a rules-based approach is:

ANSWER: T

Individuals subscribing to those rules know exactly what is expected of them to be deemed *ethical individuals*.

RESPONSE: A

Your answer is correct. The obvious **strength** of a rules-based approach is the fact that individuals subscribing to those rules know exactly what is expected of them to be deemed *ethical individuals*.

ANSWER:

It is results-oriented and can derive the "best" decision from investigation of the consequences and the individuals affected.

RESPONSE: B

Your answer is incorrect. This is not the strength of a rules-based approach.

ANSWER:

It is rigid.

RESPONSE: C

Your answer is incorrect. This is actually a weakness of a rules-based approach.

ANSWER:

It allows the decision-maker to take into account the facts and circumstances surrounding the situation.

RESPONSE: D

Your answer is incorrect. This is not the strength of a rules-based approach.

QUESTION 2: Refer to Section 3.0, page 6

Compounding the difficulties inherent in making ethical decisions is the fact that:

ANSWER: A

There are no formalized approaches to doing so to help decision-makers.

RESPONSE:

Your answer is incorrect. Compounding the difficulties inherent in making ethical decisions is the fact that there are a variety of formalized approaches to ethical decision-making.

ANWSWER: B

Anything goes with respect to making ethical decisions

RESPONSE:

Your answer is incorrect. Compounding the difficulties inherent in making ethical decisions is the fact that there are a variety of formalized approaches to ethical decision-making.

ANSWER: T

There are a variety of formalized approaches to ethical decision-making.

RESPONSE:

Your answer is correct. Compounding the difficulties inherent in making ethical decisions is the fact that there are a variety of formalized approaches to ethical decision-making.

ANSWER: D

Formalized approaches to ethical decision-making always lead to chaos.

RESPONSE:

Your answer is incorrect. Compounding the difficulties inherent in making ethical decisions is the fact that there are a variety of formalized approaches to ethical decision-making.

## 4.0 Available Guidance

Ethical guidance for insurance professionals comes from a number of sources: some national, some company-based and some local.

### 4.1 The National Association of Insurance Commissioners

Concern over ethical guidance is not new. Rather, it has been evident for many decades and comes from various entities and a number of directions. The National Association of Insurance Commissioners (NAIC), for example, has been in existence since 1871, when it was created by state insurance regulators for the purpose of protecting the interests of consumers purchasing insurance policies by supporting state insurance regulators' efforts to fulfill their responsibilities and protect the interests of consumers. The initial immediate goal of the NAIC was to address the need to coordinate the regulation of insurance companies that did business in more than one state. The NAIC initially addressed this need by developing a uniform set of financial reporting guidelines.

As presented on its website:

> The mission of the NAIC is to assist state regulators, individually and collectively, in serving the public interest and achieving the following fundamental insurance regulatory goals in a responsible, efficient and cost effective manner, consistent with the wishes of its members:
>
> - Protect the public interest;
> - Promote competitive markets;
> - Facilitate the fair and equitable treatment of insurance consumers;

- Promote the reliability, solvency and financial solidity of insurance institutions; and

- Support and improve state regulation of insurance.

In pursuit of these goals, the NAIC provides support to state regulators in a wide range of ethics-related areas through its various divisions. For example, the Executive Division of the NAIC includes not just Finance, Business Strategy and Risk Management Departments, but also a Compliance Department. The focus on compliance issues has been very strong as insurance products have become more and more complex or related to performance in the securities markets. The NAIC Communications/Media Relations Department promotes consumer insurance education throughonline education. The Legal Division researches and analyzes developments in insurance law and serves as a key player in the development of NAIC Model policy forms and regulations, along with the Regulatory Services Division.

### 4.1.1 First IMSA, Now CEFLI

The Insurance Marketplace Standards Association (IMSA) was founded in 1996 for the express purpose of fostering the implementation of ethical practices in the insurance marketplace from the top down, that is, through commitments from individual insurance companies to develop and implement ethical practices for their home office and field personnel. To become a member of IMSA, a company not only had to subscribe to its Principles of Ethical Market Conduct, but also undergo an extensive review of its current practices. This review was two-pronged: One review would be conducted internally by members of the company; a second review would be undertaken by an independent IMSA-approved Assessor.

To pass muster, a company had to meet standards in the 144 specifics of company conduct that addressed the IMSA Principles of Ethical Market Conduct, which included the adherence to and promotion of:

- high standards of honesty and fairness,

- competent and customer-focused sales and service,

- active and fair competition,

- advertising which is clear as to purpose and honest and fair in content,

- fair and expeditious customer complaint and dispute handling, and

- an established system of supervision and monitoring.

IMSA members that were approved after both reviews gained the privileges of being able to advertise their IMSA qualification and display the IMSA logo on their promotional materials. To maintain these privileges, an IMSA-approved company needed to undergo reassessment and requalify every three years.

The creation of IMSA shined a spotlight on insurance industry concern for ethical conduct and the commitment of participating companies to follow through on that commitment through self-regulation. On September 20, 2010, the Board of IMSA voted to disband IMSA and form a new organization, the proposed name of which was the Life Insurance Forum for Ethics and Compliance (LIFEC). This transition was proposed based on the belief of the IMSA Board that IMSA had achieved the main goals it had set out at inception. The new organization would take as its focus compliance support and education, shifting its focus from company assessment and certification. On October 19, 2010, the membership of IMSA—the companies it had certified—voted to disband IMSA and create a new organization with the stated education and compliance goals of the proposed LIFEC, but with a different name: The Compliance and Ethics Forum for Life Insurers (CEFLI).

### 4.1.2 State Insurance Laws and Regulations

Organizations like the NAIC and CEFLI provide invaluable ethical guidance to and through insurance companies, to their home office and field staffs. In addition to any ethical guidance that may come from those organizations, insurance companies and field personnel must abide by the insurance laws and regulations of the states in which they carry on business activities.

Each state has a body of law that governs every aspect of insurance-related transactions. These laws and regulations are principally enforced by each state's insurance department. Individuals who seek and obtain licenses to sell insurance products in a given state are issued licenses under the presumption that they will abide by all existing insurance laws and regulations. To support this assumption, every state insurance department has a consumer protection arm that monitors complaints against the insurance companies admitted to do business in the state and the licensed insurance professionals who represent those companies. When insurance companies violate state laws governing how they can conduct their business, they may be subject to substantial fines or, in the worst case, loss of their ability to conduct business within a state's borders. Individuals who violate insurance laws and regulations in their dealings with consumers will find themselves potentially subject to a wide range of penalties, including censure, fines, mandated restitution, license suspension, license revocation, and possibly civil lawsuits or, if their activities are of a criminal nature, arrest and imprisonment. What adds weight to the penalties that companies and individuals suffer is that they are generally made public, if not in the news media, then in insurance department publications or on their websites.

### 4.1.3 Company-based Guidance

Individual insurance companies—clearly those that subscribed to and were admitted to IMSA membership—promote ethical conduct among their employees in a number of ways, both with respect to relevant state laws and regulations and the relatively new federal regulation requirements generated since 2010. In some cases, insurance companies will generate a code of conduct that they publish and provide to every individual employed by the company. Sometimes a code will simply state very general ethical principles; other times it will address specific activities in which the individuals to whom the code is addressed are engaged. The code of conduct a company might generate for its office staff has the potential to differ substantially from one that might be published for its field sales force.

Companies also provide ethical guidance through company memos and bulletins. For example, a company might periodically issue a bulletin reminding employees that it is unethical and against state insurance department regulations to disparage another insurance company or other company's representatives. A company might also periodically remind its field underwriters that they need to be in compliance with the company's Anti-Money Laundering education requirements.

The institution of company manuals outlining the practices required to engage in relevant insurance transactions also gives a company an opportunity to convey ethical principles to its home office or field underwriters. A training or procedures manual for a policy owner service representative would specifically list who may be given information about a specific insurance policy, along with what would be required before one of the individuals who is not entitled to receive information about the policy could obtain it: For example, a writing agent, a general agent, and a policy owner are entitled to information about a life insurance policy, but an insured's accountant or investment advisor is not, unless he or she has been specifically authorized to obtain policy-related information by the policy owner.

Field underwriting manuals often convey ethical principles related to field sales work, though not specifically in the form of a field underwriter's code of ethics. For example, with respect to the agent report section of an application, a paragraph in a field underwriter's manual might address a question on the application about whether the field underwriter personally saw and asked all the questions on the application. The directions in that paragraph may state very

clearly that the only time a field underwriter can answer that question with a *yes* is when he or she has actually seen the proposed insured and actually asked the proposed insured all the questions on the application. It may go on to further state that it is not permissible to obtain the answers to the questions over the telephone, through mail, or from someone other than the proposed insured. The focus of these directions is to make clear to the agent what is ethical and what is not when getting answers to questions on an application. What is permissible is ethical and acceptable from a company standpoint; what is not permissible is unethical and unacceptable.

### 4.1.4. Professional Creeds and Society Codes of Ethics

Many individual insurance practitioners want to expand their knowledge base, enhance their professional standing, and the range of sophistication they can bring to their work. These individuals look beyond what they have an opportunity to learn through their primary company or presentations made available to them through their broker relationships or access to programs presented by local professional organizations to more formal courses of study that require them to pass a number of relatively sophisticated examinations toward the goal of earning a professional insurance designation, such as those offered through the American College of Financial Services in Bryn Mawr, Pennsylvania. In some cases, a measure of classroom attendance is required, as with Masters Degree programs offered through the American College; while in others, such as studying for CLU (Chartered Life Underwriter) or ChFC (Chartered Financial Consultant) designations, classroom attendance or home study is an acceptable exam preparation.

On completion of a professional designation program (and sometimes while in the process), membership in an insurance professional organization is possible. Whether an insurance professional joins a professional organization while studying to achieve a designation or after receiving it, access to membership requires an affirmative statement that the individual seeking membership will abide by some kind of ethical code.

For example, individuals who join the Society of Financial Service Professionals (SFSP) are required to act in an ethical manner through adherence to the CLU Creed and the Society's Code of Professional Responsibility.

The SFSP Code of Professional Responsibility is more extensive, addressing ethical principles in more detail. It contains a Preamble (brief introduction) to the Code, including its history and purpose. Following the Preamble are a series of Canons that lay out general goals of ethical behavior, as opposed to addressing specific ethical behaviors. Following the Canons are rules that lay out the standards the SFSP has adopted for its membership. These are the rules that individuals who wish to remain in good standing in the SFSP must follow. To aid the membership in doing so, the Code presents a number of applications or practical examples in which the membership can see how the Canons and rules are applied. The Code ends with a presentation of the procedures to be instituted when a member of the SFSP violates one of the Canons or rules.

### 4.1.5 Violation of Ethical Guidelines

Individuals or entities that violate the ethical precepts by which they have agreed to conduct themselves face penalties for their actions. These penalties can range from censure to revocation of a company's right to conduct business activities in a specific state; for an individual, the penalties might extend beyond censure to fines, license suspension or license revocation. When civil or criminal charges are brought against an entity or individual, the penalties can go well beyond those that might be imposed by a state insurance department to levy a fine or prohibit a company or individual from conducting business within a state's borders or a professional society's ability to expel a member and prohibit him or her from using the society's professional trademark.

Beyond the damage that can be done to the image of a company or individual in the professional community and in the larger community within which he or she lives and works, and beyond the economic loss that might result for an insurance company or an individual from being prohibited from engaging in insurance business within a state's borders, is the damage—psychological, emotional, and economic—done to consumers whose trust has been betrayed and whose financial security may have been seriously compromised.

### 4.2 Review Questions

QUESTION 1: Refer to section 4.1, page 24

The NAIC was created for the purpose of:

ANSWER: A

regulating state insurance departments.

RESPONSE:

Your answer is incorrect. The NAIC was created for the purpose of protecting the interests of consumers purchasing insurance policies.

ANSWER: B

protecting insurance agents and brokers from unscrupulous consumer actions.

RESPONSE:

Your answer is incorrect. The NAIC was created for the purpose of protecting the interests of consumers purchasing insurance policies.

ANSWER: C

regulating financial advisors' interactions with insurance companies.

RESPONSE:

Your answer is incorrect. The NAIC was created for the purpose of protecting the interests of consumers purchasing insurance policies.

ANSWER: T

protecting the interests of consumers purchasing insurance policies.

RESPONSE:

Your answer is correct. The NAIC was created for the purpose of protecting the interests of consumers purchasing insurance policies.

QUESTION 2: Refer to section 4.1.1, page 25

IMSA, the Insurance Marketing Standards Association, changed its name ultimately to the Compliance and Ethics Forum for Life Insurers (CEFLI) principally because:

ANSWER: A

The new name had more industry appeal.

RESPONSE:

Your answer is incorrect. IMSA, the Insurance Marketing Standards Association, changed its name ultimately to the Compliance and Ethics Forum for Life Insurers (CEFLI) principally because the IMSA board believed the organization had accomplished its goals.

ANSWER: T

The IMSA board believed the organization had accomplished its goals.

Your answer is correct. IMSA, the Insurance Marketing Standards Association, changed its name ultimately to the Compliance and Ethics Forum for Life Insurers (CEFLI) principally because the IMSA board believed the organization had accomplished its goals.

RESPONSE:

ANSWER: C

The IMSA board believed that the organization's goals were unattainable.

RESPONSE:

Your answer is incorrect. IMSA, the Insurance Marketing Standards Association, changed its name ultimately to the Compliance and Ethics Forum for Life Insurers (CEFLI) principally because the IMSA board believed the organization had accomplished its goals.

ANSWER: D

Insurance companies refused to cooperate with IMSA in any way.

RESPONSE:

Your answer is incorrect. IMSA, the Insurance Marketing Standards Association, changed its name ultimately to the Compliance and Ethics Forum for Life Insurers (CEFLI) principally because the IMSA board believed the organization had accomplished its goals.

## 5.0 "Star Trek" and the Hippocratic Oath

What "Star Trek" and the Hippocratic Oath have in common is a focus on a paramount guiding principle: *First, do no harm*. Star Fleet officers, crew and medical practitioners since (and perhaps before) the time of Hippocrates take as a guide this seemingly simple and straightforward principle. It is the paramount guiding principle that should apply to the work in which insurance professionals engage with prospects and clients.

The problem, however, is this principle only *seems* simple and straightforward, as "Star Trek" episode after episode and news story after news story have shown us. "Star Trek" and news stories notwithstanding, this simple directive gives us insight into the role insurance professionals should adopt. To suggest that insurance professionals should adhere to the principle that one should do no harm places the insurance professional in the role of mediator, attempting to address multiple needs and concerns simultaneously: those of a prospect or existing client, those of the insurance carrier the professional is recommending, and those personal and professional concerns the insurance professional brings to any insurance transaction. To the extent that insurance professionals can stand outside themselves and at the center of often competing needs and demands, they can address the transactions in which they are being engaged in an ethical manner.

### 5.1. Who's the Chump at the Table?

The role of a mediator is to attempt to provide every party in a transaction with equitable treatment. This notion of equitable treatment often arises in insurance work with respect to

the wealth transfer plans parents make for their children. It arises when there are multiple children, only one or some of which will inherit all or a disproportionately large interest in a successful, family-owned business. It arises when children have chosen life paths that may bring one to substantial wealth and another to a more modest lifestyle: The child who becomes a successful surgeon and the child who pursues a career as a public school teacher, artist or dancer, respectively.

In these cases, the notion of equity is laid side-by-side with the notion of equality, a comparison that often leads to wealth transfer decisions that are, in the case of many business transfers like the one mentioned, designed to provide what is determined to be equal dollar value to all children through the purchase of an insurance policy, the proceeds of which are principally paid to those children inheriting less valuable or no family business interests. In the case in which different children enjoy different levels of economic success, parents often choose to make a disproportionately larger transfer of their wealth to a child whose career path provides a more modest lifestyle to provide that child with the opportunity to enjoy a lifestyle more "equal" to that of his or her siblings. Whether these types of wealth transfers achieve the equitable or equal distribution goals of the transferors in these cases is not clear. What is clear in the vast majority of these types of wealth transfer decisions is that parents don't want any of their children to feel they have been harmed.

When it comes to an insurance transaction, the three principal partners are: the owner/insured, the insurance professional and the insurance company. The insurance professional's job as mediator is to make sure no one involved winds up the chump at the table. One or another of the parties could find the transaction unsatisfactory in the end. A prospect or client could find that he or she has paid more for insurance coverage with the company their insurance professional represented than could have been available from another agent representing another company. The insurance professional could find he or she has been working with someone who seemed on the surface to be a preferred, insurable risk, only to find out after an insurance examination that the individual had serious, as yet undiscovered, medical problems that made obtaining insurance coverage impossible. A company could find that it has taken on a risk it did not anticipate when a client who honestly obtained insurance coverage as a nonsmoker decides to stop exercising and take up smoking. The question to ask: Is anyone at the table a chump? The answer in these situations is *no*.

There is virtually always a chance an individual can purchase insurance coverage at a lower price than he or she currently pays. Term rates change in one company or another—most frequently getting reduced—on a monthly basis. Interest rates and securities market performance projections change with the ups and downs of the economy, resulting in higher or lower current and future premium cost projections. Consumers ignore the value—difficult as it is to express in dollars and cents—of the insurance professional who has brought them to the table to consider their needs and moved them to take action to satisfy those needs. There is always a chance that some adverse or even potentially life-threatening medical condition can develop in a person between doctor visits, often, as in the case of high blood pressure or the early stages of a wide range of cancers, with no immediate recognizable symptoms that would send someone to a doctor to seek treatment. And people make lifestyle changes all the time. Underwriting is always a snapshot, and though it takes into account past medical history, it is never a complete life story.

An insured that places no value on the services provided by the insurance professional may be unhappy with the price paid for insurance coverage. The agent, who has spent time, energy and perhaps incurred substantial travel expenses only to find the individual who seemed an ideal prospect actually turns out to be uninsurable, may be unhappy about his or her investment in an unsuccessful insurance case. An insurance company that must pay a claim far in advance of when its underwriting would have predicted it would pay that claim, would probably be unhappy about the outcome of that particular transaction. No one, however, could be considered the chump at the table in any of these transactions; and one could presume, based on what is presented, these transactions were conducted in an ethically sound manner.

## 5.2 REVIEW QUESTIONS

QUESTION 1: Refer to Section 5.0, page 29

What "Star Trek" and the _____ have in common is a focus on a paramount guiding principle: *First, do no harm*.

ANSWER:

NAIC

RESPONSE: A

Your answer is incorrect. What "Star Trek" and the Hippocratic Oath have in common is a focus on a paramount guiding principle: *First, do no harm*.

ANSWER:

The Empirical Code

RESPONSE: B

Your answer is incorrect. What "Star Trek" and the Hippocratic Oath have in common is a focus on a paramount guiding principle: *First, do no harm*.

ANSWER:

Seller's Statement

RESPONSE: C

Your answer is incorrect. What "Star Trek" and the Hippocratic Oath have in common is a focus on a paramount guiding principle: *First, do no harm*.

ANSWER: T

Hippocratic Oath

RESPONSE: D

Your answer is correct. What "Star Trek" and the Hippocratic Oath have in common is a focus on a paramount guiding principle: *First, do no harm*.

QUESTION 2: Refer to Section 5.1, page 29

The role of a(n) _____ is to attempt to provide every party in a transaction with equitable treatment.

ANSWER:

broker

RESPONSE: A

Your answer is incorrect. The role of a mediator is to attempt to provide every party in a transaction with equitable treatment.

ANSWER:

insurance agency

RESPONSE: B

Your answer is incorrect. The role of a mediator is to attempt to provide every party in a transaction with equitable treatment.

ANSWER: T

mediator

RESPONSE: C

Your answer is correct. The role of a mediator is to attempt to provide every party in a transaction with equitable treatment.

ANSWER:

lawyer

RESPONSE: D

Your answer is incorrect. The role of a mediator is to attempt to provide every party in a transaction with equitable treatment.

## 6.0 The Three M's: Misconduct, Misrepresentation, & Mismatching

The remainder of this course will focus on examples in which insurance professionals act unethically. The distinctions made in this section among *misconduct, misrepresentation* and *mismatching* are not hard and fast distinctions as the first example will show. The agent in this case may be considered to be engaging in all three.

### 6.1. Misconduct: Acting as if...

Nelson has an appointment with Judith. Judith is interested in investing funds she inherited to supplement her current retirement income sources. She's heard a great deal about index annuities and how they offer protection from loss of capital investment. Their conversation, in part, goes like this:

> **Nelson**: I'm very glad to have the opportunity to meet with you to investigate your interest in purchasing an index annuity.
>
> **Judith**: What caught my eye was that this type of annuity guarantees return of your principal. Are you familiar with this kind of annuity and am I right about the guarantee?
>
> **Nelson**: I am very familiar with index annuities and am well-versed in the features and benefits they offer. You are absolutely right. Index annuities have very competitive fixed rates of return; so from the first day you invest, you can't lose a dollar when the market goes down.
>
> **Judith**: I really don't know much about these policies, so I don't really understand about not losing anything when the market goes down. I thought this annuity had a really long-term guaranteed rate, one that would get me substantially more than I'm getting in my bank savings account right now and more than I could get if I just got a fixed interest rate annuity, like the ones with a couple of years of guarantees that my bank keeps trying to sell me.

> **Nelson**: It does have a guaranteed rate; it will get you more than you're getting in the bank accounts you've got your money in right now and more than regular bank annuities could pay. Let me explain. The money you deposit into the annuity gets reinvested in the market indirectly, by getting tied to a stock index like the S&P 500 that has 500 different stocks in it. The stock index is always moving, sometimes going up, sometimes going down. When it goes up, your policy value will go up based on how much the stock index increases. On the other hand, when the stock index goes down, you don't lose a thing. Only growth in the index affects your earnings.

If you have some familiarity with index annuities, you may be asking yourself, "*Where should we start to address the inaccuracies in Nelson's presentation?*" The best place to start is with Nelson's statement about his familiarity with index annuities.

It's hard to believe that Nelson is familiar with index annuities beyond the most cursory level. For example, it is true that index annuities have fixed rates of return, but the fixed rate of return is the minimum guaranteed return built into the index annuity contract. In many index annuities, the guaranteed rate is as low as 1%. This rate is not what would normally be considered a *competitive rate*. Nor are these minimum guaranteed rates the competitive rates that would be quoted in any kind of advertisement for or article on index annuities. Rather, the rate more likely be addressed in an article as *competitive* would be the cap rate at which the annuity would post earnings, a contractual rate that should be addressed along with any participation percentage that might apply. Nelson should also have noted that there is no absolute guarantee that an index annuity will outperform a "regular" multiyear guarantee annuity.

It's also not accurate to say that the money used to purchase an index annuity is "reinvested in the market indirectly" or any other way as far as the owner of the annuity is concerned. The funds are not reinvested there, at least not by the purchaser of the annuity.[1] And further, the earnings on the purchase price of an annuity invested by the insurance carrier will have no bearing on the earnings credited to the annuity itself (though consistently low-earnings insurance carrier investments might eventually lead to changes in annuity caps and participation rates that would ultimately affect annuity earnings). Certainly, as they might apply to the index annuity products Nelson has available to sell Ms. Consumer, one would expect him to caveat his statement that "policy value will go up based on how much the stock index increases" with additional information on those index annuity elements that have the potential to limit earnings in the annuity.

Whatever good intentions Nelson has in meeting with Judith, he is acting unethically when he states he is familiar with index annuities and well-versed in their features. The impact of his unethical behavior is compounded by the fact that what little knowledge he does seem to have, he presents inaccurately or in a misleading manner.

## 6.2 Twisting and Churning

Twisting and churning are some of the oldest and, unfortunately, most common unethical practices in the insurance market. From a distance, twisting and churning can look very much alike, but they are not. Twisting is the practice of convincing someone to move forward with a replacement of their current insurance coverage for the sole purpose of benefitting the insurance agent recommending the replacement. It is a practice that can be engaged at any

[1] In the past it was common to call these annuities "equity index annuities," but the term fell out of favor because it misleadingly implies that a consumer is investing in stocks. They are not investing in stock.

time in an insurance agent's career, and will be influenced by how much the agent will earn on any individual case.

Churning, on the other hand, often occurs in the early years of an agent's career or at certain times when an agent makes a career change that affects him or her adversely, such as when an agent who has done substantial business with one insurance company decides, or has the decision made for him or her, to move to another company. The agent may seek, either quickly or over a protracted period of time, to move all of the individuals to whom he or she sold insurance from their old insurance company over to a new one. Like a twisting transaction, a churning transaction will generate income for the agent, and this may be the principal motivation for engaging in churning, since it is common for companies that have a career agent field force to stop paying renewals to a career agent who leaves the company to work elsewhere. Of the two, twisting is more closely associated with deceptive or misleading practices, actions that make the transaction look as if it is in the best interests of the insured, and may be anything but. The very word, *twisting*, has a harder edge than does churning.

Alternatively, churning may, through the quick generation of a stream of insurance business over a short period of time, serve to impress a new insurance carrier with which an agent has arranged to write business, making it look as if the agent is a successful producer, which may or may not be the case. From a distance, churning looks the same whether it is being done by an experienced agent to replace lost renewals or by a new agent changing companies because he or she has not met production goals required to maintain employment with a company (if a career agent) or have access to its products (if a broker).

## 6.3 Forging a Client's Signature

It seemed, suddenly, that things couldn't get any worse for agent Kim and her relationship with Terry. Not only had it taken nearly three months to get an appointment with Terry, but during that time and at the meetings Kim had with Terry, Terry had been what can only be described as *nasty*. Terry stated more than once that he thought all financial institutions were out-and-out crooks, and that their henchmen—bankers, lawyers, investment and insurance sales staff—were untrustworthy and worthless parasites feeding off the people in society who did real work. Kim was sure that Terry meant her along with everyone else. And when it had come to completing the application, Terry challenged the need for every bit of information Kim asked for, questioning not only Kim's motives, but the notion that any information he gave Kim would remain confidential and safe.

Worst yet, it had snowed all night before Kim's 9:00 a.m. appointment with Terry. Kim was still reeling physically at 3:00 p.m. from having started her day at 5:00 a.m., shoveling a foot of snow from her driveway so she could spend nearly two intense hours on slippery roads at 25 miles an hour to make her appointment on time. And there, in front of Kim on her desk was the company copy of Terry's Authorization and Consent to HIV Testing—unsigned. Kim couldn't believe that signing this form could have escaped her notice during her meeting with Terry after she'd gone through the form so thoroughly, marking every place that signatures were needed. She couldn't believe this happened.

Raising her head, Kim looked at her phone. She reached for it and picked up the handset. She put it to her ear and listened to the dial tone buzz in her ear for what seemed like more than a minute before a recorded voice told her that if she wants to make a phone call she should hang up and try again. As Kim put the handset back in its cradle, she said to herself, "Thanks, but no thanks."

Kim found another form Terry had signed and took it and the Authorization and Consent to HIV Testing that Terry hadn't signed over to her window. Then she held the two forms up so the light shone through them, matching up the lines on which Terry's signatures should go. Once that was done, she took a pen out of her jacket pocket and traced Terry's signature on

the HIV Authorization and Consent form. Even as she walked back to her desk, Kim dreaded the fact she would have to see this buyer again to deliver his policy, pick up a check and have him sign the policy delivery receipt.

One can't help but feel sorry for Kim and her experience, not just with Terry, but the weather conditions that made her day so long and miserable. What one can't do, however, is ethically justify Kim's decision to forge Terry's signature on the company copy of the Authorization and Consent for HIV testing or on any other document that was supposed to have been signed by a prospective insured. Had Kim simply needed to add other information, such as dates to pages of the application, she would not be acting unethically. It is the privileged nature of each individual's signature that makes what she did wrong.

## 6.4 Company Bashing

Nancy works for XYZ Insurance Company, a career agency that allows her to sell only its products. She's a relatively new career agent, still working her way through her training allowance program, attempting to firmly establish herself in the life insurance business and having difficulty arranging consumer meetings. One of the calls that turned out better than most has lead her to arrange a meeting with Carol, who is interested in purchasing some insurance to cover the mortgage she recently refinanced at a substantially higher rate than her original note. Here, in part, is how their meeting goes as Nancy reaches into her briefcase and takes out an application.

> **Nancy**: I'm happy to tell you about the term insurance products offered by XYZ. As with all insurance though, there's no guarantee that you can get the coverage you want until you've completed an application and submitted it for review by our underwriters.
>
> **Carol**: I don't know, I guess I should have mentioned this before, but I kind of set up another appointment to see somebody about this.
>
> **Nancy**: Oh, yes, well, let me ask you this: Is the price on the coverage we discussed one you could pay?
>
> **Carol**: Yes, I don't think that's a problem.
>
> **Nancy**: Good. Is there any reason you wouldn't do business with me?
>
> **Carol**: No, you've been very helpful and I really appreciate the time you've spent, but I just made this other appointment.
>
> **Nancy**: I understand, and what company is that with?
>
> **Carol**: The company the other agent mentioned was one I hadn't heard of before: ABC Assurance.
>
> **Nancy**: Oh, really?
>
> **Carol**: Yes. Why? Is there something wrong?
>
> **Nancy**: Well, I shouldn't really say this. The company might be a fine company, but, I mean, you've heard of my company haven't you?
>
> **Carol**: Of course.
>
> **Nancy**: Then I guess I'm having trouble trying to understand why you might want to purchase insurance from some company you never heard of, I mean, some company that doesn't even tell people that it's around. What kind of business does that?

**Carol**: What do you mean?

**Nancy**: I guess what I'm saying is, wouldn't a company that had a good reputation and provided consumers with competitive insurance products want to let people know it exists? What kind of business doesn't advertise itself? And who is this agent that represents a company that's afraid to make itself known to the public? I mean really, I don't want to stop you from meeting with someone else, but I'd urge you to at least choose a company that's doing business out in the open and not one that comes out of nowhere.

What Nancy is doing here is called company bashing. She could be more brazen, saying outright that ABC Assurance is a terrible company to do business with, that its products are too expensive and don't have the same beneficial features as hers do, and so on. Even though she hasn't said anything specific about ABC Assurance, what Nancy is attempting to do is undermine a homeowner's confidence that she's made a reasonable choice to meet with another insurance agent; even mentioning something as seemingly innocuous as a news story about a company, if it is not positive, can be construed as subtle company bashing. In this case, Nancy is actively suggesting that something might be wrong with ABC Assurance because it doesn't advertise to the public the way XYZ Insurance Company does. In truth, Nancy knows nothing about ABC Assurance and will probably not learn anything about the brokerage marketplace until she's been in the insurance business for a few more years, at which time she'll understand why ABC Assurance doesn't advertise to the public but does to established insurance agents instead.

## 6.5 Agent Bashing

Nancy has made some headway in disturbing Carol's decision to meet with another insurance agent representing ABC Assurance; however, Carol has not given up the idea. Nancy changes her focus in an attempt to undermine the other agent personally:

**Nancy**: You know, I don't want to be mean about whoever it is you've set up this other appointment with, but have you asked yourself, *who is this guy?* Do you know him any more than you know his *we-don't-want-the-public-to-know-us company*?

**Carol**: No, I don't. He just called me. He said he got a list of people who just refinanced their mortgages and thought I might be able to use his help covering mine with life insurance.

**Nancy**: So this is just some guy who stuck his nose into your personal business to dig up information about you? Have you thought about why this guy is really doing this?

**Carol**: I suppose to sell me life insurance, like you.

**Nancy**: Maybe, but maybe not. When I called you, I called you from an insurance company you know about, a company, I can tell you, that takes the time to train people like me in their products and the things we need to do to help people in the community provide themselves with the financial security they want, whether it's with life insurance or some other appropriate product. I called you without you knowing me, but I got your phone number right out of the telephone book. I didn't snoop around in your personal finances before I called you. I came all the way out here to meet you personally before I asked anything that personal about you. What kind of person does what he did?

**Carol**: Do you think I shouldn't see him?

**Nancy**: I wouldn't bring a stranger into my house who contacted me like that, a no-name company, prying into my personal life. Where does he get the nerve to do that?

> To me, that just doesn't seem right. Besides, when I took out this application, I knew nothing really personal about you that you haven't already willingly shared with me. I have the integrity to ask you the rest of the questions I need to ask, like the value of your mortgage, to your face and relate to you one-on-one. That's what this meeting and completing an application is about; this is my job. My job is not to root around in people's personal business.

Whether Nancy can transition this into a way to move Carol to complete an XYZ Insurance Company application for the insurance to cover her mortgage and cancel her second insurance appointment, is not yet certain. What is clear, however, is that Nancy has aggressively shifted her focus to raise unfounded questions about the second agent Carol has arranged to meet. Nancy has suggested the agent has done something wrong by obtaining information about Carol's mortgage, and by "prying" inappropriately into her life. She characterizes herself as someone with integrity, suggesting obliquely that the other agent doesn't have integrity. If Carol doesn't pick up on what Nancy is doing, she may well complete an application and purchase insurance with Nancy's help, beginning a new relationship with a financial advisor based on the unethical practice of agent bashing.

## 6.6 Presenting Truncated Insurance Ledgers

Willard has spent more than six hours working on insurance strategies using eleven different insurance carriers, to present to his prospect, Ned, at their fourth scheduled meeting. With the six hours he's spent in front of the computer, running variation after variation on premium payment and term/permanent blend options, he's racked up more than 23 hours devoted to meeting Ned's insurance needs and is exhausted and pretty much tapped out of ideas. Given what Ned is willing to pay, most of the illustration options Willard has developed don't meet Ned's long-term needs. As Willard reviews them, though, he picks out one—a term/permanent blend that costs a smidgen less than Ned indicated he'd like to pay to get long-term coverage, but the ledger shows the policy lapsing in year 43, when Ned will be in his early seventies.

Willard is about to set the illustration aside and leave his office for lunch when it occurs to him that he should present the first 40 years of the 43-year policy option and plan on working Ned around to pay more in premium a couple of years down the road when Ned's making more money. After Willard removes the ledger pages beyond the 40$^{th}$ year, he thinks: "What's wrong with this? I've worked like a dog for this guy, and he's being stupid and unreasonable. He wants what he wants, but he won't ante up to pay for it. He'll have the money to pay more ten years from now anyway. Besides, if I walk away, he'll still be uninsured and his family unprotected. When push comes to shove, I'm doing this guy a favor—more than he has the sense to do for himself."

Certainly, if Willard never talks to Ned again and Ned purchases the coverage Willard is going to present him, Ned will only enjoy the favor Willard's planning to do for him if he dies in the next 42 years. If he lives longer than that, he'll arrive there without the policy Ned sold him—unless, that is, someone else convinces Ned to put some additional money into his policy down the road.

For us, the purpose is to decide whether Willard is acting ethically, and, of course, it's clear he's not. Willard has a responsibility to provide Ned with as much information as possible about the insurance option he's presenting, including what is projected to happen to the policy. In reviewing this situation, it's clear Willard has spent too much time on this case, attempting to provide for Ned what cannot be purchased with what Ned is willing to pay. Had Willard been supervised in this case, he'd have gotten advice, to be sure, to lay out the possible options and walk away if Ned were unwilling to embrace any one of them to satisfy his insurance protection needs. This would have been a possible ethical end to Willard's work with Ned. Shortening an illustration to present only those years that show the policy being supported the way Ned wants it is not an ethical choice for Willard under any circumstances. And, of course, Willard acts unethically in not following the approved procedures of his

company, which would not have designed its illustration software to include material it did not expect its field agents to present to proposed insureds at every sale in which a policy ledger was presented.

## 6.7 Omitting information on an Application

Keith has been talking to Phil about some disability income insurance for which Phil has decided to apply. Let's look in on Keith and Phil as Keith is asking Phil about his medical history just prior to asking him the specific medical questions on the application.

> **Keith**: Phil, before I start putting information down on the application, I'd like to ask you some questions about your medical history. Have you ever had any disabling injuries in the past, anything major that sent you to the hospital or laid you up for a long time, or maybe some chronic condition that impinged on your ability to work?
>
> **Phil**: Nothing recently, well, except for a couple of back pain episodes I've had that were pretty severe, but these all happened before I hired a couple of guys to do the heavy outside work and started to run things in the office myself.
>
> **Keith**: Did you lose work time in these incidents?
>
> **Phil**: Oh, yeah. For one of them, I was laid up in bed for more than a week, but that was a long time ago.
>
> **Keith**: When was that and what did you do about getting some medical care?
>
> **Phil**: It must have been over a year by now. All I did was take pain killers.
>
> **Keith**: Medication?
>
> **Phil**: Yeah, I got a prescription from an emergency room doctor. And then I saw a chiropractor for about six months, but not recently, except to get a little adjustment every once in a while. Sitting in the office all day can kill you.
>
> **Keith**: Does the back pain impede your ability to work?
>
> **Phil**: No, not really. I mean I have taken a couple of half days off, but that's nothing. It mostly just makes me cranky.
>
> **Keith**: I understand what you mean. Did your insurance company pay for most of this care?
>
> **Phil**: No. I didn't even have insurance at that time. I'd just started out and didn't have anybody else working for me to cover, so I ate the expense. But I've got a group plan now.
>
> **Keith**: And do you put your chiropractic bills through your insurance plan now?
>
> **Phil**: No, the coverage stinks and I don't have the time to waste on that. I really got the plan in case I have a heart attack or something.
>
> **Keith**: Is having a heart attack a concern you have?
>
> **Phil**: No, other than what I've just told you, I'm healthy as a horse.

**Keith**: Okay, based on the facts that you're healthy, you don't really have any accessible records on your back problem, and your backaches are what happen to everybody who sits at a desk, I want you to forget about the early back problems. You're not planning to go back working out of the office again, are you?

**Phil**: Not this lifetime. I'm not even sure I could anymore.

**Keith**: Okay, that's good. So, forget about the back issues that can't be traced and if you get a call from the company, don't mention them and don't volunteer information about something as minor as getting a backache from sitting in a chair all day. And I think we're good to go.

The ironic twist this conversation takes at the end is, I am sure, not lost on you. Keith is acting anything but professionally. The advice he has given Phil is to forget about his previous back problems and withhold this pertinent information from anyone who might call him from the insurance company to ask him about his health history.

This kind of unethical behavior has a specific name: *Insurance fraud*. Perpetrating insurance fraud, unlike making an inadvertent material misstatement on an application, will not be subject to the two-year incontestability clause in any disability income insurance policy that Phil might obtain. Rather, insurance fraud leaves the door open for the company to deny a future claim and perhaps rescind his disability insurance policy at any time in the future if the fraud is uncovered. This might happen, for example, at a time when Phil might have an unrelated back problem, only perhaps a more serious one, when he might not think, while perhaps experiencing severe pain, to edit the medical history he provides the doctor trying to determine how best to treat him. If Phil were subsequently to apply for benefits under his disability policy and the company were to request his most recent medical records, it is possible that the discrepancy between the information on his application and that given most recently to his doctor might come to light.

In this case, Keith has acted unethically toward the company he represents in suggesting that Phil leave pertinent medical underwriting information off his application and toward Phil in leaving him exposed to the possibility that the coverage he thinks will protect him in the event of a future disability may indeed not do so, even if the disability is unrelated to his previous back injuries. The policy might very well be rescinded if the omitted information would have stopped the company from issuing a policy at the time of application.

## 6.8 Circumventing Anti-Money Laundering Rules

Attempts to circumvent anti-money laundering rules can take at least two general forms-- one directly related to the movement of money into an insurance product for later withdrawal, that is, to launder and legitimize it by having the money pass through an insurance company's hands; the other is by proactively ignoring the requirements that the identity of an individual purchasing an insurance product be confirmed. Laundering money is not an unsophisticated undertaking, as you are aware from the required Anti-Money Laundering training insurance agents must complete and follow-up on annually. This training alerts us to a variety of ways in which an individual can move money around to "cleanse" it. A method less easy to detect, when an insurance agent might be reluctant to pursue the need for affirmative personal identification, is money laundering done using a false identity or using someone else's identity.

Here's part of a conversation that took place during a meeting between Gil and Natalie in which Gil was working with Natalie to complete an application for a single premium life insurance policy that Natalie is eager to get and Gil is equally eager to sell.

**Gil**: All right, Natalie, the next form I need to complete is designed to confirm the identity of an individual purchasing a life insurance or annuity policy. Are you an American citizen?

**Natalie**: Yes, I am.

**Gil**: And where were you born?

**Natalie**: Detroit, Michigan.

**Gil**: Gee, small world. I'm from Lansing. It's nice to meet somebody from my home state. Can I see some identification? It's part of compliance with the USA PATRIOT Act. I have to ask you for it.

**Natalie**: Sure, let me get my wallet out. Oh, man. I don't have my wallet. I must have left it at my uncle's house. I have a copy of my birth certificate. Would that work?

**Gil**: I'm supposed to see ID before I submit the application.

**Natalie**: I really want to get this thing set up. Can't I get it to you later? I mean, do I look like a terrorist?

**Gil**: No, you don't look like a terrorist. I really shouldn't, but I'll indicate I saw your birth certificate and we'll get this application into the system.

Even if Natalie's desire for a single premium life insurance policy is entirely legitimate and she was able to pay for her life insurance in a way that was acceptable to the company, Gil has done something unethical. He's engaged in behavior that his company, not to mention the federal government, have deemed unacceptable and wrong. Gil betrayed the trust his company placed in him to represent the company as it wants to be represented and carry out its established policies and procedures.

## 6.9 Inflating a Prospect's Net Worth

Individuals purchase life insurance on their own lives for a range of personal, business and charitable reasons, but rarely is greed the motivation behind the purchase. That changed recently, when the development of the secondary market in which life insurance policies could be sold offered a number of different ways for individuals to gain by buying insurance on their own lives. Here's one of the earliest ways this might have been presented to a potential insured, Madeline, by a potential seller, Lillian:

**Lillian**: What I'm talking about is capitalizing on what's called your *life insurance capacity*. Insurance capacity is the amount of life insurance a company or a series of companies might be willing to issue on a particular person's life. The opportunity that presents itself right now has to do with the fact that many individuals' insurance needs don't require them to apply for and own as much insurance coverage as it would be possible for them to obtain. Another way of looking at this is to say that people generally buy the life insurance protection they need, rather than buying every dollar of life insurance protection they possibly could.

**Madeline**: Well, that makes sense. Why would they buy something they don't need that requires them to make premium payments every year?

**Lillian**: Generally, Madeline, you're absolutely right. What's different right now is that there are investors willing to purchase life insurance policies that the buyer no longer needs.

**Madeline**: That's fine, but it still costs me money to buy the insurance.

**Lillian**: Well, that's where I come in. I can arrange for someone to lend you the money.

**Madeline**: No, I don't want to borrow money to buy something I don't need or want.

**Lillian**: Just wait a minute, Madeline, hear me out. Here's how this works. I can arrange for a lender I work with to provide all the money necessary to pay the premiums on a life insurance policy for the next two years. You'll own it, and you'll name the beneficiary in the unlikely event you should die in the next two years. So far, it costs you nothing. And, when the policy gets issued, the lender is going to give you a bag of money. Could you use some extra money?

**Madeline**: Who couldn't? What's the catch?

**Lillian**: There is no catch. The policy gets issued and you get a bag of money. At the end of two years, though, you have to make a decision about this insurance policy that you don't want and you don't need: Give it to the lender in full satisfaction of the outstanding loan, loan generation expenses and accrued interest and keep the bag of money, or buy the policy by repaying the loan, expenses and interest and give back the bag of money to the lender.

**Madeline**: You're telling me someone will spend a lot of money to loan me a lot of money to buy a life insurance policy that I'll keep for two years and then give to them to wipe out the loan and all the costs associated with it? And I can keep the bag of money the lender gave me at the beginning?

**Lillian**: That's it in a nutshell.

**Madeline**: How big is the bag of money?

**Lillian**: It's substantial, but before we get there, we have to be able to get you a life insurance policy that's big enough for the lender to want to loan you the money. To do that, we have to qualify, medically and financially. Are you in good health?

**Madeline**: Yes, excellent health actually.

**Lillian**: Great. Do you have a problem with telling the insurance company that you're worth $10 million?

**Madeline**: Ten million dollars? I'm not worth nearly that much.

**Lillian**: That's okay. What we do is say on the application that you have $10 million of assets, plus or minus, and you have to say the same thing during a personal interview that the company will want to conduct. Would you be willing to do that to get a bag of money?

**Madeline**: I suppose I'm back to my last question: How big is the bag of money?

Perhaps this conversation is an insurance fraud investigator's dream: an all-too-clear case of suggested complicity to defraud an insurance company by providing false financial justification for issuance of an insurance policy. Nonetheless, variations on this conversation have taken place and individuals who would otherwise never have given insurance fraud a first, much less a second thought, went along with this or a similar scheme. Both individuals here are acting unethically and certainly colluding to break the law.

## 6.10 Misleading a Company About the Amount of Insurance in Force

A variation on inflating the net worth of a prospective insured to obtain more insurance coverage than he or she would legitimately be entitled to purchase is deflating, reducing or

under-reporting the amount of insurance coverage an individual already has in force when applying for new coverage. What follows is an essentially true tale, though some of the facts (including the principal player's name) have been altered:

> Mary is in her late 70s. For much of her life, she was an active and successful businesswoman. Her late husband was a doctor whose practice generated a very high income. Her ever-expanding business enterprises and his practice made it possible for the two of them to accumulate a net worth in excess of $35 million. During the years she and her husband amassed their wealth, more than $20 million of insurance was purchased on Mary's life, some of it by the companies she owned and now managed by her children, some of it by trusts she established for the ultimate benefit of her children and grandchildren, some of it by her personally with the intent to transfer the insurance coverage to charitable organizations she supported, and some of it to be held in an irrevocable trust to pay potential estate transfer expenses at her death.
>
> In the early years of the development of the secondary market for the sale of life insurance policies, all of the policies held by the companies she founded were sold, as were the insurance policies held in the trusts for her children and grandchildren, with proceeds from those sales having been distributed to the trust beneficiaries. A number of policies she owned personally were sold as her net worth declined.
>
> Shortly after the time the policies on Mary's life were sold, Mary's health took a turn for the worse, leaving her uninsurable for a number of years. As sometimes happens, the passage of time reduces or eliminates the effect of certain medical conditions on a person's insurability. When Mary found a number of years later that she was insurable again as a standard risk, she and her children set about leveraging a substantial portion of her remaining wealth through the purchase of new life insurance policies on her, using the same insurance agent who had helped them obtain insurance coverage over many years, but from a number of different companies, none of which they had purchased coverage from before.
>
> On each application, Mary's lower net worth was accurately stated, but none of the existing insurance that had been sold to third-party investors was listed in answer to the questions about existing insurance coverage. Each of the companies applied to issue new insurance policies on Mary's life. When the last of them was issued, $32 million of life insurance was in force on Mary's life. The justification for issuance of the new insurance policies --$12 million of coverage, all held in newly created trusts-- was to pay Mary's potential estate transfer expenses. Her present life expectancy and growth rates on her present assets justified the amounts.

Even if Mary's estate were projected to increase to somewhere between $24 million and $30 million, amounts that could possibly justify issuing $12 million to manage estate transfer expenses, the reality is that with the issuance of these last policies, there existed $32 million of life insurance on Mary's life, an amount far in excess of what would be considered her *insurance capacity*. It's possible that because they no longer owned the policies they had previously sold, Mary and her children thought those policies had fallen off the edge of their financial world and it was as if they never existed. And, as trustee after trustee purchased new insurance on Mary's life, each could answer honestly that, as trustees, he or she was not applying for coverage with the intent to sell other life insurance policies in the life insurance policy secondary market; but what about the agent who sold the new policies?

The agent that sold Mary and her children new insurance policies had knowledge of the existence of the previous policies. By selling additional insurance to Mary and her children, this agent acted unethically by not acting in the best interest of the companies engaged in the insurance transactions. It is true that those companies issued policies for which they levied what they believed to be appropriate premiums; however, it is also true that, had those

companies known about the already existing insurance on Mary's life, they would not have issued the additional coverage to her, regardless of the fact that, absent additional insurance coverage in place specifically to provide liquidity in her estate to pay potential estate transfer expenses, her estate would suffer substantial financial loss. Simply because a policy on someone's life has been sold into the secondary insurance market does not mean that the policy ceases to exist for the purpose of determining whether an individual has additional insurance capacity.

## 6.11 REVIEW QUESTIONS

QUESTION 1: Refer to section 6.0, page 32

True or False? The distinctions between misconduct, misrepresentation, and mismatching are hard and fast.

ANSWER: A

True.

RESPONSE:

Your answer is incorrect. The distinctions between misconduct, misrepresentation, and mismatching are not hard and fast.

ANSWER: T

False

RESPONSE:

Your answer is correct. The distinctions between misconduct, misrepresentation, and mismatching are not hard and fast.

QUESTION 2: Refer to Section 6.2, page 33

Among the oldest and most common unethical insurance practices are:

ANSWER: A

double-dipping with dividends and premium offset.

RESPONSE:

Your answer is incorrect. Among the oldest and most common unethical insurance practices are twisting and churning.

ANSWER: B

disintermediation and prepaying premiums.

RESPONSE:

Your answer is incorrect. Among the oldest and most common unethical insurance practices are twisting and churning.

ANSWER: C

consolidation of coverage through replacement and removal of policy waivers.

RESPONSE:

Your answer is incorrect. Among the oldest and most common unethical insurance practices are twisting and churning.

ANSWER: T

twisting and churning.

RESPONSE:

Your answer is correct. Among the oldest and most common unethical insurance practices are twisting and churning.

QUESTION 3: Refer to section 6.6, page 37

Not providing all the information required for a prospect or client to make an informed decision is:

ANSWER: T

unethical.

RESPONSE:

Your answer is correct. Not providing all the information required for a prospect or client to make an informed decision is unethical.

ANSWER: B

ethical.

RESPONSE:

Your answer is incorrect. Not providing all the information required for a prospect or client to make an informed decision is unethical.

ANSWER: C

neither ethical nor unethical when it expedites a sale.

RESPONSE:

Your answer is incorrect. Not providing all the information required for a prospect or client to make an informed decision is unethical.

ANSWER: D

standard insurance industry practice.

RESPONSE:

Your answer is incorrect. Not providing all the information required for a prospect or client to make an informed decision is unethical.

QUESTION 4: Refer to section 6.10, page 42 near bottom.

True or False? An insurance policy that has been sold into the secondary insurance market is not counted when determining how much insurance has been issued on an individual's life.

ANSWER: A

True.

RESPONSE:

Your answer is incorrect. An insurance policy that has been sold into the secondary insurance market is definitely counted when determining how much insurance has been issued on an individual's life.

ANSWER: T

False.

RESPONSE:

Your answer is correct. An insurance policy that has been sold into the secondary insurance market is definitely counted when determining how much insurance has been issued on an individual's life.

## 7.0 Misrepresentation

Misrepresentation can take a wide range of forms, some of them entered into consciously by an insurance agent or broker, some of them not. All forms of misrepresentation, however, are unethical. Conscious misrepresentation constitutes fraud and unconscious misrepresentation is clear negligence. In this latter case, one could say that the insurance agent or broker who misrepresents without realizing it should be held to the standard of having known better, that is, should have known what he or she did and did not know and could or could not do.

### 7.1. Misrepresentation of an Agent as a Broker

Insurance agents and brokers technically have an agency agreement with the company or companies they represent; that is, they have an agreement to act as the field representative of each company. In agreeing to do so, they take on certain responsibilities. How an insurance professional presents him- or herself to a consumer, beyond the assertion that an agency agreement exists between the individual and one or more companies, will set up the expectations the consumer will have. Here's part of a conversation that takes place between Jill and Malcolm:

**Malcolm**: Well, I guess the real thing that bothers me is this: How do I know I'm going to get the best deal on the insurance we've been discussing?

**Jill**: I can answer that very easily. You know you'll get the best deal because I work for you, not as an agent representing a single company, but as a broker. A broker's job is to represent someone who has an interest in getting insurance coverage, to make sure that their needs come first, that you get the product that provides you with the best value available. You're number one—not me, and not the company you place your insurance with.

**Malcolm**: So you're telling me that you'll do whatever it takes to get me the best insurance deal on the market.

**Jill**: What you've just said is partly true and partly—potentially—not true. I will work to get you the best deal you can get. That may not be the best deal that somebody else could get in the marketplace. There are factors to consider, like height and weight, health history, whether someone is a smoker, and in some cases, family history: whether a parent, for example, had died of a heart attack or had cancer before a certain age. I can't change those things without lying to the insurance company, and that's wrong, whether they find out or not. What I can do is take what you give me and do the best with it for you.

**Malcolm**: Okay. What you're saying makes sense, and I understand that you can't lie to the company I want insurance from. What do you need to know?

This is an interesting situation in that Jill has taken a clearly ethical stance with respect to providing accurate and true information about underwriting to any company being asked to issue a policy. What is not ethical about Jill's interaction with Malcolm is that Jill knew when she left her office which company with which she was going to place Malcolm's insurance and why. The company's ratings are not as high as some of the other carriers Jill represents, nor is their pricing on the term insurance that Malcolm wants the best, nor are their policy conversion privileges as liberal with respect to age or product availability as other companies.

The reason Jill knows she is going to sell Malcolm a policy from that company is because Jill is trying to win a trip to the Bahamas, offered by the company. She's well on her way to getting there but still needs to place some business to lock in her spot on the plane. In light of Jill's willingness to act unethically to win a trip to the Bahamas, it is not impossible that Jill would act equally unethically, even were there no Bahamas trip to motivate her, and choose to sell Malcolm a policy from whatever company paid her the highest commissions.

In this circumstance, Jill is certainly not acting in the best interest of her prospect the way a broker is supposed to act. She is acting more like an agent, as someone who has a responsibility to sell a particular company's products, though one could assume that her agent-like allegiance will shift with the shifting production perks offered by the companies she represents. In explaining how she would work for Malcolm, Jill acts unethically, lying to him about what services she will perform for him, since we know that it would be expected of someone acting as a broker to investigate what was actually available in the marketplace for a prospective insured. What is ironic is that Malcolm may never know how unethically Jill acted toward him. He may in fact have very positive feelings about Jill's ethical values, based on her response to his question about getting him the very best deal in the marketplace.

### 7.2 Long-term Care Misrepresentations

Here's part of a conversation Ned has with a prospect, Betty, about long-term care insurance.

**Betty**: You know, I don't have a lot of information on long-term care insurance, so I really do need to rely on your expertise in this area.

**Ned**: And well you should. Keeping up with all the changes in the tax laws affecting long-term care insurance, its relationship to Medicare and Medicaid, and the range of options you have to choose from to design a policy that meets your specific needs are daunting tasks.

**Betty**: Then how do you do it?

Ned: I do it because keeping up with that kind of stuff is what I do for a living. It's overwhelming for anyone who hasn't made doing that their life's work.

**Betty**: Well, I have to tell you, I'm glad somebody does it, because it's well beyond me.

**Ned**: Then let me start to educate you so you can make an informed decision about how you plan to deal with the potential need for long-term care sometime in the future.

**Betty**: Please do.

**Ned**: Okay. Here's how it works. To begin with, the chances that you or I will need long-term care in the future are about one out of two. The last statistics I saw actually said two out of five men and three out of five women would wind up needing long-term care sometime in their lives.

**Betty**: That's not comforting.

**Ned**: No, it isn't; but you don't need that care now, and that's a comforting fact because you can do something to manage the potential costs in case you need it in the future. And it's not like you're alone and there's no help for you in your planning—and I'm not talking about just me.

For example, Medicare can provide you with up to 100 days of long-term care. It pays the full cost for 20 days and 80% for the next 80 days. This helps keep your personal long-term care insurance policy costs down because you don't need to buy a policy to cover those days too. In fact, long-term care policies don't duplicate payment for any benefits paid by Medicare or Medicaid. On top of this, you get a federal tax deduction for your premium payments and maybe another tax deduction on your state tax return. You can practically zero out your cost with the deductions currently available. You spend $3,000 for the premium, you deduct $3,000. It's that simple.

**Betty**: But it isn't that simple to get the policy to pay when Medicare stops. I've heard a lot of stories.

**Ned**: Betty, the beauty of how these policies work is that all you've got to do is have your doctor, or whatever medical professional is treating you, explain to the company that you qualify under your policy. Once you qualify, the company must pay you. Access to our benefits is what you pay your premiums to get.

In his description of himself, Ned has acted unethically. He doesn't come out and say, "I am a long-term care expert," but he implies that fact by telling Betty that he keeps up with changing laws, Medicare, Medicaid and policy features in his "life's work." Clearly, his desire to be seen as an expert far exceeds his capacity as one. Let's count the ways that Ned misleads Betty:

1) in stating that he has long-term care expertise,

2) in his characterization of access to Medicare long-term care benefits (which are not guaranteed to be available, but available only if one meets all the qualifications to get them, and are limited solely to skilled nursing facility benefits that will bring a patient back to health),

3) in his statement that it is possible to "zero out" payment of long-term care premiums with a combination of state and federal tax deductions, and

4) in suggesting all that needs to be done to obtain policy benefits is have a personal medical practitioner attest to the fact that one's condition warrants payment of benefits (as if there were no concurrent review by trained medical personnel in the issuing company's offices).

Even if Betty purchases a policy that ultimately provides her with benefits when she needs them, she will have arrived at that result through the unethical behavior of Ned in suggesting he is someone with expertise in the area of long-term care and in his faulty presentation of information relevant to long-term care issues. Alternatively, of course, she could wind up sorely disappointed when and if she comes to learn that Medicare will not cover her for the first 100 days of her long-term care custodial need, that she is never able to "zero-out" her long-term care costs, or that her insurance carrier will not pay benefits immediately or perhaps ever, because her claim is contested or rejected by her long-term care company's medical staff.

### 7.3 Dividend Misrepresentations

Roger, a producer, has been working with Nelson on the purchase of a life insurance policy. The sticking point has been that Nelson doesn't like the idea that he has to pay premiums for the rest of his life. He tells Roger he wants some kind of approach to insurance coverage like the one he's heard about from his friends, where he doesn't have to pay premiums forever, but can choose how long he's going to pay but keep his insurance permanently. Roger knows that Nelson is referring to a secondary no-lapse guarantee universal life plan, but his company doesn't offer one, so he's brought Nelson an illustration of a participating whole life policy ledger showing only 12 years of out-of-pocket premium payments. From year 13 on, the policy values are shown to carry it for the rest of Nelson's life. Part of their conversation goes like this:

**Roger**: I think I've found what it was you were hearing about, Nelson: A policy that requires just 12 out-of-pocket premiums, after which you don't pay anything more. The policy pays for itself.

**Nelson**: And it lasts until I die, whenever that happens?

**Roger**: Absolutely. This is a policy designed to guarantee that you have the coverage you want for as long as you want it.

**Nelson**: How does it do that?

**Roger**: Well, it works like this. You pay the premium for the first twelve years. During those years, the policy will generate dividends, like a return on your premiums, which will be used to buy you more insurance. This isn't done because you want more insurance, but because buying this additional insurance is the best way to build up value in the policy for later use. From year 13 on, the internal policy values will pay the premium for you. You won't ever have to pay another dime into the policy for as long as you live.

**Nelson**: Guaranteed?

**Roger**: Nelson, the company that offers this policy to the public has been in business for more than 75 years. I've worked for the company nearly 30 years. There hasn't been a year that I know of that the company didn't stand by its promise to pay dividends to its policyholders. Do you think there's any reason to think they will now, after having weathered the Great Depression and the numerous recessions that have hit the country since the company was founded?

**Nelson**: I hear what you're saying, Roger, but I'm no economist. I just want to know that my policy will pay off when my family will need it.

**Roger**: I guarantee it, Nelson. As long as you pay the premiums, the policy is guaranteed to do its job. In that respect, it's as good as gold.

Roger has skirted the issue that the policy he has brought for Nelson to consider is not the same type of policy that Nelson had heard about. Beyond this, he has stated that all Nelson will have to do is pay 12 premium payments, after which the policy will pay for itself, a circumstance which may or may not come to pass since dividends are not guaranteed, and it is the dividends as projected that support the limited out-of-pocket premium payment strategy.

Roger has also skirted the issue of whether this policy design will guarantee coverage for Nelson as illustrated in the ledger by focusing on the fact that the company offering the policy for sale to the public has been around for more than 75 years, and Roger with that company more than 30 years, during which time Roger has no knowledge of the company not paying an annual dividend to its policyholders. Of course, the fact that Roger doesn't know of any year in which this was the case doesn't mean that there were no years in which no dividends were paid. Indeed, whether Roger knows this is irrelevant. What Roger has done that is unethical is he avoided the relevant issue of the policy dividends not being guaranteed.

Roger takes a step deeper into the unethical, however, when he says that he—personally—guarantees that the policy will pay off when Nelson's family will need it. He does caveat his guarantee by saying that the policy will perform as it is supposed to as long as Nelson pays the premiums. This, of course is true, but not a totally relevant statement in that Nelson is expecting the premiums to be paid, not by himself, over the entire life of the contact, but indirectly, out of the policy values from year 13 on. By not making clear to Nelson that the dividend projections illustrated and the premium payment strategy based on them are not guaranteed, Roger has clearly acted unethically.

### 7.4 Misrepresenting the Consequences—Immediate and Potential—of a Policy Replacement

Virginia, an agent, has been speaking with Gladys about replacing Gladys' current whole life insurance policy. Gladys purchased the policy more than 20 years ago, initially to provide herself with a supplementary source of retirement income. However, a prolonged period of illness led Gladys to take a number of substantial policy loans that cumulatively exceed her policy basis to pay medical bills as well as the ongoing premiums her policy required. Currently, though fully employed and in excellent health again, she finds it increasingly difficult to pay for the policy out of her current cash flow. Gladys called Virginia, an insurance agent recommended to her by a friend, to find out what she can do to keep her insurance coverage—not as a source of supplemental retirement income, but as a vehicle through which Gladys will be able to provide a small legacy to her sister's two daughters—and get out from

under the burden of having to continue to make premium payments. Part of the second meeting Virginia has with Gladys goes like this:

> **Gladys**: Well, Virginia, I hope you've come up with something to get me out of this bind I've got myself in.
>
> **Virginia**: I believe I have, Gladys. I think I've got just the thing to keep your insurance coverage in force so you can substantially reduce your premium payment amount and provide your nieces with the legacy you'd like them to have.
>
> **Gladys**: That would be a blessing. What did you find?
>
> **Virginia**: I'm recommending, not a new kind of life insurance, but a new kind of life insurance policy design called a *secondary no-lapse guarantee universal life policy*. It sounds very technical, and it is if you look at all the actuarial details that go into making it work, but from our perspective it's very simple. You pay your premium and your policy stays in force. It won't provide you with the supplemental retirement income the old policy was supposed to provide.
>
> **Gladys**: Well, that's all right. With all those loans I had to take, the policy I've got now won't do that either.
>
> **Virginia**: That's true. This policy will allow you to drastically reduce the amount you'll have to pay every year for your coverage, and as long as you pay the premiums, the policy will work the way you want it to.
>
> **Gladys**: Just like the one I've got, then. All I have to do is pay the premium.
>
> **Virginia**: That's right. And that premium is less than half of what you were paying. Is that a reasonable premium payment to make at this time?
>
> **Gladys**: Half what I was paying?
>
> **Virginia**: Actually, quite a bit less.
>
> **Gladys**: What do we do next?

It's surprisingly simple to unconsciously engage in unethical behavior. In this interchange, there is no hint of any desire on Virginia's part to avoid Gladys' questions or to misrepresent the solution to Gladys' problem that she's come up with; yet, unwittingly, she does. First, she does not address the potential additional financial burden that Gladys will incur when she replaces her current life insurance policy, in which there is a substantial outstanding loan in excess of her basis in the policy. This loan will be netted out of her policy cash value at the time of replacement, and even if the remaining cash moves into Gladys' new policy under the umbrella of IRC Section 1035, the current policy loan will be considered repaid using policy gain to the extent that there is gain in her policy. Gladys will find out about this gain—called "boot"—when she receives a 1099 at the end of the year from her current insurance company.

Second, Virginia neglects to make clear that paying premiums on the whole life policy that Gladys bought 20 years ago is not exactly like paying premiums on a secondary no-lapse guarantee universal life policy. When Gladys didn't have the money to pay her whole life

premium during her illness, the premium loan provision of her policy made it possible for her policy premium to be paid, the downside of which was the institution of a policy loan and the annual accrual of policy loan interest. Incurring a loan in this way, however, did not shorten the period over which the policy would provide Gladys with coverage, though it did reduce the net benefit payable under the policy.

In a secondary no-lapse guarantee contract, the premium payments that support the life-long guarantee of coverage under the policy must be paid, and paid on time. At one time, this meant no later than the policy due date, though for many companies, "on time" now encompasses the policy due date plus a 30-day grace period. Any premium that is unpaid or paid outside the grace period immediately affects the policy coverage guarantee, shortening it. This is an important issue to make clear to Gladys so she doesn't think that if she has trouble paying the premium in the future, for whatever reason, she can skip one or more premium payments, then resume paying what she originally was scheduled to pay and maintain her policy as she originally intended. Even if there is sufficient cash value accumulation in her policy under the policy's primary guarantees, the secondary no-lapse guarantee will be affected and her policy potentially could lapse, thwarting her plans to provide a legacy to her nieces.

Virginia, meaning well, has not done her job well. Negligent behavior—intentional or not—is unethical behavior.

## 7.5. Misrepresenting the Ongoing Tax Consequences of Sequential Split Annuities

Ben Broker is working with Nancy Retiree to see if it's possible to get her some additional monthly income to help her pay her bills and have a little fun after more than 35 years in the workplace. This is their first meeting, but Ben has come up with an idea he thinks Nancy will like. She's very conservative and likes the idea of her principal being guaranteed. For this reason, she has a substantial amount of her accumulated wealth in a number of bank accounts that she considers ideal. What Ben is going to present to her is a split annuity.

> **Ben**: Nancy, I think I've got a way for you to have your cake and eat it too, though not quite at the same time.
>
> **Nancy**: Oh?
>
> **Ben**: Yes. What I'm recommending to you is a split annuity.
>
> **Nancy**: Is this a new kind of investment? I'm fairly familiar with annuities, but I never heard of this one.
>
> **Ben**: No, Nancy, it's not. It's a strategy, and in fact, what everyone calls this strategy is a little misleading since it's not really a single annuity, but two annuities. What's unique about this strategy is that it's all guaranteed. Here's how it works: You take a sum of money, such as $100,000—what you might have in one of your larger bank CDs—and split it into two pieces.
>
> **Nancy**: I already have misgivings about this. I like those CDs. I like the principal guarantee and the fixed rates I get.
>
> **Ben**: Nancy, that's exactly why I thought of this for you. You take that sum of money and split it into two pieces. One piece goes into an immediate annuity. The amount that goes there will provide you with additional guaranteed monthly income for, let's say, five years. The rest of the money goes into a deferred annuity that's designed to grow—over five years—to an amount equal to what you started out with. I haven't run any real numbers yet, but here's an example. You start out with $100,000. You split it into two pieces: $15,000 and $85,000. The $15,000 goes into

an immediate annuity that provides you with an extra $250 a month for five years. Sound good so far?

**Nancy**: Yes, so far.

**Ben**: Good. The $85,000 goes into a deferred annuity with a guaranteed interest rate for the next five years that will grow your $85,000 back to the original $100,000 you started with. You have your principal back, guaranteed to be there after the five-year period is up. That's how you can have your cake—your principal—and eat it—have some additional income—but not at the same time: Your principal comes back—on an absolutely guaranteed basis—when your income stops, which means you have your original $100,000 to split again and again and again. And what's great about this is that because the $100,000 you start out with is money you've already paid tax on in a bank CD, virtually all of the money you get as income is tax-free!

**Nancy**: Really?

**Ben**: Absolutely, split after split after split.

**Nancy**: How fast can we set one up?

Ben's idea is good for Nancy. He presents it well enough for her to understand how it works from a mechanical perspective and it does, in its own way, meet her needs to have additional income and know that her principal is secure: In this case, guaranteed to be regenerated. Ben does, however, either lose himself in his own enthusiasm or has not done is homework well enough with respect to the taxation of future splits. In the first split, $100,000 of cash from a bank CD will be 100% after-tax cash. In a second split, only $85,000 from the original CD will be after-tax money; the rest--$15,000--will be untaxed gain. While in the first split, 100% of the money used to purchase the immediate and the deferred annuities was after-tax money, very little taxable interest accrued to the funds paid out of the immediate annuity. In the second split, only 85% of the funds used to purchase the immediate annuity will be after-tax money, with 15% of the sum representing untaxed gain from the first deferred annuity. In subsequent splits, the percentage of untaxed money used to purchase the immediate annuity will increase, resulting in a larger and larger portion of the immediate annuity payments being taxed in the year paid.

The fact that subsequent splits result in increased annual taxation may not even have meaning to Nancy if she has been taking current income—little as it may be in this economic climate—from her bank CDs. All of it would have been taxable to her as received. Nonetheless, Ben's statement about the taxable nature of payments to Nancy "split after split after split" is misleading; and because it is misleading, it is unethical.

## 7.6 Review Questions

QUESTION: Refer to section 7.0, page 45

True or False? Misrepresentation is always intentional.

ANSWER:

True

RESPONSE: A

Your answer is incorrect. Misrepresentation can be intentional or unintentional.

ANSWER: T

False

RESPONSE: B

Your answer is correct. Misrepresentation can be intentional or unintentional.

QUESTION: Refer to Section 7.4, page 50

True or False? Paying premiums on a whole life policy is like paying premiums on a secondary no-lapse guarantee universal life policy.

ANSWER:

True

RESPONSE: A

Your answer is incorrect. Paying premiums on a whole life policy is NOT like paying premiums on a secondary no-lapse guarantee universal life policy.

ANSWER: T

False

RESPONSE: B

Your answer is correct. Paying premiums on a whole life policy is NOT like paying premiums on a secondary no-lapse guarantee universal life policy.

## 8.0. Mismatching or Ignoring Suitability issues

**The following scenario illustrates the sale of a whole life policy when a term insurance policy would have been the appropriate product to sell.**

Stephanie has been speaking with Gary and Eugenia about their insurance coverage. Gary and Eugenia have been married a year and Eugenia is pregnant and in the middle of her second trimester. Gary is in excellent health and employed in a firm where he's earning about $50,000 a year, and that has provided the couple with health insurance, state-mandated short-term disability and workers' compensation coverage. Eugenia is in excellent health and could have kept working for a number of additional months at her job, but Gary and she decided that this was a good time for her to stop working and focus her attention on getting everything ready for the arrival of their baby. All of her insurance coverage at work has terminated. Stephanie was made aware of these facts during their first meeting. This is the second time Stephanie has been to their home.

> **Stephanie**: I have something I think you'll like given your needs, especially, your needs related to having a new baby: insurance protection, the need to plan for the future with respect to accumulating college funds and to plan long-term for yourselves as well.
>
> **Eugenia**: Great.

**Stephanie**: What I'm recommending is that you use the budget you've given me to purchase two participating whole life insurance policies. They'll meet your needs in a number of ways. The policies provide $100,000 of death benefit, will accumulate cash value on a guaranteed basis, and have the ability to increase in terms of the death benefit and cash value through the use of dividend earnings on the policy to purchase additional insurance each year. Your policy will replace two full years of your salary if something happened to you, and will keep pace with your insurance needs as your income grows. Eugenia, your policy will grow the same way, providing Gary with the benefits he would need to replace all that you do, from maintaining your home to raising your baby. In addition, policy cash value can be borrowed in an emergency, or to help pay future college costs—and these loans wouldn't necessarily have to be paid back. But if you did pay them back, your policy would have a substantial amount of cash by the time you retired, which you could then get access to on a tax-advantaged basis by taking withdrawals that would be considered return of your premiums—which were paid with dollars that had already been taxed—and by taking tax-free policy loans. How does that sound to you?

Regardless of how this recommendation might sound to Gary and Eugenia, the recommendation is not right. The fact that Gary and Eugenia are expecting a baby and have immediate needs, far in excess of the $100,000 of coverage Stephanie is recommending, makes her recommendation inadequate. In the event of Gary's premature death, replacement of just two years of his salary would be woefully inadequate to meet the needs of a mother with a new baby, and the policy being recommended would not increase in value commensurate with even the most meager raises Gary might get over the next ten or more years. The proceeds from Eugenia's policy might provide adequate funds for full-day childcare for some period of time, but not, certainly, until Gary and Eugenia's child would be old enough to manage on his or her own until Eugenia came home from work.

The right choice here would be to look at term insurance in a substantially greater amount and the possibility of providing Gary with a disability income insurance policy. We are all well-schooled in the statistics: The chance someone in his or her 30s, 40s, and even 50s will suffer a protracted disability is substantially greater than the chance he or she will die prematurely. Were Gary to become disabled, not only would there be little meaningful benefit available from his whole life policy—perhaps some small amount of cash and reprieve from having to pay premiums if the policy had a waiver of premium feature—but whatever benefits might be forthcoming from his state-mandated disability and workers' compensation coverage may be so short-lived (in the case of the former) or so long in coming (in the case of the latter), that he and Eugenia could be financially ruined. And, of course, if his disability is due to a non-work-related cause, only his state-mandated short-term disability benefit would be available.

What Stephanie has done—for one or more reasons that this exchange doesn't make clear—is make an inappropriate insurance recommendation. Perhaps she is not well-enough trained to present herself as a competent insurance agent. Perhaps she has chosen whole life because it pays the highest commission. Whatever the case, her recommendation is inappropriate, hence unethical.

## 8.1 Selling a Multiyear-Guaranteed Deferred Annuity to a Young Person

Tom has been speaking with Ted about how to invest a small legacy Ted received from his Aunt. Ted is in his early 20s and has virtually no investment experience. In their conversation, Tom presented himself as a seasoned investment advisor and explained the basics of how investments work in a fluctuating market, emphasizing the loss that can occur. Still, this basic information and heavy warning built Ted's trust in Tom's knowledge and his distrust of an investment where he could lose money.

What was absent in the conversation between Tom and Ted was any evidence that Tom is really a "seasoned investment advisor." Tom also failed to mention the wide range of

investment options appropriate for Ted. Tom is only interested in selling a multiyear-guaranteed deferred annuity and in keeping Ted underinformed.

Certainly, an argument could be made that Ted should not be looking at an annuity at all, that he should be looking at mutual funds where he can diversify his investment and take advantage of his youth. The advantage of his youth would be that he will, in all likelihood, live through a significant number of business cycles that will see interest rates and market values fluctuate substantially, allowing him to take advantage of upward moving rates and markets and, if he is careful—and to some degree lucky—protect himself when rates and markets go down. He would also have the opportunity, over time, to invest and reinvest with substantial flexibility outside of annuity contracts, since once funds are invested in an annuity, moving those funds to an investment, other than another annuity, exposes previously tax-deferred earnings to taxation as ordinary income in the year they are moved.

Multiyear, fixed rate annuities, of course, are not the only kind of annuity available in the marketplace today that provides meaningful guarantees coupled with potentially substantial market-driven growth. There are index annuities and variable annuities, each with upside potential and guarantees that can limit downside potential in various ways.

What is clear, though, is that Tom has an agenda: to sell a multiyear, fixed annuity to Ted, who may make that agenda easier to realize because of his youth and inexperience. There is a sense that Tom is hustling Ted. Tom misrepresented himself as a financial advisor, when he is one only in the narrowest sense of the word, and he has not offered investment advice in Ted's best interest, like he implied he would. This is implied in every relationship in which a financial services professional engages a potential prospect or client. Beyond this, an argument can be made that the sale of an annuity contract to a young person places undue and inappropriate restrictions on the investment and reinvestment of those funds. Tom was not being above-board with Ted; what he did is unethical.

## 8.2 Selling a Secondary No-Lapse Guarantee Universal Life Insurance Policy to a Young Person

In much the same vein as the sale of the multiyear fixed rate annuity Tom is attempting to close in the previous section, sale of a secondary no-lapse guarantee universal life insurance policy to a young person may be considered unethical. The attraction to such a policy would, of course, reside with the policy guarantees: A guaranteed premium, a guaranteed premium payment period, and a guaranteed death benefit. In the same way that a multiyear fixed annuity would limit the investment flexibility from which a young person could benefit over a protracted investment period, a secondary no-lapse guarantee universal life policy would limit the life insurance planning flexibility from which a young person could benefit over a protracted period during which s/he needed insurance protection.

A strong argument can be made for recommending current assumption life insurance products to younger people for the same reason; they will have an opportunity to live through a significant number of business cycles in their lifetimes. The benefit of rising interest rates or market values is largely lost in the no-lapse guarantee universal life product. In addition, since secondary no-lapse guarantee products are, by design, products that will generate only modest cash value which will eventually be recouped by the insurance carrier to pay internal policy expenses, the potential benefit of an IRC Section 1035 Exchange is often lost or minimized for the owner of such a policy. The benefit sought in other policy designs to insulate against interest rate and securities market volatility can turn out to be unbeneficial to a youthful no-lapse guarantee policy buyer.

## 8.3 Annuity-related Suitability Mismatches: Ignoring Investment Horizon, a Prospect's Health or Suitable Coverage Options

Barry is an annuity salesman with a real knack for prospecting. A day doesn't go by that he doesn't have at least two appointments. The day we're going to focus on is even better. Barry's got three appointments in a row: the first with Nat, the second with Janet, and the third with Tony. Here are pieces of Barry's conversations with each of these potential annuity buyers.

First up is the conversation between Barry and Nat, a businessman who has recently sold one business and is thinking about starting up or buying into another in the near future:

> **Barry**: I understand that you're looking for someplace to park some money at a decent rate?
>
> **Nat**: Correct. I've just sold a business and I'm looking around for something else to invest in. I don't want the cash that I've got to just sit around in a money market account earning practically nothing. It could take me a year or two to find something that interests me.
>
> **Barry**: I understand how you feel about leaving money just sitting in a money market account. I wouldn't leave my money there either. And, in fact, I haven't. I've turned instead to a number of fixed rate annuities for this kind of investing.
>
> **Nat**: I don't really know much about annuities. What are they? Are they like bank CDs?
>
> **Barry**: No, they're not like a bank CD. The rates are better than the rates you can get from a bank with a CD, the earnings aren't taxable as they accrue, and you have the substantial right to access your money in the annuity, even in the first year with some companies, without penalties. They're probably the last win-win-win investment around.
>
> **Nat**: Win-win-win?
>
> **Barry**: Yes. You win with a great rate that's closer to a competitive market rate than any bank can provide. You win with ready access to your money without the kind of guaranteed penalties associated with taking even the smallest amount of money out of your CD. And you win because the earnings on your money are tax-deferred; they don't hike up your taxes every year.
>
> **Nat**: That sounds good, especially the access part. What kind of rates are we talking about?
>
> **Barry**: Well, right now we're talking about rates in excess of 3% for the amount of money you mentioned on the phone when we spoke. These are not the kind of rates we would have been talking about a few years ago, but they're way beyond what you can get from a bank. Make sense to move forward?
>
> **Nat**: Yes, on this basis it does. What do we do next?
>
> **Barry**: What we do next is simple as pie: You complete a short application, write out a check, and the deal is done. Your money starts earning interest within a day or two of the time I turn all the paperwork in.
>
> **Nat**: Let's do it.

Let's move on to an excerpt from his conversation with Janet, an elderly woman with a number of severe chronic conditions that require substantial, costly care and have led to early retirement:

**Barry**: I understand, Janet, from the little you told me over the phone, that you've got a concern about being able to remain in your home and living independently, because your current expenses are very high.

**Janet**: Yes. That's correct. I need more income than I can get from anything I've seen a bank offer, and I need to know I can count on the income from month to month. I have some resources, but I can't keep dipping into them every time I have a shortfall, or they'll be completely used up.

**Barry**: I understand, and I think I can help you. Do you have any children, Janet?

**Janet**: No, I don't. I have a niece and a nephew—my brother's children—but, they're pretty well along in setting up their lives.

**Barry**: So, there's no one you particularly want to leave money to at the end of your life?

**Janet**: No, no one.

**Barry**: Okay. I think I can help you get the income you want using a fixed annuity, Janet.

**Janet**: How does that work?

**Barry**: It's really very simple. When you purchase this type of annuity—called a single premium immediate annuity—you pay a lump sum just once. Then the insurance company that sells you the annuity guarantees to pay you a monthly income for the rest of your life, no matter how long you live.

**Janet**: Guaranteed, for life? What if I live to be 120?

**Barry**: The company pays, absolutely guaranteed.

**Janet**: So how do they make any money on me?

**Barry**: If the economy makes it possible, they make more investing the money than they pay out; or if the economy is not so good, they don't make much money on you, but do on people who buy these kinds of annuities and don't live to 120.

**Janet**: Sounds too good to be true.

**Barry**: But it is true, and what we would do to make sure the insurance company promises are met is go to one, or maybe more than one, very big, long-standing, financially stable company, and spread your risk around. And what's really great about purchasing an annuity is that there's no medical underwriting, no examination, no blood test, no waiting for your doctors to provide the insurance company with your medical records. You can fill out the paperwork today, give me a check, and have your first payment in your mailbox or your checking account in as little as a couple of weeks.

**Janet**: That would be a great relief.

**Barry**: Then let's get started.

Lastly, let's look at an excerpt from Barry's conversation with Tony.

**Barry**: So, Tony, I think I can be of service to you based on what you told me on the telephone. Let me recap what you said to make sure I understand what you want to accomplish: You're a widower, you've got two kids, you have a concern about the

rising cost of staying in your home, and you're afraid that those rising costs are going to force you to spend every penny you've saved, leaving you—and after you, your kids—with little or nothing to show for your life's work. Is that pretty much it?

**Tony**: That's it on the button.

**Barry**: Then I think I can help you. Would you be interested in looking at a way to get yourself some additional income every month for the rest of your life—more than you could get out of any bank CD or money market today?

**Tony**: Sure.

**Barry**: Would it interest you if we could build in a feature for that additional income payment to increase by a couple of percentage points every year to help keep pace with inflation and the increased costs of what you need to purchase to stay in your home?

**Tony**: Sure.

**Barry**: Would it interest you to be able to get that income stream right away, with no medical exam, not even any medical questions, right away—today—by just asking for it?

**Tony**: Sure, but this is starting to sound too good to be true.

**Barry**: Trust me. It's true. In fact, I ran some numbers for you, based on the date of birth you gave me. You can choose a monthly amount—increasing every year by 3% for inflation—for 10, 15, or 20 years, or a lifetime guaranteed period. Which one do you like?

**Tony**: I like the one that's going to give me the most money, of course.

**Barry**: Lifetime, then. Here's what you need to do . . . .

In these three appointments, Barry has provided Nat with what Nat thinks is a great vehicle in which to park the proceeds from the sale of his business and earn a very competitive interest rate; Janet with almost immediate income relief to help her with her medical bills and other living expenses; and Tony with an inflation-protected lifetime income. Barry seems to be nothing less than a saint to these three prospects. But from another perspective, we might think of Barry as a train wreck waiting to happen.

While Barry has provided Nat with access to an investment vehicle with a very attractive interest rate, he has not addressed Nat's real need to have access to his money in the short-term. Barry's comments about access to Nat's money only refer to any annual surrender charge-free withdrawal privilege that might be built into the annuity contract he's selling. It does not apply to the total withdrawal of the annuity account balance in the first couple of years. Best case with such an early withdrawal is that Nat would lose perhaps all or a portion of the interest earnings that have accrued in the contract. This assumes there is a principal guarantee in the annuity effective from inception. At worst, Nat could lose some of his principal to surrender charges, which is certainly not what he would expect. In fact, most annuities are not suitable for short-term investment. Though there are CD-type annuities that run for as little as one or two years, there is no indication that the annuity Nat intends to sell is such an annuity. If it were, one would have expected Nat to make much of that feature. By not addressing Nat's real potential need for total withdrawal of annuity funds or the surrender charges that might be incurred if the total annuity account value were withdrawn, Barry acts unethically, mismatching Nat's need to the product he is going to sell, a product clearly unsuitable for Nat's situation.

Barry's conversation with Janet focuses on her need for additional income to address the difficulty she's having paying her medical and general living expenses. Barry's presentation to her of an option to purchase a lifetime income, the first payment coming very quickly to provide her immediate relief, seems like a good thing to do. And, of course, it is, but it is not the right thing to have done. What Barry should have suggested to Janet—who has no one to be concerned about with respect to legacy planning—is a rated annuity, one that would indeed take into account her serious medical conditions. The result of taking those conditions into account would have been to provide Janet with a higher—perhaps substantially higher—lifetime guaranteed income than could be provided to her under any available standard annuity contract. By not addressing her medical issues, Barry has recommended that she purchase a product not specifically suited to her needs. In doing so, he has acted unethically.

In the bit of conversation excerpted from Barry's meeting with Tony, we find out that Tony needs additional income to deal with rising prices and he's concerned about all of his assets being spent, leaving him and his children with nothing from the many years he worked. In this case, Barry again mixes good with bad. The good is that he suggests a way for Tony to obtain some additional guaranteed income that can be increased annually to help address inflationary pricing trends. In his presentation of what Tony can actually receive, he lays out a number of options: Guaranteed income for 10, 15, or 20 years or for Tony's lifetime. Tony is thinking long-term and opts for a lifetime income. What Barry neglects to do is fully explore the options available to Tony. Barry doesn't mention the possibility of guaranteeing payments for a period of time in tandem with a lifetime payment guarantee. In addition, Barry doesn't address the fact that life-only benefits cease at the annuitant's death, regardless of when that occurs, leaving nothing from the annuity to pass on to heirs. These concerns may not have been high on Tony's priority list, particularly if he assumed that the additional income would allow him to retain his home as an asset he could leave to his children. What is unethical about Barry's interaction with Tony is that he doesn't address these issues with him. He withholds what might be important information to Tony, and in so doing has perhaps mismatched an annuity income option with Tony's broader needs.

### 8.4 Review Questions

QUESTION: Refer to Section 8.1, page 54

A disadvantage of investing in annuities is that moving those funds to an investment other than another annuity exposes previously tax-deferred earnings to taxation as ordinary income in the year they are moved.

ANSWER: T

True

RESPONSE: A

Your answer is correct.

ANSWER:

False

RESPONSE: B

Your answer is incorrect. A disadvantage of investing in annuities is that moving those funds to an investment other than another annuity exposes previously tax-deferred earnings to taxation as ordinary income in the year they are moved.

QUESTION: Refer to Section 8.2, page 55

_____ limits life insurance planning flexibility.

ANSWER:

No policy or annuity

RESPONSE: A

Your answer is incorrect. A secondary no-lapse guarantee universal life policy limits life insurance planning flexibility.

ANSWER: T

A secondary no-lapse guarantee universal life policy

RESPONSE: B

Your answer is correct. A secondary no-lapse guarantee universal life policy limits life insurance planning flexibility.

ANSWER:

A multiyear fixed rate annuity

RESPONSE: C

Your answer is incorrect. A secondary no-lapse guarantee universal life policy limits life insurance planning flexibility.

ANSWER:

A multiyear fixed annuity

RESPONSE: D

Your answer is incorrect. A secondary no-lapse guarantee universal life policy limits life insurance planning flexibility.

## 9.0 Conclusion

Treading an ethical path is not always easy. There are a wide range of concerns to be considered, not the least of which is that ethical behavior is not about good or bad behavior much of the time, but appropriate and inappropriate behavior, about whether one has done what is expected fully or only partially, about whether one has acted in such a way as to commit some kind of unethical act or to omit some act that casts an unethical light on what other good one might have done. Acting ethically in insurance sales situations is made even more complicated by the fact that every party in an insurance sales transaction—the field representative, the purchaser, the company—has its own set of expectations, some of which are in direct conflict with the expectations of the others. The growing complexity of products, insurance strategies and insuring techniques further complicates insurance sales transactions. All that can save someone from acting unethically is constant application and questioning: application to the task of keeping abreast of product and tax-law developments, application of the basic comprehensive fact-finding principles field people are taught in the early years of their training, and questioning oneself in every instance whether everything has been done to fully address a prospect's or client's needs in an unbiased and open manner.