An Ethical Insurance Practice

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The sales process is the heart of any company's distribution system. Its ultimate success is based on the salesperson's ability to develop trust and create rapport with a prospect. The salesperson's ethics and values contribute more to the process' success than any specific technique or strategy the agent might use. For a professional, selling is not a one-way transaction; instead, it is a collaborative process in which the professional and the buyer work together to achieve an exchange of value.

The Approach

"You never get a second chance to make a first impression" the old saying goes. The initial meeting with a prospective client -- the so-called "approach" -- is a critical one. Whether the salesperson is an agent, stockbroker or other financial services agent, he or she must be viewed as both competent and credible before the prospective client will trust the salesperson with the client's personal financial information.

The purpose of the approach step of the sales process is to cause the prospective client to come to the understanding that the agent is someone with whom he or she may want to do business as a result of the rapport that has been created. The approach may be accomplished in any number of environments -- in person, on the phone, etc. -- but to be ethical, any information imparted to the prospect in the approach step must be balanced and complete.

This step of the sales process allows the agent to present him- or herself to the prospective client, the most serious ethical issue in the approach step has to do with the agent's stating or implying that he or she has skills, experience or credentials that are not possessed. Consider, for example, the declaration that the agent is a financial planner or financial adviser when, in fact, the agent is a life insurance agent or registered representative. Such a statement could suggest to the prospective client that the agent was in the business of providing unbiased analyses of client financial situations while having no inherent conflict of interest. Of course, the agent's selling of financial products clearly creates such a conflict and makes that kind of statement misleading and a breach of ethics.

Misleading Credentials

Another type of misrepresentation occurs when agents use credentials to mislead prospects into thinking the agent is more experienced and knowledgeable than is indeed the case. There are a number of organizations that, for a fee, will simply hand out credentials and official-looking designations to bolster the agent's résumé.

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In 2008, Florida law was amended to specifically prohibit agents from using designations that misrepresent the agent qualifications:

- When making a sales presentation or solicitation for insurance, an agent is prohibited from utilizing designations or titles that falsely imply that he or she has special financial knowledge or has obtained specialized financial training or is certified or qualified to provide specialized financial advice to senior citizens.

- Terms such as "financial advisor" may not be used to falsely imply that an agent is licensed or qualified to discuss, sell, or recommend financial products other than insurance products.

- When making a sales presentation or solicitation for insurance, an agent is prohibited from falsely implying he or she is qualified to discuss, recommend, or sell securities or other investment products in addition to insurance products.

The law makes exceptions for bona fide credentials. An agent who also holds a designation as a certified financial planner (CFP), chartered life underwriter (CLU), chartered property casualty underwriter (CPCU), chartered financial consultant (ChFC), life underwriter training council fellow (LUTC), or the appropriate license to sell securities from the Financial Industry Regulatory Authority (FINRA) may inform the customer of those licenses or designations and make recommendations in accordance with those licenses or designations.

The manner in which the agent holds him- or herself out to the prospective client could also impact the client's reasonable expectations and the agent's liability. The reason for that heightened liability may be obvious; if the agent represents or implies that he or she has certain skills, the client may have every right to expect the agent to provide service at a level expected of one who possesses those skills. Failure to provide that expected level of service could make the agent liable for damages the client sustains as a result.

Some agents may choose to use a trade name. While using a trade name is certainly acceptable, its use by the agent as a way of identifying him- or herself without also identifying the company being represented would be misleading. To the extent that it misleads, it is unethical. Consider, for example, the life insurance agent who identifies himself simply as a member of the "The Suncoast Group" in order to disguise his affiliation with a life insurance company. There should be no question about the ethical value of that deception. The agent is clearly attempting to mislead his prospective client, an obviously unethical act. Any implication by the agent that he or she is affiliated with the government or any governmental agency in an attempt to suggest governmental approval of the agent or products is unethical.

Ethical Concerns During the Approach

Discussion in the approach step of the products being offered presents another area that could create ethical concerns. As in the other areas we've discussed, the ethical requirement is for full and fair disclosure. Any product discussion should have as its objective a complete understanding by the listener. Here are some practical examples of the meaning of full and fair disclosure:

- If the agent states or implies that the products offered involve tax advantages, it should also be stated that only a thorough review of the client's situation would determine if those advantages apply to him.

- The real nature of the product should not be obscured through the use of unfamiliar names. Any product should be identified by its common name. As an example, the use of the term "plan" or "private pension" to describe a life insurance policy could be unethical since those terms would tend to obscure the true life insurance nature of the product. Likewise, to refer to an HMO as "health insurance" would mislead potential purchasers as to the nature of the underlying product.

- Using highly technical information about the products being offered that could be expected to mislead the person(s) receiving the information is unethical even if the information is true in every regard. If the initial approach is made by telephone, as is normally the case, the agent should usually avoid discussion of specific products since adequate explanation in the relatively short space of time on the telephone is difficult. An attempt to discuss a complex financial product in this setting often results in misunderstandings. Unless the prospect is highly knowledgeable with respect to the product, a brief explanation is more likely to cause confusion rather than understanding.

- Even providing the prospect with a disclosure documents such as an outline of coverage or prospectus -- without a discussion of the various costs of the product with the prospect -- could be unethical if the agent believed the documents would not be read. A failure to discuss costs would be less than full and fair disclosure.

Interviews

Usually, the first substantive step in the sale process is the **opening interview**. The principal function of the opening interview is to continue to develop the rapport created in the approach step. The opening interview is typically followed by the fact-finding interview. As was mentioned in earlier chapters, insurance agents have a fiduciary responsibility to the insurers they represent. The ethical principles governing full disclosure require that the prospective client be fully apprised of the agent's status as an advocate for a financial product or products.

To be ethical, agents must share identifying information with the client. This includes the agent's status as a property and casualty, health or life insurance agent. If the agent represents a particular company, the status as a representative of that company needs to be disclosed, as well as any other relevant business arrangements.

Often the prospect needs to be disturbed about his or her present situation before taking any steps to improve it. There is a fine line, though, between rousing a client's interest and scaring them. Any effort to outline risks should be balanced and represent realistic scenarios.

Agents also use testimonial letters from satisfied clients. If you choose to use testimonials or en-

dorsements, they must be genuine and reflect the endorser's *current opinion*. Any financial interest held by the endorser -- for example, that it is a *paid* endorsement -- must be disclosed.

Sometimes a **fact-finding interview** is scheduled as a separate meeting; but just as often, it flows as a natural extension from the opening interview. The object of the fact-finding interview is to gather sufficient information to analyze the client's needs and support a recommendation that is suitable to the client's situation -- consistent with his or her objectives and tolerance for risk.

Usually, the fact-finding step of the sales process presents few specific ethical issues that have not already been considered. The agent has an ethical and legal duty to make a diligent effort to determine all of the client's circumstances that are relevant to his financial situation. For the financial services agent seeking to make a suitable recommendation, these circumstances include the prospect's current finances as well as his or her hopes and dreams.

Whenever interacting with the prospect, care must be taken to ensure that your questions don't inadvertently lead the prospect to believe that you are in the business of providing services not actually provided. For example, a general lines agent is discussing an auto policy's personal injury protection (PIP) and questions an applicant about her current health care coverage as part of the fact-gathering process. The agent should not suggest that PIP is a substitute for comprehensive health coverage, nor should the agent imply that he is a health insurance agent unless that is indeed the case.

Likewise, the marketing tools that the agent uses could lead the prospect to erroneous conclusions. For example, suppose the data-gathering form shown to the prospect is titled *Financial Planning Form.* It would be reasonable for a client to come to the mistaken conclusion that the agent is in the business of providing financial advice for a fee – as opposed to earning a commission on sales. Agents have the responsibility to avoid anything that could reasonably be expected to mislead the prospect. Additionally, you have the ethical responsibility to correct any misperception of which you become aware.

Privacy of Client Information

Federal law requires financial institutions, including insurance companies, banks, brokerage firms, etc., to safeguard the privacy of client financial information. The Financial Modernization Act of 2002, also known as the Gramm-Leach-Bliley Act, limits the ability of financial institutions to share non-public financial information. This federal law requires state regulatory authorities to enforce restrictions on the use of such client information -- Florida's Department of Financial Services complies with this federal mandate.

In general, the rules require insurers to notify policyholders and other customers of their privacy rights (what type of information is collected and disclosed, the types of affiliates and other third parties with whom information might be shared, etc.) This disclosure is required when the relationship is established, and an annual notification thereafter. Customers must be given the opportunity to "opt-out" of information sharing for marketing and other purposes not related to the execution of the contract. Non-public information may be disclosed to the extent it is necessary to implement the contract. This rule also extends the policyholder's privacy rights to health information collected

by the insurer. Agents should be aware that information collected during the fact-finding interview is "privileged" and the consequences of unauthorized disclosure of financial and medical information.

Presenting Recommendations

A critical step in the sales process is the presentation of the agent's recommended course of action. The purpose of this step is to present to the prospect a solution to a need that he or she has admitted having. Two primary ethical considerations of this step are suitability of the recommendation to the client's needs and a balanced disclosure of risks and benefits.

The only ethical recommendation an agent can make is one that is "suitable" for the client. The overriding ethical issue with respect to product selection is that it must be suitable to the prospect's particular circumstances and the produce meets the client's needs.

During the early phases of the sales process, agents should inquire as to the prospect's tolerance for risk -- financially and psychologically. Prospects will vary substantially from one to the other in their risk-comfort levels. While many will avoid risky planning strategies, others will try to push the envelope as much as they can. When discussing the possible use of strategies or products that involve risk, the key ethical consideration for the agent is appropriate risk disclosure. The competent agent will understand the risk being taken by the prospect that implements a proposed strategy; often, however, the prospect's awareness level is far below that of the agent. The agent's failure to advise the prospect of the risks inherent in the adoption of any recommended strategy is unethical and likely to expose the agent to the risk of a malpractice claim.

The second ethical consideration in the presentation step concerns how the product being presented is communicated to the prospect. Obviously, the product must be properly identified. Regardless of the nature of the recommended product, it needs to be referred to in terms that offer understanding. Agents should use general terminology to identify the recommended product. Insurance products should be described as a means of protection, not as an investment vehicle. Calling the product by a name that is unfamiliar to the prospect may result in its true nature being disguised. To do so intentionally is unethical.

Misleading Terms

Selling often involves educating the prospect has to how a recommended product functions. When the client possesses only a rudimentary knowledge of financial products, this process is frequently done by explaining the unknown in terms of what the client already knows. This fundamental teaching technique is commonly used when selling insurance coverage since insurance tends to be a somewhat complicated subject for many customers.

Using that teaching technique, we might use phrases like "similar to" or "very much like." However, this intention to make insurance clearer and its benefits more obvious to our prospects may have unintended and serious adverse consequences. The ethical risk of an analogy is that it often leaves out more important information than it imparts. As a result, the prospect may have an in-

complete and erroneous understanding of the product. For example, referring to the personal injury protection of an automobile policy as "health insurance" overlooks the limited role that coverage may afford the client.

In many cases, the customer remembers only the analogy and may believe the insurance product is identical to the product to which it was compared. Eventually, the customer may discover that the insurance is not identical to the product used in the analogy. Frequently the customer then feels that the insurance product has been misrepresented and that he or she has been misled.

Since the ethical requirement in the insurance business calls for the full and candid disclosure of everything that is material to the sale, the agent needs to avoid any terms that might tend to obscure the facts. It is both ironic and unfortunate that the terms that might have been used to help clarify the insurance product at the time of the sale are often viewed as obscuring those facts the agent hoped to make clear.

Since certain terms have a high likelihood of ultimately being misleading when used to describe the features of insurance products, the ethical agent will take pains to avoid them. Premiums should never be referred to as "contributions, deposits or investment". Insurance policies should be referred to as such, not as "accounts, plans, programs or strategies". Instead of illuminating the agent-customer conversation, these terms obscure it. Likewise, agents should be careful to not confuse the terms "tax-deferred" with "tax-free"—and any discussion of tax benefits should be full and balanced.

Another ethical concern is when the terms used to refer to insurance products have a different meaning when applied to non-insurance products. For example, a dividend on a participating insurance policy is in reality a refund of premiums paid by the policyholder. In non-insurance contexts, dividends are a return of profits earned by a corporation. To state that policy dividends are an "investment return" or to allow a client to believe that is misleading and unethical, for a couple of reasons: It misstates what a policy dividend truly is, and it mistakenly draws a parallel between insurance and securities.

In summary, misrepresentations, whether deliberate or unintentional, are the root cause of many ethical lapses. The misrepresentation may be in writing, but is more often verbal. In most cases misrepresentations are unintentional -- the agent believes that he or she is being truthful -- but the agent's ignorance is not a defense against liability arising out of unintentional misrepresentation. The existing laws that hold agents responsible for misrepresentation are generally based on the premise that agents have an ethical duty to know what they are selling and to present policies in a truthful manner.

Comparisons

Comparisons of insurance policies must be approached carefully. It is rare when an agent compares two policies with identical coverage. More likely, comparisons of policies will be "apples-to-oranges". The purpose of a comparison is to educate a client, so that he or she is better able to make a fully-informed decision. A fair and balanced comparison that details the pros and cons of each product along with a detailed examination of their similarities and differences is the only ethical way to do that.

Rarely does an agent represent the full range of insurance products available in the market-place. Clients may be approached by agents of competing insurers. Agents will often present the relative merits of competing products or sponsoring companies. The ethical imperative in such a comparison is that it must be balanced and complete. A "balanced" comparison is one that compares all of the important features of the products and examines the advantages and disadvantages of both products. It is obvious that the intentional misstatement of fact concerning a competing company or product would be unethical; it may be less obvious that the intentional *omission* of material information would also be unethical. The guiding ethical principal is that a comparison must include a comparison of all of the important features.
Statistics are often necessary and helpful when comparing products or companies; they must be substantiated and referenced whenever they are used. Agents should be careful that statistics be used only to clarify a comparison and not used to confuse the prospect or obscure the facts.

Marketing Materials

Insurer-provided product illustrations and sales materials normally present few ethical problems -- principally because they are insurer-provided. The significant ethical issues generally arise when the illustration is not insurer-provided but is created by an outside vendor or by the agent. Insurers often prohibit the use of illustrations created by their agents unless the illustrations have been approved by the sponsoring company. The obvious reason for the prohibition is that company-created illustrations contain important information that helps provide a balanced and complete presentation of the product to the prospect.

While an agent should only present illustrations provided by the sponsoring companies, sometimes it may be desirable to present supporting or ancillary information to the prospect. These supporting illustrations present a large area of ethical concern. In order to comply with ethical obligations, an agent should be sure these supporting illustrations are accurate, balanced and complete, and presented in a manner that enables the client to understand the situation as it truly is. For example, an illustration that presents only the benefits of an offering without consideration of the attendant costs would be unbalanced, misleading and unethical.

Any sales literature used by the agent -- including agent-created supporting illustrations -- should be submitted to the companies whose products are illustrated for their input and approval. While many companies require submission of sales literature, the agent should submit the point-of-sale supporting information used to all of the companies represented, *whether or not they require such submission*. Insurers are generally better equipped to assess the ethical and legal pitfalls inherent in the literature. And, we shouldn't forget that the agent has an ethical and legal duty to those companies that could be held liable for his acts by virtue of the law of agency.

Testimonials and endorsements

Florida regulations require testimonials and endorsement by third parties to "be genuine, represent the current opinion of the author, be applicable to the policy advertised and be accurately reproduced". If the person endorsing the insurance product is considered a "spokesperson"", the spokesman most likely must be licensed as an insurance agent. A spokesperson is anyone who has a financial interest in the insurer, is in a policy-making position or is in any way directly or indirectly

compensated for making a testimonial or endorsement. The financial interest of the spokesperson, or his or her capacity as a representative of the insurer must be disclosed. If the spokesperson is compensated for the testimonial or endorsement, the phrase "Paid Endorsement" must also be included. When a testimonial refers to benefits received under a policy for a specific claim, the specific claim data, including claim number, date of loss, and other pertinent information shall be retained by the insurer for inspection for a period of four years.

Follow-through

While ethical problems and compliance issues can occur during the sales process, many ethical issues arise out of the agent's conduct following the sales interviews. Keep in mind, ethical lapses can occur from things the agent does (*errors of commission*) as well as what an agent fails to do (*errors of omission*). Two critical problem areas are:

- failure to *obtain* proper coverage, and
- failure to *maintain* proper coverage.

These problems frequently occur on the property & casualty side of the business.

Failing to *obtain* coverage is usually caused by one or more of the following: improper analysis of the client's needs, failure to request the proper form of coverage from the insurer, or delays in obtaining the necessary coverage.

Failing to *maintain* coverage usually occurs because of a failure to notify the insured of non-renewal or internal agency problems in renewing coverage. According to industry surveys, renewal-related complaints account for more than one-third of all errors and omissions claims for property & casualty agents. Such problems often affect health agents as well. Since many life policies are permanent, renewal problems are less frequent than in health coverage or P&C business.