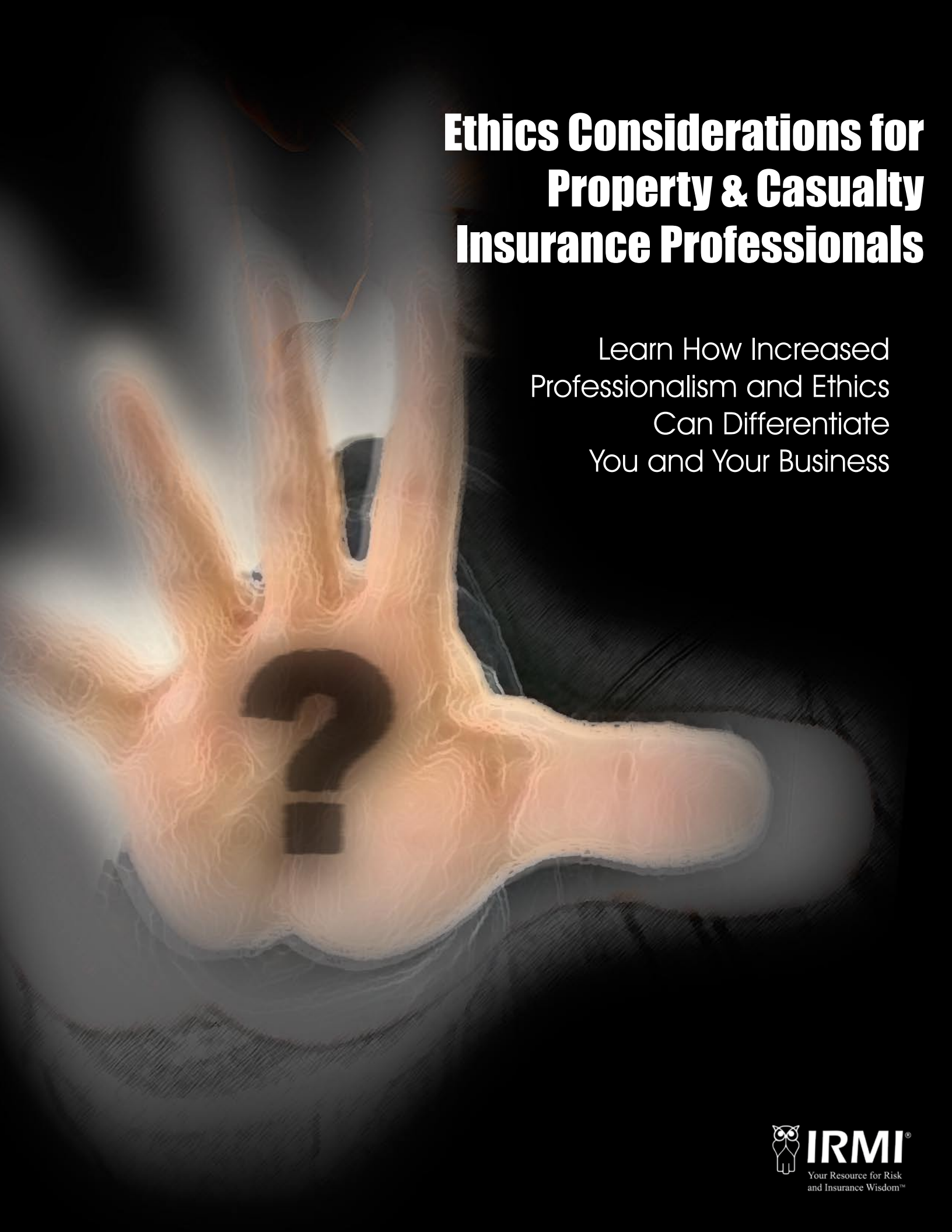


# Ethics Considerations for Property & Casualty Insurance Professionals

Learn How Increased  
Professionalism and Ethics  
Can Differentiate  
You and Your Business



# Ethics Considerations for Property & Casualty Insurance Professionals

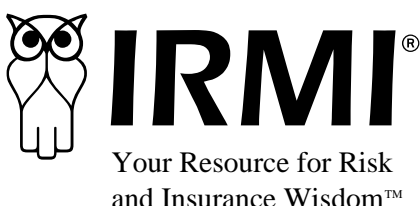
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# Ethics Considerations for Property & Casualty Insurance Professionals

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# Preface

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*Ethics Considerations for Property & Casualty Insurance Professionals* is the text for an online insurance continuing education course prepared by International Risk Management Institute, Inc. (IRMI) and WebCE. We are making this text available at no cost to insurance practitioners as part of our ongoing support of professionalism and ethics in the industry. We sincerely hope that you find it interesting and useful.

The ethics CE requirement in most states may be met by successfully completing the online exam for this course on our Web site. Of course, there is a fee for the CE credit (in most states the fee for this course and any others you may need to complete your annual CE requirement is under \$50). To learn more, visit this Web site: <http://irmi.webce.com>.

With a premise that ethics is good business, this booklet avoids academic and philosophical discussions to focus on some of the practical considerations for insurance agents, brokers, and adjusters. It discusses the concepts of ethical behavior, conflicts of interest, and some of the real world ethics failures that hit the headlines in recent years. The ways people can gain the trust and confidence of others—and succeed in business—by demonstrating ethical behavior are examined. It looks at the objectives of ethics codes, provides examples of ethics codes, and gives guidance on how to draft an ethics code for a business. Lastly, it challenges the reader to think about ethical decision-making with real world case studies. This course is intended for insurance professionals at all levels of experience. After reading this booklet, you will:

1. Know some of the key questions to consider when trying to make an ethical decision.
2. Understand the need to use individual judgment and reasoning in resolving ethical dilemmas in insurance.
3. Know specific ways to demonstrate to others a commitment to ethics.
4. Understand the reasons organizations develop ethics codes.
5. Have specific ideas for developing a code of ethics for your organization.
6. Have experience in identifying and resolving ethical dilemmas in insurance situations.

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# Chapter 1

## Ethics Defined

A common dictionary definition of the term “ethics” is “a system of moral standards or values” (*New World Collegiate Dictionary*, 3rd ed., Simon & Schuster, 1996). Another common definition in books and Web sites is “the rules or standards governing the conduct of a person or members of a profession.” While these definitions give an indication of what ethics is, they fail to provide definitive insight because different people and different organizations have different standards and values. Thus, an action considered to be ethical by one person might not be considered ethical by another.

Over the years, philosophers, religions, and various groups have attempted to define ethics and to formulate standards and values to which people should adhere. Additionally, the leaders of nations play a large role in establishing standards and values for their citizens, and corporate executives set the ethical tone for their organizations.

While these environmental factors shape the behavioral expectations for people in societies and organizations, family upbringing and the values learned as a child also have a substantial influence on an individual’s ethical standards. Since the teachers of these values have varying beliefs, there is great variation in the standards and values that people develop. Nevertheless, this is where most people learn to recognize basic ethical and moral behavior, such as it being wrong to kill or wrong to steal. While there are certain basic universal standards such as these, even they have gray areas. The three ethical questions presented in Exhibit 1.1 illustrate how basic universal standards for moral and ethical behavior can have gray areas.

### **Exhibit 1.1** **Examples of Gray Areas in Ethical Questions**

1. Is it wrong to kill in time of war?
2. Is capital punishment wrong?
3. Is it wrong to steal to feed your children if they are starving?

It is the gray areas that challenge us when trying to make ethical decisions. If it is difficult to answer basic questions such as these; it is all the more difficult to answer business ethical questions that are not covered by rules or laws of religion or society.

## Ethics Considerations for Property & Casualty Insurance Professionals

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Often the gray areas in business ethics require a difficult choice between two “right” answers rather than a “wrong” and a “right” answer. For example, should a company accept certain risks to the health of its employees if it will enable the company to improve its profits and pay the employees more? By not engaging in this new activity, the employee’s financial well being is harmed, as is the company’s. On the other hand, by engaging in it, the employee’s health is at risk—and the company may also ultimately incur substantial additional costs if the risk results in actual harm. These are the types of ethical decisions that are most difficult to make—and most easy to second guess after the fact.

While the law provides some help, it doesn’t go far enough to be a person’s sole guide to ethical behavior. Laws are not generally adequate standards for reaching ethical decisions. Illegal acts are unethical, but compliance with the law does not always equate to ethical behavior. In other words, actions that are completely legal may still be unethical. Essentially, laws might be viewed as establishing the minimum standard of acceptable behavior in a society while ethics goes beyond the minimum standard to promote optimal behavior. Ethical behavior recognizes and abides by the spirit of the law, not just the law itself.

Some qualities that society views as ethical are listed in Exhibit 1.2.

### Exhibit 1.2 Ethical Qualities: What Society Values

**Honesty**—telling the truth and earning trust from others.

**Integrity**—doing what is right without regard for the consequences.

**Responsibility**—honoring promises and commitments.

**Respect for others**—making decisions in a manner that treats people fairly and consistently.

**Courage**—making the right decisions, even when they are unpopular.

## Conflicts of Interest and Ethics

A conflict of interest might be described as a situation in which a person or organization has a personal incentive to make a decision or act in a way that is not in the best interest of another party to whom the person owes such a duty. The incentive is often financial in nature, but may be something else. Conflicts of interest are inherent in life and in business, and a person’s ethics largely determine how the person will deal with a conflict of interest. An ethical decision is one in which the person makes the best choice in compliance with his or her duty rather than the best choice for him or her personally.



Since conflicts of interest in essence are the causes of unethical behavior, reducing or eliminating them helps lead to ethical conduct. This is why many ethics codes, the subject of Chapter 5, prohibit certain activities that result in conflicts of interest.

Nevertheless, it is impossible to eliminate all conflicts of interest. They are unavoidable in the insurance business or any business. For example, the traditional approach to compensating an insurance agent or broker—commissions—gives the agent or broker a financial incentive to seek higher premiums for his or her customers. Of course, in addition to the ethical issues, the competitive marketplace makes this practice unfeasible. Nevertheless, the conflict exists.

Many conflicts of interest, such as the conflicts associated with sales commissions, are obvious and are acceptable because the other party knows of them and can factor them into his or her own decision making. On the other hand, many conflicts of interest are not obvious. These often arise from unique circumstances, relationships, or business arrangements that are not known to the other party. For example, an insurance brokerage that owns all or a substantial portion of an insurance company would have certain conflicts of interest with respect to placing its clients with the company. The mere fact that there are conflicts of interest does not mean the broker is unethical. Rather, the conflicts might be looked upon as temptations that the broker must resist if it will provide ethical advice and service to its clients.

One of the primary techniques for dealing with conflicts of interest such as these is to disclose them. A number of things occur when the other party is made aware of a conflict of interest. First, if the party determines that the conflict of interest is unacceptable, he or she has the option of doing business with another party. Second, the impact of the conflict is reduced because it becomes much more difficult to act unethically than when the conflict is not known by the other party. Third, the other party has the knowledge to factor the conflict into his or her own decision-making. Fourth, disclosing the conflict avoids the suspicion that would arise with the other party if he or she discovered an undisclosed conflict on his or her own (even if no unethical behavior had resulted from the conflict of interest, the mere fact that it was hidden will raise suspicion).

Recent insurance scandals have caused the industry to focus on increasing “transparency” in insurance transactions, particularly with respect to the flow of compensation to intermediaries. While disclosure or transparency does not prevent unethical behavior, it reduces the temptation and makes it more difficult. Insurance professionals who embrace this concept are likely to benefit from it in the long run.

## Ethics in Summary

Stated generally, acting ethically is simply “doing the right thing.” It involves applying individual values and standards to balance various interests and make the best possible decision for all parties concerned. Independent insurance agents and brokers, for example, must consider the sometimes opposing interests of their employer, the insurer(s) they represent, and their customers. The agent or broker will have varying moral and legal duties to each of these constituents to consider when making decisions. In balancing conflicting interests to make ethical decisions it is often useful to consider the answers to such questions as those found in Exhibit 1.3.

**Exhibit 1.3**  
**Balancing Conflicts of Interest: Questions To Consider**

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1. What are my legal duties and contractual obligations in this situation?
2. What benefits and what costs or harms does each course of action produce for each involved party, and which alternative leads to the best overall result?
3. Does one course of action best respect the moral rights of all the parties?
4. Is one course of action fairer to all the parties than are the others?

Of course, making ethical decisions will sometimes reduce compensation. For example a recommendation to change insurers to obtain broader coverage at a lower premium will result in lower commission income. However, over the long term, the reputation one earns through consistent ethical behavior is likely to provide far greater financial rewards than will be gained by periodically relaxing ethical standards to maximize short term financial gains. Individuals who consistently make ethical decisions gain the trust and respect of those around them. This trust and respect will usually translate into career success.

# Chapter 2

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## Ethics is Good Business

The most basic advantage of ethics and integrity is that it gains people's trust and opens lines of communication. An individual who behaves ethically and with integrity will quickly gain the trust of others. This trust will allow them to communicate more openly with the ethical individual because they will not fear that the information they divulge will be used improperly (i.e., against them). Thus, an organization that requires ethical behavior at all levels is likely to have higher morale among its workforce and greater loyalty from its customers than one that does not. This inevitably leads to more sales and higher profits.

Having a formal code of ethics that is strongly supported by the organization promotes ethical behavior throughout the company by helping people manage values and conflicts. When a difficult decision arises, people will intuitively make the right choice by following the code. Some decisions are easy (don't steal, don't lie). However, many business decisions involve conflicts between choices, alternatives that can all be justified (or rationalized), and different consequences for the various stakeholders. There is a wide range of gray areas, and a code of ethics can help employees make ethical choices.

In other words, having employees who are customer focused and ethical will promote good decision making. Decisions made with the best interest of customers in mind will rarely be bad decisions. Nevertheless, good employees will not always make the very best decisions. If they follow the ethics code, however, even their poor decisions will be moral and legal. Thus, another important advantage of behaving ethically as an individual and establishing a requirement of ethical behavior throughout a company is avoiding regulatory or legal troubles.

Particularly in the new world of insurance following the fallout from Eliot Spitzer's investigations into the industry, ethics can be a valuable sales tool. People want to do business with people and organizations they can trust. An agency, brokerage, or insurer that can demonstrate a strong commitment to ethical behavior will have a leg up on its competition. Adopting and committing to a strong code of ethics and showing that it is taken seriously from the top management down is how this is achieved.

### Examples of Ethical Behavior

If ethics and integrity will cause people to place their trust and confidence in you, career success can be facilitated by displaying your commitment to these concepts. You can demonstrate your integrity through your actions. Some examples of ethical behavior are listed in Exhibit 2.1.

### **Exhibit 2.1** **Examples of Ethical Behavior**

- Only making promises that you can keep.
- Fulfilling all promises you make or explaining why they cannot be fulfilled.
- Being honest in all communications.
- Accepting only assignments that are within your realm of expertise.
- Never overselling your knowledge or abilities.
- Disclosing bad news in a timely manner.
- Disclosing unavoidable conflicts of interest.
- Admitting when you do not know the answer to a question.
- Working through the proper channels to get something done rather than going around them.
- Maintaining confidences.
- Quickly admitting and rectifying mistakes.
- Associating with others who are known for their ethics and integrity.
- Joining organizations that support ethics and integrity in business.

People who consistently display these behaviors are quickly perceived as dependable and trustworthy. These are the people with whom others want to do business. Add to this mix an in-depth and up-to-date knowledge of the technical side of the business and you become an insurance professional. Conversely, it is wise to be careful when dealing with people who exhibit the opposites of these behaviors until they demonstrate that you can trust them.

The insurance business inevitably presents conflicts of interest and the possibility of unethical behavior. Exhibit 2.2 presents some examples of ethical behavior in situations where conflicts may exist.

### **Exhibit 2.2** **Make Ethical Choices When Conflicts of Interest Arise**

- Obtain competitive proposals from insurers only in those situations when the customer would be willing to change insurers.
- Advise customers when an error causes the premium quoted or charged to be higher than it should have been and quickly processing a refund.
- Upon request from the customer, fully disclose all compensation received from any source in placing a customer's insurance.
- Abstain from the practice of locking up markets in competitive bidding situations by contacting insurers from which you have no intention of requesting bids.
- Disclose to the insured any "subjectivities" or "contingencies" that are contained in a quote such as loss control recommendations or loss runs that may need to be provided.
- Don't "shop quotes" (i.e., avoid telling one underwriter the premium his/her competition has proposed).
- Assure all exposure bases (valuation, payroll, sales) are stated correctly so that the insurer receives the appropriate premium at inception and the insured avoids a large audit additional premium or co-insurance payment.
- Only request an Agent or Broker of Record Letter when it is needed and make certain the insured understands the implications of signing it.
- Place a client's business with the insurer that provides the broadest coverage terms at the lowest price even though another market would pay a higher commission.
- Never restrict a customer's coverage to reduce the premium without being certain that the customer understands the implications of the change.

Companies that operate ethically and with integrity often contribute to their communities in many ways, earning reputations of being good corporate citizens. The Web site [www.businessethics.com](http://www.businessethics.com) demonstrates this with its annual listing of the 100 Best Corporate Citizens. Some examples of these activities among the 100 best in 2004 included those presented in Exhibit 2.3.

### **Exhibit 2.3** **Corporate Ethics: Examples of the 100 Best Corporate Citizens, 2004**

- Fannie Mae (number 1) created a Native American Conventional Lending Initiative to help finance \$75 million in loans on trust land for the Navajo Nation of Arizona, Oneida Nation of New York, and Menominee of Wisconsin.
- Green Mountain Coffee Roasters (number 5). Though it could take advantage of farmer cooperatives in Peru, Mexico, and Sumatra, Green Mountain pays Fair Trade prices for coffee beans.
- Deere & Company, Moline, IL (number 6). As one example of its practices, John Deere recently decided to forgo selling prime real estate to a developer, instead donating \$1.5 million in land and facilities to Western Illinois University, allowing the university to better serve the community, including Deere's employees.
- Eastman Kodak (number 58) was recognized for their anti-discrimination policies toward gay, bisexual, and transgender employees. These policies have earned the company the rare distinction of receiving a perfect score from the Human Rights Campaign.

Source: [www.businessethics.com](http://www.businessethics.com)

## **Recent Ethical Issues in Business—How Not To Act**

Over the past few years there have been several notable cases where large, well-known businesses suffered serious financial loss on which unethical or illegal behavior by management was blamed. A review of these illuminates many examples of improper behavior.

For example, Enron was involved in energy trading and distribution. At the time of its demise, it was the seventh largest corporation in America. The company was accused of causing energy shortages in California to increase prices and profits. In addition, it hid over one billion dollars of debt through complicated offshore trusts and partnerships. Although this was known to management, the CEO continued to tell analysts and investors that the company was in good shape, and employees were encouraged to invest in the company through their 401K plans.

When these discrepancies came to light, the stock price plummeted and the company could no longer borrow money to handle its debt load. Employees were not allowed to liquidate their holdings, causing many to lose huge amounts of retirement funds. The ongoing investigation and civil and criminal actions have resulted in charges of buying influence at senior government levels, improper campaign contributions, and document shredding by both Enron and its former accounting firm. While there are many ethical issues surrounding the ENRON debacle, some of the most notable were the use of complicated offshore schemes only to obscure financial transactions and the many dishonest statements made to investors, employees, and the public.



Accused of overstating 2002 results by almost \$400 million, Tyco is another company that was in the headlines. The investigation indicated that the practice had gone on for 5 years. In addition, several senior executives were accused of paying themselves exorbitant bonuses and using corporate funds to purchase extravagant parties and luxury items for personal use. The key ethical issues in this case are using corporate funds for personal gain, falsifying business records, and distorting results to increase the price of the company's stock. Tyco is an excellent example of corporate executives not "walking the talk" with respect to ethics and integrity. The senior executives who so unabashedly used corporate funds to finance their own lavish lifestyle certainly were not setting an example for ethical and honest behavior in the organization. A jury found the CEO and CFO guilty of 22 counts of larceny, violations of business laws, conspiracy, and falsifying records, and they are now serving prison terms.

WorldCom began as Long Distance Discount Service (LDDS). It was later renamed WorldCom and the company bought long-distance provider MCI. Over the years, WorldCom grew through mergers with UUNET Technologies Inc., MCI, Brooks Fiber Properties, and CompuServe until it became the nation's second-largest telecommunications company, a Fortune 500 company employing over 60,000 people. The CEO, Bernie Ebbers, was reportedly worth over \$1.4 billion.

The downfall began in 1999 when a \$115 billion merger with Sprint failed. WorldCom's bankruptcy had a devastating effect on the small town where it was located through unpaid taxes, utility bills, and wages. In addition, the huge unemployment rate caused many small businesses that depended on WorldCom employees purchases to fail. Ebbers was accused by federal prosecutors of directing the \$11 billion accounting fraud that led to the company's downfall. He was ultimately indicted, found guilty of fraud, and is now serving a prison term for his misdeeds. The key ethical issues in this case are mismanagement of stockholders assets and alleged fraud.

HealthSouth Corporation ("HRC") is the nation's largest provider of outpatient surgery, diagnostic, and rehabilitative healthcare services. It owns or operates over 1,800 different facilities throughout the United States and abroad, including inpatient and outpatient rehabilitation facilities, outpatient surgery centers, diagnostic centers, medical centers, and other healthcare facilities.

HRC was accused by the government of overstating its earnings by at least \$1.4 billion over a period of years beginning in 1999. This massive overstatement occurred when HRC's earnings fell short of Wall Street estimates, and the CEO allegedly directed HRC's accounting personnel to "fix it" by artificially inflating the company's earnings. To balance HRC's books, the false increases in earnings were matched by false increases in HRC's assets. By the third quarter of 2002, HRC's assets were overstated by at least \$800 million, or approximately 10 percent of total assets.

HRC executives also knew that its outside auditors only questioned additions to fixed assets at any particular facility if the additions exceeded a certain dollar threshold. Thus, when artificially increasing the "AP Summary" at a particular facility, they were careful not to exceed the threshold. HRC also created false documents to support its fictitious accounting entries.

While the scheme was ongoing, HRC's senior officers and accounting personnel claimed they periodically discussed with the CEO the false financial statements, trying to persuade him to abandon the scheme. But they claimed he insisted that the scheme continue because he did not want HRC's stock price to suffer. From 1999 through 2001, he received \$9.2 million in

## Ethics Considerations for Property & Casualty Insurance Professionals

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salary. Approximately \$5.3 million of this salary was based on HRC's achievement of certain budget targets that the accounting scheme to artificially inflate earnings made possible.

In August 2002, in an attempt to lower Wall Street expectations, he allegedly authorized a scheme to blame a change in Medicare billing procedures for reduced future earnings. The earnings reduction was announced at \$175 million, when management knew it would be less than \$30 million. The apparent hope was, that by lowering Wall Street expectations, this press release would reduce the need to artificially inflate earnings in the future.

Once again the key ethical issues are the fraudulent and intentional misrepresentations of the company's financial results. The criminal investigation into the fraud at HealthSouth resulted in 15 guilty pleas, including five former CFOs' admissions of criminal behavior. Additionally, the company's former CEO, Richard Scrushy was indicted and tried. While the jury acquitted him on all 36 counts, he spent some \$25 million on his defense, and spent nearly 2 years in a legal battle. In an interview regarding the surprise verdict, one of the jurors was quoted as saying "there was fraud, but there was no smoking gun."

While the executives who engaged in these practices at these companies experienced short term financial gains as a result of their unethical and, often, illegal behavior, they ultimately paid a high price for it. Many lost all or large portions of their fortunes, were discredited in their communities, and have faced harrowing trials. Some have committed suicide while others received jail sentences. They all have tainted reputations that they will never regain. Ultimately, they did not profit from their unethical behavior.

All of these corporate scandals required participation from a number of individuals within the organizations. While, in many cases, they may have been initiated by a single person, others were persuaded to cooperate with or at least overlook the indiscretions. This could not occur in a company that is truly committed to ethical behavior and has integrated this commitment into its corporate culture. Such indiscretions probably would not be attempted in the first place. However, if they were, someone in the organization would disclose them long before they reached crises mode.

### ***The Aftermath of Recent Insurance Industry Issues***

Though certainly not as catastrophic as those reviewed above, the property casualty insurance industry has unfortunately experienced a series of high profile ethics-related issues in recent times. The industry was already saddled with a poor public image that was further exacerbated by these events. This poor image has been documented again and again in public opinion surveys. Some of the reasons for this perception are provided in Exhibit 2.4.

### **Exhibit 2.4** **Some Reasons for the Insurance Industry's Poor Public Image**

- The industry goes through soft and hard market cycles of cutthroat price wars and seemingly unsupportable price hikes. There are often no logical reasons supporting these cycles, though many excuses are given at the time they occur.
- The very nature of the product requires the industry to interact with people in times of grief, loss, and stress. Sometimes more bad news must be delivered—such as a coverage denial, reduced claim payment, or coinsurance penalty—which causes resentment.
- In some cases, management focuses on short-term gains designed to create immediate stock value, rather than looking longer term. Downsizing has resulted in insurance company offices being further from the agent and customer, thus losing the sense of trust that once existed.
- Many insurers, as an economic measure, have cut back on training programs for employees. Many stopped bringing new people into the business many years ago. This is starting to create a shortage of qualified middle managers with strong insurance backgrounds.
- In some cases, downsizing has resulted in an inability to provide quality service to agents and insureds.
- The industry does a poor job communicating with insureds about the purpose of insurance and the factors that go into underwriting and marketing decisions.

Recent scandals involving the brokerage community have also marred the image of agents and brokers. In 2003, Eliot Spitzer, the attorney general for the state of New York began an investigation of the insurance brokerage industry. His focus was on the conflicts of interest that arise from the acceptance by brokers of contingent commissions from the insurers with which they place their customers' business. Mr. Spitzer subpoenaed records from a number of large brokers and commercial lines insurers. In October of 2004 he filed an action against Marsh & McLennan, the largest broker, alleging bid rigging and other indiscretions.

The bid rigging allegations were that Marsh employees in its global Broking unit would obtain intentionally noncompetitive quotes from insurers—sometimes called “B quotes”—to make the incumbent insurer's quote look favorable. The broker's employees purportedly pressured underwriters to provide these quotes by threatening not to send them business in the future. Such activity is illegal under various federal and state laws. As of this writing in August 2005, investigations into these matters are ongoing, but it does not appear to have been a

## Ethics Considerations for Property & Casualty Insurance Professionals

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widespread practice within the industry or even at Marsh. Nevertheless, some 16 employees of four insurance companies and Marsh have thus far entered guilty pleas to various misdemeanor and felony criminal charges (i.e., attempted restraint of trade or scheming to defraud). Presumably, these plea bargains are intended to gain testimony for a case against one or more higher level officials with Marsh or an insurer, but only time will tell if this is will happen.

Ultimately, Marsh settled with the attorney general, agreeing to discontinue the practice of accepting contingent commissions, fully disclose all compensation received from placing a customer's insurance, and to repay its past customers \$850 million. Once Mr. Spitzer settled with Marsh, his office began discussions and negotiations with the other large brokerage firms related to their industry practices. Though the amounts varied (and were far less), settlements with other large brokers, such as Aon, Willis, and Gallagher were patterned after the Marsh settlement. Thus, all of these firms agreed to fully disclose their compensation to their customers and forego contingent commissions in the future.

Contingent commissions (sometimes called placement service fees) are fees paid by insurers to brokers based on the volume of business placed with the insurer and, usually, the profitability of that business to the insurer. They are designed to compensate the agent or broker for providing underwriting and risk control services for the insurer and/or to reward the agent or broker for placing a large volume of profitable business with the insurer. There is general agreement in the insurance industry that contingent commissions are not inherently illegal or even unethical. However, they do present conflicts of interest in that an agent or broker may receive more compensation for placing a customer with one insurer than another. In particular, brokers are open to criticism since, legally, they are representing the customer rather than the insurer. A very strong argument can be made that in this case all compensation should be paid by the customer with no behind the scenes payments made by insurers. Since agents are legally the representatives of insurers, the criticism is less valid, but is nevertheless made by many.

The largest brokers have announced that they will no longer accept contingent commissions, and some are calling for their elimination throughout the industry. It remains to be seen what the final outcome will be. In the meantime, a general consensus seems to be forming that agents and brokers should fully disclose all compensation they receive to their customers, at least on commercial lines accounts. This also seems to be the direction in which regulators are leaning, and the National Association of Insurance Commissioners has produced model legislation that would require full disclosure whenever the agent or broker receives any compensation from the insured. Since one way to reduce or eliminate conflicts of interest is to disclose them, an honest disclosure of compensation—including contingent commissions or any other fees—to commercial lines customers should be considered the ethical choice to make regardless of whether such regulations are passed.

The primary concern over contingent commissions is the conflict of interest they may create. If an agent or broker will receive higher compensation from one insurer than another, the agent or broker has an incentive to place customers with the first insurer, even if it doesn't provide the broadest coverage terms, best service, or lowest price. When this occurs, the practice is called "steering." Since contingent commissions are separate and apart from regular commissions on premiums and are based on the overall book of business with the insurer, they are not easily attributed to a particular account. As a result, many agents and brokers historically did not disclose an amount associated with contingent commissions when reporting their commission income to clients. The behind the scenes nature of contingent commissions is one of the reasons they have been criticized. Going forward, agents and brokers should not

only disclose when they are eligible to receive contingent commissions, but also an estimate of the amount of the commissions attributable to the account when providing a statement of their income to their accounts. Good ethical practices would also dictate disclosing any other types of income earned through the customer's account in an attempt to fully disclose all compensation.

Service minded agents and brokers will seek to turn this new era of disclosure to their competitive advantage. They will provide their commercial lines clients with thorough stewardship reports detailing the value added services they provide to earn their compensation. In other words they will justify their compensation. Additionally, they will pressure their prospects to require the same type of disclosure from the agents writing their accounts. Those agents and brokers who aren't providing quality services will be hard pressed to justify their compensation and will be at a competitive disadvantage.

### **Summary**

The poor reputation of the insurance industry reinforces the need for unyielding dedication to integrity and ethics in insurance organizations. Those organizations that successfully build these traits into their corporate cultures are likely to be more successful than those that fail to do so. Ultimately, an industry-wide commitment of this type is probably the only way to overcome the poor reputation the industry faces.

# Chapter 3

## Codes of Ethics

If ethics is “the rules or standards governing the conduct of a person or members of a profession,” the key to ethical behavior is determining what rules and standards to follow. Individuals knowingly or unknowingly have their own ingrained rules and standards, and they can vary greatly from one person to another. A code of ethics is a tool for establishing a uniform set of rules and standard for members of a group to follow. The individuals who subscribe to a code of ethics essentially agree to enmesh the code with their own personal ethics standards. When the two sets of standards conflict, the more stringent of the two sets would normally be followed.

There may be any number of goals for a code of ethics. Two common goals are the following.

- To protect and enhance the organization’s (or its members’) reputation by detailing expectations for behavior of its members when dealing with others.
- To protect the organization’s assets by setting clear expectations for behaviors that avoid conflicts of interest, questionable conduct, and illegal acts.

Ethics codes provide written guidelines to follow when making decisions. They become especially important when making difficult business decisions wherein financial gain must be weighed against the appropriateness of the decision itself. By comparing their decisions and actions to the guidelines before implementing them, decision makers have a reasonable assurance that their actions and decisions will be above reproach from those within or outside the organization.

Two general approaches are commonly used when drafting codes of ethics. One is the positive actions or results-based approach, which generally prescribes in broad terms the types of actions and/or results that are expected or encouraged. The “Golden Rule” is probably the best known ethics code using this approach: “Do unto others as you would have them do unto you.” The other approach instead lists the types of actions that are prohibited; this is often called a “rule-based approach.”

The advantage of the results-based approach is that its broad terms will apply to most situations. However, by being broad, its application is subject to interpretation and rationalization. On the other hand, codes that specify prohibited behaviors are less malleable by interpretation. However, many actions can fall within a gray area of these prohibited action codes. In attempting to overcome the weaknesses of both approaches, many drafters of ethics codes combine the two approaches by attempting to outline in broad terms the positive results that are expected and in more specific terms those actions that are forbidden.

Codes of ethics are drafted by various types of organizations. One is membership organizations such as professional societies, civic organizations, and trade associations. The members of these groups generally must agree to subscribe to their codes of ethics to become and remain members of the organizations. This facilitates the ability of the organizations to promote themselves and their members to the public. The other primary type of organization



## Ethics Considerations for Property & Casualty Insurance Professionals

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that drafts codes of ethics is employers. The employer expects its employees to follow its code of ethics in conducting business on its behalf. Failure to do so is considered by most employers to be grounds for dismissal.

Since ethics codes embody the ethical standards their drafters feel are important, an examination of these codes can be enlightening even to those who are not affiliated with the organization to which they apply. Thus, example codes of ethics from an insurance educational organization (the American Institute for CPCU), its membership organization (the Society of CPCU), a public employer insurance regulator (the New Jersey Department of Banking and Insurance), and a private employer are depicted and discussed below. By reading through them, you can become familiar with the types of activities that are encouraged by the codes as well as the activities and behaviors they classify as unethical.

### Chartered Property Casualty Underwriters

Insurance professionals who pass a series of exams administered by the American Institute for CPCU (AICPCU), have at least 3 years experience in the insurance business, and agree to abide by a specific code of professional ethics are entitled to use and display the Chartered Property Casualty Underwriter (CPCU) professional designation. Like its life insurance counterpart, CLU, CPCU is considered a “professional” designation rather than simply an “insurance designation” or “associate designation” because those who receive and use the designation must agree to live by the ethics code. Abiding by a particular code of ethics is not required to receive and continue to hold most insurance designations, such as the Construction Risk and Insurance Specialist (CRIS), Certified Insurance Counselor (CIC), and Accredited Advisor in Insurance (AAI) designations.

At their option, CPCUs may also elect to join the CPCU Society if they agree to abide by the Society’s code of ethics. Since most CPCUs also join the society, it is common for CPCUs to actually subscribe to two codes of ethics. These are particularly relevant for this course as they are drafted specifically for property and casualty insurance professionals. These two codes are very instructive with respect to the actions they encourage and prohibit and provide useful guidelines for any insurance professional seeking to prepare a personal code of ethics or a code of ethics for his or her organization.

When a person matriculates into the CPCU program he or she agrees to be bound by the Code of Professional Ethics of the American Institute for CPCU. This somewhat lengthy code includes “Canons” that contain high level goals as well as minimum standards of conduct in the form of “Rules.” The Canons take the positive approach to establishing ethics standards with broad and inspirational language. The Rules detail more specific actions to take and prohibited actions, combining the two approaches to ethics policies discussed above. In essence, the rules provide a means to drill down into some of the meaning behind the Canons but without limiting the application of the Canons. CPCU candidates must study this code and are tested on it as part of the course work leading to the designation.

The Canons and Rules of the AICPCU Code of Professional Ethics are presented in Exhibit 3.1 on the following pages.

**Exhibit 3.1**

**The Canons and Rules of the AICPCU Code of Professional Ethics**

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

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

- **Rule R1.1**—A CPCU has a duty to understand and abide by all Rules of Conduct which are prescribed in the Code of Professional Ethics of the American Institute.
- **Rule R1.2**—A CPCU shall not advocate, sanction, participate in, cause to be accomplished, otherwise carry out through another, or condone any act which the CPCU is prohibited from performing by the Rules of this Code.

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

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

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

- **Rule R3.1**—In the conduct of business or professional activities, a CPCU shall not engage in any act or omission of a dishonest, deceitful, or fraudulent nature.
- **Rule R3.2**—A CPCU shall not allow the pursuit of financial gain or other personal benefit to interfere with the exercise of sound professional judgment and skills.
- **Rule R3.3**—A CPCU shall not violate any law or regulation relating to professional activities or commit any felony.

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

- **Rule R4.1**—A CPCU shall competently and consistently discharge his or her occupational duties.
- **Rule R4.2**—A CPCU shall support efforts to effect such improvements in claims settlement, contract design, investment, marketing, pricing, reinsurance, safety engineering, underwriting, and other insurance operations as will both inure to the benefit of the public and improve the overall efficiency with which the insurance mechanism functions.

*continued*

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

- **Rule R5.1**—A CPCU shall support personnel policies and practices which will attract qualified individuals to the insurance business, provide them with ample and equal opportunities for advancement, and encourage them to aspire to the highest levels of professional competence and achievement.
- **Rule R5.2**—A CPCU shall encourage and assist qualified individuals who wish to pursue CPCU or other studies which will enhance their professional competence.
- **Rule R5.3**—A CPCU shall support the development, improvement, and enforcement of such laws, regulations, and codes as will foster competence and ethical conduct on the part of all insurance practitioners and inure to the benefit of the public.
- **Rule R5.4**—A CPCU shall not withhold information or assistance officially requested by appropriate regulatory authorities who are investigating or prosecuting any alleged violation of the laws or regulations governing the qualifications or conduct of insurance practitioners.

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

- **Rule R6.1**—A CPCU shall keep informed on the legal limitations imposed upon the scope of his or her professional activities.
- **Rule R6.2**—A CPCU shall not disclose to another person any confidential information entrusted to, or obtained by, the CPCU in the course of the CPCU's business or professional activities, unless a disclosure of such information is required by law or is made to a person who necessarily must have the information in order to discharge legitimate occupational or professional duties.
- **Rule R6.3**—In rendering or proposing to render professional services for others, a CPCU shall not knowingly misrepresent or conceal any limitations on the CPCU's ability to provide the quantity or quality of professional services required by the circumstances.

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

- **Rule R7.1**—A CPCU shall support efforts to provide members of the public with objective information concerning their risk management and insurance needs and the products, services, and techniques which are available to meet their needs.
- **Rule R7.2**—A CPCU shall not misrepresent the benefits, costs, or limitations of any risk management technique or any product or service of an insurer.

*continued*

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

- **Rule R8.1**—A CPCU shall use the CPCU designation and the CPCU key only in accordance with the relevant Guidelines promulgated by the American Institute.
- **Rule R8.2**—A CPCU shall not attribute to the mere possession of the designation depth or scope of knowledge, skills, and professional capabilities greater than those demonstrated by successful completion of the CPCU program.
- **Rule R8.3**—A CPCU shall not make unfair comparisons between a person who holds the CPCU designation and one who does not.
- **Rule R8.4**—A CPCU shall not write, speak, or act in such a way as to lead another to reasonably believe the CPCU is officially representing the American Institute, unless the CPCU has been duly authorized to do so by the American Institute.

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

- **Rule R9.1**—A CPCU shall not initiate or support the CPCU candidacy of any individual known by the CPCU to engage in business practices which violate the ethical standards prescribed by this Code.
- **Rule R9.2**—A CPCU possessing unprivileged information concerning an alleged violation of this Code shall, upon request, reveal such information to the tribunal or other authority empowered by the American Institute to investigate or act upon the alleged violation.
- **Rule R9.3**—A CPCU shall report promptly to the American Institute any information concerning the use of the CPCU designation by an unauthorized person.

Source: AICPCU Web site: <http://blackboard.aicpcu.org/dino/canons.pdf>

The CPCU Society is a professional society for members of the insurance industry who have earned the Chartered Property Casualty Underwriter designation. One who earns the CPCU is not required to join the Society, but most CPCUs elect to do so. It has a broad-based membership of insurance agents, brokers, underwriters, adjusters and others working in the property casualty insurance industry. The CPCU Society stresses ethics through a number of vehicles, including “The CPCU Creed” and the “CPCU Society Ethics Code.” The ethics code is a specific list of unethical actions that can result in disciplinary action by the Society that is incorporated into the Society’s by-laws. On the other hand, the creed embodies the code of ethics, but is written in a positive light—listing actions that should be taken rather than actions that are prohibited—and CPCUs are encouraged to display it publicly (e.g., on their office wall). The CPCU Society Code of Ethics (Exhibit 3.2) and The CPCU Creed (Exhibit 3.3) are reproduced below.

### **Exhibit 3.2 CPCU Society Ethics Code**

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**It may be a basis for disciplinary action to commit any of the following acts:**

#### **Specified Unethical Practices**

1. To violate any law or regulation duly enacted by any governmental body whose authority has been established by law.
2. To willfully misrepresent or conceal a material fact in insurance and risk management business dealings in violation of a duty or obligation.
3. To breach the confidential relationship that a member has with his client or with his principal.
4. To willfully misrepresent the nature or significance of the CPCU designation.
5. To write, speak, or act in such a way as to lead another to reasonably believe that the member is officially representing the Society or a chapter of the Society unless the member has been duly authorized to do so.
6. To aid and abet in the performance of any unethical practice proscribed under this Section.
7. To engage in conduct which has been the subject of a presidential or Board of Directors directive to cease and desist.

#### **Unspecified Unethical Practices**

1. A member shall not engage in practices which tend to discredit the Society or the business of insurance and risk management.
2. A member shall not fail to use due diligence to ascertain the needs of his or her client or principal and shall not undertake any assignment if it is apparent that it cannot be performed by him or her in a proper and professional manner.
3. A member shall not fail to use his or her full knowledge and ability to perform his or her duties to his or her client or principal.

*Source: The CPCU Society bylaws as amended October 7, 1990.*

**Exhibit 3.3**  
**The CPCU Creed**

As a member of the CPCU Society, I will use my full knowledge and ability to perform my duties to my client or principal and place their interests above my own.

I will use due diligence to ascertain and understand the needs of my clients or principal and will only undertake assignments that I can perform in a proper and professional manner.

I will faithfully present material facts in insurance and risk management business dealings in accordance with my duty and obligation. I will honor the confidential relationship that I have with my client or my principal.

I will obey and uphold any law or regulation duly enacted by any government body whose authority has been established by law.

I will abide by the ethical practices set forth in the Bylaws of the CPCU Society and only engage in practices that reflect well on the Society and the business of insurance and risk management.

I will write, speak, and act as an official representative of the Society or as a chapter of the Society only if I have been duly authorized to do so.

I will accurately represent the nature and significance of the CPCU designation.

*Source: CPCU Society Web site (<http://www.cpcusociety.org/index.v3page?p=46354>)*

## **State of New Jersey Department of Banking and Insurance**

Employees of governmental regulatory agencies, such as insurance departments, face many potential conflicts of interest and opportunities for unethical or illegal behavior. For this reason, it is common for them to have detailed ethics codes to guide their staffs. As an example, consider the ethics code of the New Jersey Department of Banking and Insurance which lists specific activities in which its employees are not allowed to engage. This type of code allows the drafter to focus on the most probable types of ethical dilemmas that will be faced and give specific instructions as to what behavior is unacceptable. The specific approach is probably appropriate for a regulatory agency. However, the potential problem with this approach is that it leaves “wiggle room,” since certain unethical behaviors may not be specifically addressed which may imply that they are therefore allowed. Thus, these types of codes must be carefully drafted. The New Jersey Insurance Department of Banking and Insurance code is shown in Exhibit 3.4.



### Exhibit 3.4

#### New Jersey Department of Banking and Insurance Ethics Code

- A.** No State official should have any interest, financial or otherwise, direct or indirect, or engage in any business or transaction or professional activity, which is in substantial conflict with the proper discharge of his or her duties in the public interest. Please refer to Sections V and VI for further applicable restrictions.
- B.** No State official should engage in any particular business, profession, trade or occupation which is subject to licensing or regulation by a specific agency of State Government without promptly filing notice of such activity with the Executive Commission on Ethical Standards. Please refer to Sections V and VI for further applicable restrictions.
- C.** No State official should use or attempt to use his or her official position to secure unwarranted privileges or advantages for himself, herself or others.
- D.** No State official should act in his or her official capacity in any matter wherein he or she has a direct or indirect personal financial interest that might reasonably be expected to impair his or her objectivity or independence of judgment.
- E.** No State official should undertake any employment or service, whether compensated or not, which might reasonably be expected to impair his or her objectivity and independence of judgment in the exercise of his or her official duties.
- F.** No State official should accept any gift, favor, service or other thing of value under circumstances from which it might be reasonably inferred that such gift, service or other thing of value was given or offered for the purpose of influencing him or her in the discharge of his or her official duties.
- G.** No State official should knowingly act in any way that might reasonably be Expected to create an impression or suspicion among the public having knowledge of his or her acts that he or she may be engaged in conduct violative of his or her trust as a State officer or employee or special State officer or employee.
- H.** Confidential information (information not available to the general public) may not be:
  - 1.** Willfully disclosed to unauthorized persons either during State service or after separation from State service;
  - 2.** Used by the State official to further his or her private interests; or
  - 3.** Used by the State official, directly or indirectly, for pecuniary gain or to make any investments or other financial transactions.

Source: <http://www.state.nj.us/lps/ethics/bankcode.pdf>

The New Jersey code, while listing prohibited actions states the acts in broad enough terms to make them very encompassing, which helps to overcome the disadvantage that some codes have in focusing on specific prohibited behaviors.

## Sample Business Ethics Code

Exhibit 3.5 presents an ethics code from a small insurance organization. The code is a combination of the approach used in the CPCU Creed (activities that are encouraged) and the New Jersey Department of Banking and Insurance code (forbidden activities). This code identifies specific areas where the employee may face ethical dilemmas and lists both behavior that is expected, as well as activities that are prohibited.

### **Exhibit 3.5** **Example Business Code of Ethics and Conflict of Interest Policy**

The Company will conduct its business honestly and ethically wherever we operate in the world. We will constantly improve the quality of our services and operations and will maintain a reputation for honesty, fairness, respect, responsibility, integrity, trust, and sound business judgment. No illegal or unethical conduct on the part of officers, managers, employees, or affiliates is in the Company's best interest. We will not compromise our principles for short-term advantage. The ethical performance of the Company is the sum of the ethics of the people who work here. Thus, we are all expected to adhere to high standards of personal integrity.

In all of our activities, we will always put the interests of our customers first. Decisions made in the best interest of our customers will be in the best interest of the Company. We will be open and honest in all of our communications with customers.

Officers, employees, and directors will seek to report all information accurately and honestly, and as otherwise required by applicable reporting requirements. No corporate funds or assets will be used for any purpose that would constitute violation of any law or regulation.

Officers, employees, and directors will act with respect and responsibility towards others in all of their dealings and obey all applicable Equal Employment Opportunity laws.

Officers, employees, and directors agree to promptly disclose unethical, dishonest, fraudulent, and illegal behavior, or any violation of Company Personnel Policies or procedures, directly to an executive officer.

If you ever have any doubt about whether your conduct or that of another meets the Company's ethical standards or compromises the Company's reputation, please discuss it with your manager or a corporate officer.

Remember that good ethics is good business!

*continued*

### **Conflicts of Interest**

It is the Company's goal to maintain the highest standards of integrity in all dealings with suppliers, agents, customers, fellow employees, competitors, and the public. Even the appearance of a conflict of interest should be avoided. Therefore, the following rules apply to all employees. Any question regarding whether certain conduct would be a violation of these rules should be submitted to an officer of the company before engaging in the conduct. A request for a waiver of these rules may be made to the Chief Operating Officer, who shall determine whether such an exception is warranted. Any requests from officers of the company shall also be reviewed by the audit committee of the board of directors.

No payments, material gifts, gratuities, consultant fees, retainers, items of value, vacations, or loans in excess of \$50.00 (in any calendar year) will be accepted by an officer, employee, or director from any organization, or its representative, engaging in any transaction with the Company (e.g., a vendor, service provider, or customer).

An employee, officer, or director will not hold any direct or indirect position or financial interest in any corporation, partnership, or organization with whom the Company does or may do business. Ownership of less than 1% of the securities in a corporation listed on a national securities exchange will not be considered a violation of this policy.

An employee, officer, or director will not hold any direct or indirect position or financial interest in any corporation, partnership, or other organization in competition with the Company. Ownership of less than 1% of the securities in a corporation listed on a national securities exchange will not be considered a violation of this policy.

An employee, officer, or director will not solicit, directly or indirectly, business from any business entity with which the Company does or may do business on behalf of himself or a family member.

An employee, officer, or director will not provide any services or work of any kind or accept any form of compensation from any corporation, partnership, or other organization in competition with the Company.

No payments, gifts, gratuities, discounts, or items of value in excess of \$50 may be given directly or indirectly to individuals or organizations engaged in transactions with the Company.

Employees, officers, and directors will not engage in any conduct that would give the appearance of compromising the integrity of the Company, any of its employees, our agents, or our services.

Employees will not at any time perform any services or work on behalf of another employer or on behalf of a personal business venture of any type while on the Company premises or using Company equipment, such as photocopiers, telephones, or computers.

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### **Confidential Information**

The officers, managers, and employees of our Company will often come into contact with, or have possession of, proprietary, confidential, or business-sensitive information and must take all appropriate steps to assure that the confidentiality of such information is maintained. This information—whether it belongs to our Company or any of our business partners, agents, customers, or affiliates—includes, but is not limited to, strategic business plans, operating results, marketing strategies, customer lists, personnel records, new product introductions, salary information, upcoming acquisitions and divestitures, payroll information, or new investments. Proprietary, confidential, and sensitive business information about our Company, our agents, our customers, or other companies, individuals, and entities must be treated with sensitivity and discretion, and only be disseminated on a need-to-know basis.

### **Ethics Code Enforcement**

To be credible, a code of ethics must be enforced. Most businesses enforce their ethics codes in the same manner as other corporate policies. Depending on the level of a violation, it may result in disciplinary action or even termination. Generally speaking, enforcement is initiated at the discretion of the company's management. However, a code of ethics must be applicable to all—even senior management—to gain the respect of everyone in the organization. Thus, it is beneficial to provide a reporting process that will insulate employees who report transgressions from retaliation. The approach will vary by organization, but will often provide a degree of anonymity to the person disclosing a violation of the code.

Professional societies and membership groups generally enforce their codes with sanctions and/or dismissal from the society or group. In some cases, this may include loss of the credentials and even licenses to practice. For example, the CPCU Society has the power to eject members for ethics violations and the American Institute for CPCU, which holds authority over the designation itself, may revoke the designation. Of course these actions alone do not cause loss of any insurance licenses held by the individual. This requires separate action by a state insurance regulator to revoke the person's license. In contrast, a lawyer who is disbarred loses his or her license to practice law.

When enforcing ethics codes, companies generally follow their standard process for applying disciplinary actions, and professional groups generally outline a specific process to be followed by the organization. For example, the CPCU Society uses a three step process of (1) investigation, (2) conference, and (3) action. After receiving a report of a violation, the President of the Society (a volunteer elected by the members) refers it to an investigatory committee of at least three Society members. This group reviews the facts and may question the member who is accused of wrongdoing to determine if the violation is a breach of the Society's Ethics Code. If the committee believes that a violation of the ethics code occurred, it refers the matter to a separate conference panel. The conference panel is comprised of three or more members, at least one of whom is a member or past member of the Board of Governors and none of whom may have served on the investigating committee. The conference panel holds a formal meeting that the accused member may attend. This gives the

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member an opportunity to address the issue, present evidence, and have witnesses make statements regarding the matter. The member and the Society president are notified of the panel's finding. If the conference panel unanimously concludes that an ethics violation did indeed occur, the Society Board of Governors determines what punishment to invoke. Punishment may include an admonishment, suspension of membership, or revocation of membership.

### **Summary**

Ethics codes provide valuable guidance on acceptable and unacceptable behavior to employees of companies and members of organizations. To be effective, they must apply to all members of the organization and be enforced by the organization's leaders.

# Chapter 4

## Corporate Ethics Codes

Most senior business executives believe their companies' brand equity—their image or reputation in the marketplace—is their most important intangible asset. If they lose the trust and confidence of customers, suppliers, and regulators, their companies' ability to succeed—and the values of their organizations—will be substantially and perhaps irreparably damaged. Unfortunately, this has occurred all too frequently in recent years with terrible consequences.

Perhaps the most extreme examples of organizations that suffered as a result of a systemic lack of ethics and/or conflicts of interest are Enron and its auditor, Arthur Andersen. Enron was forced into bankruptcy when investors and regulators learned that its financial success was greatly overstated by deceptive accounting practices. Arthur Andersen lost its ability to continue practicing as a professional firm when it was found guilty of criminal behavior and essentially ceased to exist. While the verdict against Arthur Andersen was eventually overturned, the firm will likely not arise from its ashes. The failure of these two organizations resulted in the loss of billions of dollars of asset values, personal fortunes of executives, and jobs and retirement assets of thousands of employees. Like Arthur Andersen, insurance agencies and brokerages must have state licenses to engage in business, and criminal charges would be equally devastating to them.

The financial services industry has also been hit hard with allegations against stockbrokers for conflicts in recommending investments in their own clients, mutual funds for trading practices that benefited larger investors at the expense of small ones, insurance executives for questionable accounting practices, and, of course, insurance brokers and underwriters for bid rigging. As a result, the companies' stock values suffered severe declines, customers moved to competitors, employees lost jobs, and executives were painted as unethical and, in a number of cases, criminal.

The executives of all these companies bet their most valuable assets, their brands, and they lost their bets. A corporate culture demanding ethical conduct and not tolerating conflicts of interest could have avoided the unfortunate events that befell them all. One way to establish such a corporate culture is to draft a code of ethics, communicate it to employees, give it strong support from the CEO on down, and vigorously enforce compliance with it. In other words, a code of ethics becomes the backbone of a risk management program protecting a company's most important asset—its brand.

When one considers that insurance agents and brokers operate in a fiduciary capacity handling large financial transactions on behalf of insurers they represent and their customers, it becomes apparent that their trust and confidence is an absolute key to success. Thus, all insurance agencies, brokers, and companies will greatly benefit by embedding ethics within their corporate cultures to help ensure this key is never lost. In fact, one result of recent insurance scandals is to make it highly likely that those insurance organizations that can demonstrate a high level of success in establishing such a corporate culture will enjoy competitive business advantages in the commercial lines marketplace and perhaps with personal lines consumers as well.



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Another use for corporate ethics codes is to provide rules and guidelines for employees with respect to honesty and conflicts of interest in the workplace. Common areas addressed in these guidelines include treatment of confidential corporate and customer information, handling of funds, acceptance of gifts or bribes from vendors and others, offering gifts or bribes to customers, ownership interests in vendors or competing companies, engaging in outside employment that may present a conflict of interest, and compliance with laws and ordinances. These rules and guidelines can help employees avoid unknowingly venturing into potentially dangerous gray areas by clearly delineating prohibited actions. They also give employers the means to take quick and decisive disciplinary action when the rules and guidelines are not followed. Used in this manner, a code of ethics becomes part of the internal controls that protect the organization from theft and dishonest acts.

In summary, Exhibit 4.1 outlines some of the reasons to establish a code of ethics for an insurance company, agency, brokerage, or adjusting firm.

### **Exhibit 4.1** **Reasons for Establishing a Code of Ethics**

- Assure that well thought out standards for putting the customer first are delineated for employees to follow.
- Provide employees with guidance on activities that are not permitted because they create conflicts of interest.
- Provide guidelines designed to protect the organization from theft and dishonest acts by employees.
- Facilitate invoking disciplinary action when employees participate in unethical behavior.
- Establish a competitive advantage in the marketplace using a strong commitment to professionalism, integrity, and ethics as a selling point.

## Establishing Ethical Standards and a Code of Ethics in a Business

Instilling ethical standards into an organization is much like any other management endeavor. It requires a process similar to this:

- **Top management commitment.** Top management must fully support ethical standards, communicate its support of those standards, and live by those standards.
- **Communicate and train on ethical standards.** Development of a code of ethics can help with both the communication and training on the companies standards.
- **Reinforce ethical behaviors.** Avoid hiring people who have behaved unethically in the past, periodically remind all employees of the organization's commitment to ethical behavior, enforce the ethics code, and reward employees who practice ethical behavior.

In establishing ethical standards in a business, the owners, executives, and managers must look first at themselves. Are they ethical in the way they run the business, including treatment of suppliers, customers, employees and compliance with applicable regulations? If not, everyone they deal with will quickly spot the “Do as I say and not as I do” mentality. If the executives don’t “walk the talk,” some employees will also stray from the path. Thus, all senior managers must agree to live by the code once it is established.

The initial step in establishing ethical standards in and drafting a code of ethics for a business is a thorough examination of its operating standards. This should include a review of the regulations with which the business must comply. In the case of an insurance organization, it can include, for example, regulations and laws related to licensing, use of the surplus lines marketplace, claims administration, and fee or commission income. Additionally, contractual commitments come into play. In the case of an agency and brokerage, these include contracts with insurers establishing agency or brokerage relationships and/or underwriting authority, and may cover such details as payment terms and how coverage comparisons are displayed when making a sale. With claims organizations, these will include contracts with customers regarding adjusting authority and practices.

Since a “top down” approach is not likely to give the staff ownership of the resulting code, it is optimal for this review to include employees at all levels to gain buy-in throughout the organization. Managers and employees must decide the purpose of the code. It is helpful to commit the overriding objectives to writing as a guide for those who will actually pen the ethics code. Exhibit 4.2 provides a brief guide with some possible objectives to consider.

### **Exhibit 4.2** **A Brief Guide for Writing an Ethics Code**

- Place primary emphasis on the customers' interest
- Provide inspiration to staff
- Deal clearly with conflicts of interest
- Avoid legal or regulatory issues
- Be reasonable so as to be acceptable to those who must live by it
- Reflect favorably on the organization
- Be simple and clear
- Deal comprehensively with the types of issues that may arise

The format of the code must be established. It can be a rule-based list of “do’s and don’ts” (such as the New Jersey Insurance Department code); it can be designed to provide overall guidance that allows the individual to decide what is right and wrong; it can provide general guidelines about behavior (such as the CPCU code); or it can combine these approaches. A combination of the approaches, such as with the sample provided in Exhibit 3.5, is probably most common.

Regardless of the approach used, it is important for the code to be specific to the needs of the organization. Generally, the principles that are most important to the organization should be addressed first. Exhibit 4.3 provides a checklist of some areas to consider addressing when developing a code of ethics.

The method by which the code will be introduced, including ethics training for employees, must be planned. A formal rollout of the policy will demonstrate that management takes it seriously. Consideration should be given to providing training on ethical behavior for all employees. Using hypothetical ethical situations, such as those provided later in this course, is an excellent way to accomplish this training.

Consideration should be given to how compliance with the code will be monitored and violations enforced. Possibilities for monitoring include the use of outside auditors or reviewers, an anonymous employee hotline, an employee peer review group, or designating an individual as compliance manager.

**Exhibit 4.3**

**Possible Points to Address in a Code of Conduct or Code of Ethics**

**Introduction**—A broad statement indicating the purpose of the code, the objectives of the code, and to whom it applies. This is an excellent place to include inspiring statements.

**Customers**—Place the customer's interest first in all decisions and actions.

**Conflicts of interest**—Avoid even the appearance of inappropriate behavior or conflict of interest by refusing to accept gifts, payments, fees, services, discounts, or other favors that would, or might appear to, improperly influence actions or decisions. Some companies specify an economic value that gifts should not exceed. Do not engage in outside employment or service on boards or commissions that may interfere with work responsibilities or present conflicts of interest.

**Contracts**—Honor the contractual rights of all parties to any transaction. Consider the spirit of the contractual relationship and not just the terms.

**Keep with your realm of expertise**—Propose only services that are within your areas of expertise, knowledge, and ability. Bring in other team members when their expertise will benefit the customer.

**Confidential data**—Guard all confidential data, whether it is regarding the company, its customers, or another organization, such as an insurer, with whom you do business.

**Intellectual property**—Respect the copyrights of publishers and other organizations and do not risk an infringement suit by inappropriately copying and distributing their content.

**Respect your colleagues**—Act professionally and with respect for your associates, abiding by the corporate harassment, safety, and other policies.

**Waivers and clarifications**—How to request an interpretation as to whether an activity may be a violation or a waiver of the code as respects a generally prohibited activity that may be taken in the best interest of the organization of an inescapable conflict of interest.

**Enforcement**—How violations of the code are to be dealt with.

Some companies incorporate ethics objectives into individual performance objectives and the review process. As part of the review process, employees may be asked to provide examples of times when they made the “hard right” versus the “easy wrong” decision. This will facilitate managers evaluating their staffs’ compliance when performance reviews are done.

A process for handling violations of the code should also generally be specified. Many companies use the same process as is used for violations of other company policies. Except in the case of the most serious lapses, this often involves an escalating series of actions, such as

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additional training, censure, probation, and ultimately, dismissal. However, willful, blatant and serious violations are often dealt with by immediate dismissal.

The company should also support organizations that promote ethical behavior and provide training from outside sources that goes beyond the requirements mandated by state insurance regulators. One way to accomplish this is to participate in Ethics Awareness Month for the insurance industry, which is generally the month of March. Ethics Awareness Month is supported by a number of industry organizations which sponsor presentations and educational programs on ethics at their monthly meetings and other events. Asking employees to attend these programs, or perhaps holding an internal ethics training session in conjunction with them, will demonstrate commitment to and raise awareness of ethics in the business. Similarly, encouraging employees to read articles on insurance ethics, such as George Head's quarterly risk management ethics column on [www.IRMI.com](http://www.IRMI.com), will also remind employees of the importance of business ethics.

# Chapter 5

## Arriving at an Ethical Decision

Often, making ethical decisions in the workplace involves difficult choices. Some issues, such as stealing, are clear cut. Other times the decision is not so obvious especially when the decision is one that will affect several people.

The first step is recognizing the key issue involved in the scenario. Is it one of morality, law, company standards, generally accepted behavior, or personal values? Does it involve a core principle such as honesty, integrity, responsibility, respect, or courage? Is it legal, but not ethical? Is it necessary?

The second step is to identify those who are affected by the decision. If some people benefit from the decision and some will be hurt, is it appropriate to make a decision that provides the greatest benefit for the most people or a certain class of people (e.g., customers) over others (e.g., owners)?

Do you have all the facts in the case? Is the information reliable or has it been slanted by someone who is affected by the decision? Have you identified everyone who will be affected by the decision? If the choice made will affect several people, it is necessary to get opinions from as many of them as possible.

Have you considered options that may not hurt as many people? If so, which option does the most good, or the least harm for the greatest number of people?

Are you rationalizing in arriving at the decision? Will the decision benefit you to the disadvantage of others?

Having some “acid tests” can help in arriving at a conclusion.

The first question should be “is it legal?” If the proposed action violates the law or a regulation, it should not be taken. However, just because something is legal does not necessarily mean that it is the right thing to do. Thus, the moral and ethical considerations of the action must then be weighed.

Similarly, it should be determined whether the proposed action is in compliance with company policies and its code of ethics. Companies often require higher standards than those imposed by the law. For example, policies regarding the treatment of employees often provide more rights and greater protection than the law.

Another test should be “how will this look if it becomes public”? If members of your company, church, community, or family learned of this decision, would you be embarrassed? If the decision was publicized in the media, would it hurt your reputation or that of your company? How will the decision look 5 years from now?

Is the decision consistent with previous similar decisions or does it favor one party unfairly or discriminate against another party unjustly? Ethical decision making generally results in

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consistent decisions. When biases result in inconsistent decisions, ethics transgressions are much more likely to be present.

If the decision does not need to be made immediately, have you considered all options and discussed it fully with others who can provide guidance? It is often helpful to consult with others when difficult decisions must be made.

After the decision is made, are you willing to go back in a few days, weeks or months to review it? If it is not working out as planned, are you willing to change?

Whatever decision is made, you have to live with the results and accept responsibility for the outcome. Are you prepared to pay the price for the decision?

Some other areas to consider in arriving at an ethical conclusion are:

- If you will personally benefit from the decision, that may be cause to examine it more carefully. At times, the appearance of unethical behavior can be as damaging as actually acting unethically. In such situations it may be especially useful to solicit the opinion of a trusted advisor or friend. Additionally, it may be useful to take extra steps to assure that the process for arriving at the decision is clear to all.
- Failure to act can also be unethical. Sometimes, doing nothing is the wrong thing.
- If you are couching your message in industry jargon or choosing your words carefully, you may be rationalizing or hiding unethical behavior. Explain any technical terms to the other parties involved.
- If you feel the need to consult with an attorney before acting, it may be a sign that boundaries are being crossed. Legal standards are often less limiting than ethical standards.

# Chapter 6

## Case Study Evaluation

This chapter uses a case study approach to examine a number of ethical dilemmas that insurance professionals routinely face. Each case lays out a fact pattern and postulates some related questions. This is followed by a few comments on the ethical considerations.

A decision process such as the one presented in Exhibit 6.1 is helpful when considering the ethics of an action.

### Exhibit 6.1 The Process of Making an Ethical Decision

1. **Define the issue.** Is it one of morality, law, company standards, generally accepted behavior, or personal values? This step will also consider why a decision is needed and what is the ideal expected outcome? This is the point where the cause of the problem will also be analyzed.
2. **Identify the alternatives.** There is a tendency to look at decisions as “either/or”, when often there are multiple choices. This is the time to ask advice from others who are either involved in the decision or who have faced similar decisions in the past.
3. **Evaluate the alternatives to see which one is the best choice.** This may be a decision that provides the greatest good for the most people or it may be one that is not at all popular, but is the ethically correct decision to make.
4. **Determine who will make the decision.** Some decisions need to be made alone or with input from a small group. Others may involve a group decision made by all those who are affected.
5. **Implement the decision and monitor its affects.** After implementation, many important decisions deserve a review process to evaluate the decision and change it if needed.

## Sharing Information about an Insurer

In most states insurers are required to file rates and forms with the state insurance regulator. Obtaining this information may often involve a costly trip to the state capital. If the person



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seeking the information is not experienced in this kind of search, many hours may be spent. An insurance company employee has a good friend at an agency. May he or she call their friend to get a copy of the competitors' rates and forms? The insurance company employee seeking the information rationalizes the request by saying "it's public information. By getting it from an agent, I'm saving my company money by not having to travel." If the employee receives the information from an agent, rather than from the insurance department, is anyone hurt by this?

**Comment:** *Agents may generally share information that is a matter of public record and filed with the insurance department (rates, filed underwriting guides and forms) as long as the insurer has not specifically prohibited this practice. Of course, proprietary information may not be shared. Improper sharing of information can damage the company whose information is being disseminated. It may also cause incomplete information to be distributed if the agent does not have all the facts. It is always best to obtain information from the source. In the case of filings, the state insurance department.*

## Intellectual Property

Acme Insurance Brokerage subscribes to several monthly insurance industry newsletters. When each newsletter arrives, the receptionist makes 100 photocopies. Each Acme account executive is provided with a copy to read, a copy is sent to Acme's top commercial accounts, and the remainder are kept in the mailroom to be provided to clients or underwriters on request. Acme's president feels that this is an excellent and low cost service for their clients. Is it ethical? Is it legal?

**Comment:** *Unless specific permission has been obtained from the publishers of the newsletters, Acme's reproduction program is both unethical and illegal. Whether distributed internally or mailed outside the firm, this practice is the equivalent of stealing the publishers' products without paying for them. Under U.S. copyright law, copyright holders only need to prove that an infringement occurred. Publishers can collect statutory damages of \$10,000 per infringement without proving that they were damaged by the violation. The copyright law includes a "fair use provision" that permits small portions of a document (e.g., a paragraph) to be quoted and distributed to a small number of people (such as in a letter) as long as the source is properly referenced. Acme would be wise to require its staff to follow this guideline. If Acme wishes to continue providing copies to its entire staff and/or providing the reproduction service for its clients, permission should be sought from the publishers.*

## Underwriting Information

An agent knows that an insurer has guidelines specifying it will write workers compensation coverage for an account only if less than 10 percent of its operations are over water. The agent has an opportunity to write a new account where the applicant states 15 percent of the operations are over water. The underwriter the agent normally uses has granted several exceptions on this percentage in the past. Unfortunately that underwriter is on vacation this week, and the account's current program expires in three days. The alternate underwriter who is filling in is known to "go by the book" and not give exceptions. A voice mail message to the underwriting manager has gone unanswered. The agent submits the application showing 10 percent of the operations are over water. The rationalization is "if my regular underwriter was here, it would be approved." As a result of this action, the agent is successful in obtaining coverage for the client. Is anyone put at a disadvantage by this action? If companies regularly

make exceptions to underwriting guides, can the agent assume they will make the exception in this case?

**Comment:** *Knowingly providing incorrect information on an application is never acceptable. The agent's option in this case is to move up the chain of command at the insurer until an appropriate decision-maker is reached. Just because exceptions have been made in the past, it can not be assumed they will be made in the future. If there are cases where exceptions are "always" made, the agent may want to ask that the guidelines be broadened. Insurers may use a material misrepresentation on an application to void coverage if the insurer relies on the information in making an underwriting decision. If the misrepresentation was made by the agent, it is quite likely the agent will face an errors and omissions (E&O) claim and be held legally liable for it.*

### Treatment of Employees

The owner of a large business frequently comes to his insurance agents' office. He is loud, boisterous, and often hugs several of the women in the office. Sometimes he makes suggestive comments and tells off color jokes. Although none of the employees have complained to the agent, he can sense several of them are offended by this behavior. Nonetheless, he does not take any action, rationalizing that no one has complained about it. He also does not want to risk losing the income this account produces. Should the owner of the agency take any action? Should he wait until a complaint is lodged before doing anything? Is any law being broken?

**Comment:** *The agent owes a duty to the employees to provide a safe and comfortable work environment. Employees should never be told to commit unlawful or unethical acts, nor should they be expected to tolerate any form of harassment from customers or fellow employees. By allowing this behavior from his customer, the agent is violating the trust his employees have placed in him and will lose their respect. Additionally, this situation may well be deemed to constitute workplace harassment that could result in employment related suits from the employees. The agent should deal immediately with a situation like this by way of a private conversation with the customer. When handled quickly, before they become routine, these situations can usually be mitigated without alienating the offending person.*

### Gifts and Conflicts

In most states, an agent can receive either commission or a fee for placing business, but not both. Agent John Doe, an employee of Acme Agency, has just placed a large account, in a difficult business class. The insured was expecting a large rate increase, but the coverage was placed at a premium less than expiring. John Doe and the insured are not close friends, but they live in a small town and see each other at church, school, and civic functions. The insured offers to take both John Doe and a guest on a long weekend to a resort, and offers to pay hotel, meals, and any fees for recreational activities. The agency has an ethics policy prohibiting the acceptance of other than "normal business amenities." John Doe rationalizes that this trip is based on his friendship with the customer. He also concludes that this kind of reward is a normal business occurrence since he has seen his CEO accept similar offers from presidents of large companies they place. Was John Doe's acceptance of this trip proper? If a business has a policy regarding accepting gifts from customers or others, does what can be accepted vary by a person's position in the company? Can the CEO accept gifts that employees would not be allowed to accept?

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**Comment:** *Many corporate ethics codes allow employees to accept “normal business amenities.” The problem is that this term is not defined. Each person must decide for themselves what is appropriate for their position, based on the relationship they have with the person providing the gift. When in doubt, it is always wise to consult with management concerning the proper response to an offer of this type.*

*Depending on the situation, it may be acceptable for a CEO to accept a gift (trip to a major sporting event) that an employee could not accept. The questions are (1) “Will participating with the gift-giver in this endeavor be in the best interest of the business?” and “Will accepting this gift inappropriately influence my decisions affecting the gift-giver in the future?” Of course, however, CEOs must tread carefully for they are setting an example for everyone, and merely taking advantage of rank sends the wrong message.*

*In this particular case, it was probably not appropriate for John Doe to accept the gift. The value was certainly more than a normal business amenity. Additionally, since the trip is directly tied to performance on a particular account, it may violate his state’s law mandating that an agent be compensated by either a commission or fee, but not both.*

*As an aside, some of these issues can be avoided by using a specified value for acceptable gifts rather than a phrase that is left open to interpretation and stipulating a process for requesting exceptions. For example any gift valued above \$50 might be prohibited.*

## Renewal Pricing

Every year a large account you write goes out to bid with other agents. You obtain three quotes: one at 20 percent less than expiring premium, one is at expiring premium, and one is a slight rate increase. When you go to present the quotes, the account tells you that he is happy with your service and has not gone to get other bids.

Which quote do you present? Does it make a difference if the quotes are with three different insurers? What if they are with the same insurer and the underwriter has said to use the lower quotes “only if you must?” In a hard market, is it unethical to present the quote with the slight rate increase? After all, you are getting more premium for the insurer.

**Comment:** *If you are an agent, you represent the insurance company and are obligated to get the best deal for it. If you are a broker, you represent the insured and owe the insured the duty of obtaining the best deal. If the quotes are from different insurers, present all three, point out the coverage differences, and let the insured decide. If they are with the same insurer, you should seek guidance from the underwriter as to which quote to present. If that is not possible, the quote that is closest to “current market conditions” is probably the appropriate one to use.*

## Insurance Certificates

One of your accounts calls late Friday afternoon before a three-day holiday weekend. They need a certificate of insurance to present at a bid opening. The coverage is with a surplus lines insurer and you do not have authority to issue a certificate. You try calling the insurer, but get voicemail saying “closed until Tuesday.” Do you exceed your authority and issue the certificate? What if the certificate requires coverage that is not on the policy, but you believe the insurer will agree to the extension of coverage? Is exceeding your authority justified in any instances?

**Comment:** *If you do not have authority to issue a certificate, you should not do so. Try to develop another alternative that will satisfy your insured's customer. For example, you could write a letter explaining how the insurance program you've placed for the client will meet the insured's customer's needs and that an insurance certificate will be available the next week. It may be a good idea to also provide a copy of the policy and highlight the coverages that are requested in the contract's specifications.*

### Surplus Lines Declinations

Your state has a law forbidding agents from delivering a surplus lines quote on an account for which an admitted insurer is willing to write the business with equivalent coverage (the law doesn't mention premium amount as a factor, only coverage). One requirement of the law is that you must provide the quoting E&S broker with an "evidence of diligent effort" form listing three of your admitted insurers who have refused to write the risk. You want to put the coverage with the non-admitted carrier. Is it ethical to call three of your insurers and ask if they would decline this account without taking the time to actually submit the account to them? Your thought process is that it is a class of business that none of them write, and they will decline the account if you do submit it. The problem is that they will not get to it for 10 days or more, and you need a response now. Is this ethical? Does this approach comply with the spirit of the law as well as the letter of the law?

**Comment:** *Agents will often call underwriters before submitting an account to see if it meets their guidelines, and this is no different. Underwriters at admitted insurers are given the opportunity to receive a submission should they desire to, and they have the responsibility of determining if the account is one that they will consider. Thus, unless the law requires a written submission to admitted insurers, this approach is acceptable.*

### Downsizing

You are an officer in an insurance agency. You know that your firm is going to be acquired by a larger firm, and the acquirer intends to eliminate some jobs. The agreement is structured so that the other firm will determine who stays and who goes. The parties involved want confidentiality since they are concerned about possible business loss arising from the acquisition. What obligations do you have to your employees? What if you know an employee is about to enter into a major financial commitment (buying a home, new car, Ivy League college for a child)? What situations justify breaching confidentiality?

**Comment:** *As an officer of the company you should honor its contractual commitment to keep the pending transaction confidential. Your duty to employees is to honestly communicate non-confidential facts and considerations that do not violate your duty to your employer. In the case of an employee who is about to make a major financial commitment, you might seek approval from the acquiring firm to discuss the situation on a confidential basis. Depending on the situation and your relationship with the employee, another approach may be to simply suggest that he or she hold off on making the decision for a short while.*

### Referrals to Competitors

A customer needs coverage, but cannot afford the price that you present. You know that a competitor has a product that is more affordable. Do you try to make the sale or refer the customer to your competitor?

**Comment:** *Once it becomes apparent that you will not make the sale because of price, it is appropriate to refer the customer to the competitor. Putting the interests of others above your own will pay dividends in the long run.*

### Hiring Practices

Your company encourages the hiring of minorities, and you have interviewed a candidate who has all the requisite skills for the position. However, the position requires a considerable amount of communication with customers by phone, and she has such a heavy accent that you are concerned that they will have trouble understanding her. What is the ethical way to handle this? If you also feel that she will not fit into your company culture should that be a reason not to hire her?

**Comment:** *An inability to effectively communicate is an acceptable reason not to hire an otherwise qualified job candidate. In this case, you might consider whether it would be possible to place the person in a position where she is not required to deal with the public, with the understanding that, as her language skills improve, she may be moved to a different position.*

*The company culture consideration is a more difficult one. The Equal Employment Opportunity Act makes it illegal to discriminate with respect to five “protected classes” (i.e., age, race, sex, religion, and national origin), and other state and federal laws also come into play in making personnel decisions. While it is unethical, and in many cases illegal, to refuse to hire a person merely because he or she is “different,” consideration as to how a candidate would perform within the company culture is warranted. For example, hiring a very timid and sensitive person to work on a team with highly aggressive and competitive people is unlikely to work out for the person or the company.*

*When making hiring decisions, it is wise to set a goal of finding at least two, preferably three, qualified candidates to choose between. Then carefully compare the candidates’ job skills, education, experience, performance in the interview, and what their references say about them, choosing the candidate who you feel is the best fit for the job and the company. This approach will maximize the probability of selecting a superior performer while mitigating the possibility of using improper criteria.*

### Personal Relationships and Duty to the Employer

The performance of a longtime employee has slipped lately. While he is out, you open a file cabinet in his office looking for a customer’s file, and you discover a partially consumed bottle of vodka, an unopened bottle, and an assortment of pills. You are a manager in the company, but he is not one of your reports. What do you do? If you are a fellow employee and not a manager, will this affect your decision?

**Comment:** *Most companies have policies prohibiting the use of alcohol or drugs on the company premises. In this case, confronting the employee directly is likely to lead to a denial of the problem. The best approach is to go to the person’s manager and the human resources*



department if there is one. There is a tendency for friends to ignore this kind of situation, hoping it will “go away.” However, any substance abuse problem in the workplace is serious and should be dealt with carefully.

*The proper response to violations of company policy does not change substantially with one’s position in the company. Most policies serve the purpose of protecting, either directly or indirectly, the employees as well as the company. Thus when an employee violates a policy, he or she is inflicting or creating the potential for inflicting some degree of harm on his or her co-workers and the company. All employees are subject to company policies and are responsible for ensuring their compliance. Looking the other way when a fellow employee violates policy makes one an accomplice to the indiscretion. Since, in most cases, a simple reminder of the policy is all the encouragement a fellow employee needs to cause a change of behavior, doing the right thing does not always necessitate violating confidences and friendships by going to managers.*

### Rebates and Premium Financing

Assume the laws in your state prohibit rebating. In order to be competitive on a large account, you agree to finance the premium with no interest. You know that many insurers offer finance plans with only nominal monthly fees, although your insurer does not. You further rationalize your decision by saying that it is no different than taking a reduced commission from your insurer and passing on the savings to the insured through lower rates. Now that you have sold it, you need to determine how to set it up. One option is to use a finance company with the insured paying the principal and you paying the finance charge each month. Another option is for you to pay the insurer at policy inception and then collect from the insured each month. Is this rebating? If you offer this for one account and not to other similar accounts, is this unfair discrimination?

**Comment:** *Offering financial inducements, such as interest-free loans, to one account that are not generally available to other similar accounts is a form of rebating. This is different from taking a reduced commission, since that is a direct expense reduction that is allowed by most rating plans to be passed on to the insured.*

### Claim Settlements

You have a contingency agreement with your insurer that will pay a 3 percent override if you have over 15 percent growth, with less than a 55 percent loss ratio. You also have authority to settle automobile physical damage claims up to \$20,000. It is December 20 and your loss ratio is right at 54 percent. You have achieved the growth plan. An insured reports a vehicle that was stolen. He also says he is traveling during the holidays and wants to have the check when he gets back. Are you justified in delaying payment until the next year? Your insured is in no hurry for the check, so you are not hurting him. Would it make a difference in your decision if the claim occurred December 29 and it would have taken extra effort on your part to get it processed by December 31?

**Comment:** *If normal business practice would delay reporting the claim until the next month, it is acceptable to do so. However, manipulating the process to benefit yourself would be unethical. Most insurers want to book premium and claims in the period in which they occur. By waiting to process the claim, you would circumvent the company’s business objective to benefit yourself.*

### Duty to Customers

You have recently purchased a book of commercial business from another agent in town who is retiring due to poor health. It becomes apparent that the previous agent has not always been returning audit return premiums to the insureds. Your agreement says the prior agent is responsible for any premium transactions that occurred prior to the sale. What action should you take? Do you notify the insureds who may have been harmed by the former agents' actions?

**Comment:** *When you discover a situation in which an error or misdeed causes financial harm to a customer, insurer, or business partner, you should attempt to rectify the mistake. Since your agreement to purchase the agency makes the former agent responsible for premium returns before the date of the sale, you should first try to get the return premiums that are due from the former agent. If this fails, it is appropriate to notify customers of the situation, so they may take action against the agent if necessary. The insurance company may also be liable for the actions of the former agent.*

### Competitor Misdeeds

When reviewing a prospective account's current insurance policies you notice a discrepancy between the property insurance and a summary prepared by the current agent. The coverage summary prepared by the agent says they have open perils coverage and an 80 percent coinsurance clause, when the coverage is only named perils and there is a 90 percent coinsurance clause. You recall that you've seen this before; you look back in your files and realize that this has been the case on five of this agent's other accounts that you have reviewed. What action do you take? Do you address this with the customer, the other agent, or the insurance department? If you also represent some of the same carriers as the other agent, do you disclose this to them?

**Comment:** *The frequency of this error implies that this agent is intentionally misleading his clients, a practice that reflects poorly on his firm and the insurance industry in general. It is appropriate to address this with the agent directly, the customer, and the insurance department. While criticizing a competitor is not usually good form, it is acceptable if people are being misled or hurt by the actions being taken.*

### Data Sharing

Individual privacy and identity theft have become critical issues over the past few years. Insurance companies have long reported claims information to several central bureaus. This can help to identify fraudulent claims or individuals with multiple claims. Should this practice continue? What obligations do you have to your clients to protect their privacy? What steps do you need to take to keep information regarding your accounts secure?

**Comment:** *An agent has a duty to keep customer data and personal information secure, and should implement security systems and procedures to safeguard it. Certain types of data sharing among insurers are necessary and acceptable because it helps reduce insurance fraud. The fact that claims data may be shared with various bureaus should be disclosed to insureds by insurance companies or their agents.*

## Board Member Conflict of Interest

As an insurance agent, you are on the board of the local hospital and have access to information regarding its financial status, payroll, coverage, and the current cost of insurance. If the hospital puts their insurance to bid, are you precluded from bidding because of your “insider” status? Are you obligated to share information you know as a board member with other bidders? Due to your insurance background, the organization asks you to prepare bid specifications for their renewal coverage. Can you ethically put bid requirements for coverages that you know your companies will write, but other companies may not?

**Comment:** *Assuming the hospital has no conflict of interest policy to the contrary, it would not be unethical to bid on the account. However, you will appear to have a conflict of interest and will be vulnerable to criticism. If you elect to participate as a bidder, make certain that all bidding agents have access to the same information and an equal opportunity to win the account. You would also be wise to avoid becoming involved in managing the bidding process or selecting the winning bid. It would certainly not be appropriate to design insurance specifications that include requirements that only the insurers you represent can meet.*

## Application Misstatements

An insurance company you represent has strict guidelines for the acceptance of new automobile accounts. It will not write someone who has more than three incidents (i.e., a moving violation or accident), regardless of fault. You have an applicant who has two speeding tickets and two accidents. In both accidents, the other party went through a stop sign, hitting your customer. Since these are not at fault, are you justified in leaving them off the application?

**Comment:** *Misstatements on the application are not acceptable at any time. You should explain to the underwriter that the losses are not at fault or present the account to a company that has less stringent underwriting guidelines.*

## Commission Levels

One of your carriers has several different companies within its group. They offer different commission levels and those that pay the higher commissions build a portion of the higher cost back into the premium. What factors do you consider in determining what company you use for particular clients?

**Comment:** *In selecting the company and commission level, an important factor to consider is the level of service that the account will require. This will assist you in determining the income level you need to properly service the account. Of course, you should also consider any differences in the coverages offered and their significance in light of the insured’s exposures.*