Ethics in the Insurance Marketplace

A Continuing Education Course

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Chapter 1

The Developing Environment of Ethics and Ethical Behavior

An Introduction to the Course

The past twenty years have witnessed numerous changes in the insurance industry as well as in American business in general. The concepts of consumerism and full-disclosure, begun in the automobile industry, spread rapidly to other fields including that of life insurance and life insurance sales. At the same time, the life insurance industry itself underwent enormous changes both in the technical structure of many of its products and in the way life insurance in general was sold.

The Life Insurance Product

Consumerism and full disclosure would have been enough to deal with for an industry as inherently complicated as life insurance. The actuarial structure of a cash value life insurance policy has always been difficult for the layman to comprehend, even on those rare occasions when a knowledgeable person has attempted to explain it. Most often it was presented as a package of ideas, "bundled" together, which was assured to the prospect by the agent to do certain things, among which were: provide a death benefit, accrue a cash value, pay dividends (in some cases), permit loans, and provide a number of non-forfeiture options. It was almost impossible to explain to the prospect exactly how these benefits were provided by the policy, and, in fact, most agents had a less than perfect understanding of it themselves. They could only assure the prospect, with the help of historical data, third party information and centers of influence, that the policies did work as they described and had done so reliably for many, many years. For an agent to succeed in selling insurance under such circumstances, without the prospect's complete understanding of the product itself, required the development of an adequate trust relationship between the agent and the prospect.

The Trust Relationship

That trust relationship, so vital to the sale of valuable, needed coverage, often proved to be a door that could swing both ways. On those occasions when the prospect would encounter a serious disappointment with his or her purchase, or when the agent's motives had been called into question by a third party, the prospect's perception of the situation often was not that of a simple business disagreement or misunderstanding. Rather, it would take on elements of a betrayal, that the prospect looked to the agent to care for his or her interests, and allowed the development of a delicate trust relationship, only to be let down in later years.
The "Buy Term and Invest" Philosophy

This was the environment of potential problems that existed in the late 1960's and 1970's, and which created many sales opportunities for the "buy term and invest" movement which advocated the purchase of lower priced term insurance instead of cash value life insurance, with the difference in price invested in other types of savings or investments.

Owing largely to the sales efforts of agents who promoted the "buy term and invest" method, many prospects came to feel that they understood that method much better than they did cash value life insurance. They came to believe that mutual funds or other investments would give them the opportunity to accrue greater values, and that they would be better off with those investments in the long run. Sometimes they came to feel that the agent who had sold them cash value life insurance had made too much commission income from the sale, and were, therefore, in a conflict of interest situation between their own financial needs and those of the prospect. Such agents frequently found their ethics being called into question and would find that it required a strong agent-client relationship indeed to weather the ensuing storm.

On the other hand, the "buy term and invest" proponents were in a good position to develop their own strong relationship by appearing to save the clients from what they described as an undesirable insurance situation, and providing a sometimes more understandable one with higher potential returns. However, this type of insurance and investment also has its areas for potential misunderstandings, disappointments and the deterioration of relationships, and not all of its converts remained entirely with the term insurance philosophy.

Replacement

One of the most controversial aspects regarding this "term and invest" sales drive was the tendency of some agents to replace existing whole life coverage with term insurance, and to take the cash values from the surrendered policies and place them into other types of investments such as mutual funds. Many whole life agents, who had placed the original policies, felt this process was unethical and only served the interests of the replacing agent. So, the process resulted in agents from both sides raising ethical questions about their competitors in the opposite camp.

Policy Loans

The late 1970's also saw a tremendous rise in the interest rates paid on relatively secure investments in the form of corporate and government bonds. Owners of whole life insurance policies, who had generally borrowed against their cash values conservatively in the past, began borrowing heavily from their policies at guaranteed low interest rates in order to invest in these high interest investments which eventually paid interest rates in the high teens. The high percentage of loans made by policy owners at guaranteed low rates greatly damaged the insurance companies' ability to invest and earn income as they needed to in the high interest bond investments available on the market.
These two forces, the "term and invest" sales campaign and the unacceptably high level of whole life policy loans, put enormous pressure on the providers of whole life insurance policies to find ways not only to stem the tide of policy loans, but also to develop new forms of insurance policies that could compete in a high interest environment with the "term and invest" philosophy.

**Universal Life insurance**

Such were the market circumstances that set the stage for the first broad-scale marketing of universal life insurance policies in the early 1980's. Companies which developed and marketed universal life insurance were able to invest the policies' reserves in secure financial instruments that paid the current high interest rates of that day, and then passed those earnings on to the policy owner in terms of cash value growth. Many companies adopted indexes to assure policy owners they would always receive a rate based on the actual interest rates available in the open market. Under these indexes they provided a floor guarantee in the range of 4%.

These first universal life companies offered indexed rates of interest on their policies in the range of 12 percent in 1981, and generated sales illustrations based on such rates which far out-projected any sales illustrations seen before in the insurance industry. With an "unbundled" approach, the developers of universal life allowed the various elements of the policies to be seen and understood by prospects and their accountants and attorneys. They could see for the first time what the various types of expenses, loads and mortality costs looked like. It had some aspects in common with the "term and invest" idea but with a difference. Universal life was a true cash value life insurance policy, which meant that the cash values not only grew at the attractive current rate of the day, but did so tax-deferred, as policy cash values are allowed to do. This made a very attractive combination of features for many prospective buyers and universal life quickly gained a significant share of the insurance market.

**Variable Whole Life Insurance and Variable Universal Life**

Another type of life insurance had been available since 1976 which was a type of whole life policy, but different. Traditional whole life cash reserves had historically been invested in carefully selected, conservative investments, like corporate bonds, which had modest, secure returns and maturity dates of 20 years or more. This allowed the insurance company to provide stable returns over the long run, and to provide certain minimum guarantees in the policy itself in terms of the death benefit and the non-forfeiture options such as the cash value, reduced paid-up insurance, and extended term insurance all of which were based on the minimum rate of earnings guaranteed in the policy of between 3 and 5%. Any earnings in excess of the guarantee would be returned to the policy owner in the form of a dividend, which could be used in a number of ways to augment policy values. The new type of policy, called variable whole life, allowed its reserves to be invested in equity "separate accounts" which in turn were invested in common stocks and other speculative investments. Such investments made it possible for the reserves to earn much higher returns than a traditional whole life policy. It also eliminated most traditional policy guarantees and even allowed the policy owner to lose money, a previously unheard of possibility. This policy was more complicated that whole life or universal life, and required
the policy owner to make decisions about what types in investments would be used. These companies and others would also develop a later generation of variable life called variable universal life, which had flexible premiums and "unbundled" costs like universal life, but with the opportunity for stock market-type gains.

The Changing Sales Environment

By 1981 the life insurance industry, which had been one of the most stable in the country for decades, found itself in the middle of a competitive battle of huge proportions:

- Providers of traditional whole life continued to promote the virtues of long term conservative thinking with minimum guaranteed cash values and death benefits and excess earnings expressed as dividends.

- "Term and invest" proponents continued to promote the idea of surrendering whole life contracts, buying term insurance, and investing in mutual funds, and later, variable annuities.

- Universal Life advocates were promoting the new policies in all life markets, and finding its unique features to be extremely popular.

- Promoters of variable life found a following, too, in the ranks of insurance buyers with a "risk tolerance" that would let them buy an equity based policy with fewer guarantees and the possibility of loss.

The Product Wars

Many people felt that the American life insurance industry had degenerated into a product war characterized by rampant replacement, and that the consumer's long term interests had been removed to a position of secondary consideration. The client-centered process of carefully exploring and analyzing a prospect's financial situation in order to make thoughtful and accurate recommendations of the correct type and amount of life insurance he or she should have was still practiced by many of the best, most far-sighted agents. However, it was very often superseded in the highly competitive sales environment by a battle of products, with the newest, most competitive product and the best product promoter getting the sale.

This highly competitive situation motivated insurance companies to continually update their products to make them more competitive and more attractive than before. Every insurance policy has certain features that are guaranteed, like maximum mortality costs and minimum rates of return on reserves, that can't be readily changed. These features govern the minimum possible performance of the policy. However, each policy also has a set of "current" figures for such costs and returns which are not guaranteed, and which will not support the policy under the most adverse circumstances. These, however can be illustrated to support the policy under the circumstances in effect at a particular time. Sometimes these "current" criteria are highly favorable and allow a policy illustration to be produced with very high performance. It may allow premiums to appear to vanish in
particular year or illustrate extremely attractive cash values at the policy owner's age 65. For example.

**The Vanishing Premium**

Because performance criteria can fluctuate widely, illustrations based on current assumptions may not be valid once they have changed. In the mid-1980's it was common for companies to illustrate premiums on whole life policies that would "vanish" in six to eight years. The word "vanish" did not mean premiums were not due, but rather that the premiums would be paid by a combination of current policy dividends and dividends that had been previously stored up. Universal life policies also illustrated very low premiums required for very few years using the high interest rates of the day. Often it seemed the sale of the product depended on how low the premium obligation could go.

Today, eight to ten years later, the criteria are not as favorable. Interest rates have generally gone down and caused the number and sometimes the size of required premiums to go up dramatically, often to twice the original amount of overall premium required. The illustrations generated in the 1980's were so wrong in the eight to ten year time frame that some policy owners have instituted legal action against the companies whose policies they bought. Under the sales philosophy of the 1970's and 1980's, there was a limit to what the policy owner was expected to understand, and to what the agent was expected to explain. In the 1990's the expectations have become considerably higher.
Chapter 1

TEST PREPARATION QUESTIONS

* What is the primary difference between universal life and variable universal life?

* What characteristic of the "buy term and invest" sales method was most strongly criticized by the sellers of whole life insurance?

* What typical interest rate was initially paid on the early universal life policies?

* Is the same range of interest rates being paid on universal life cash values today as in the 1980's? What effect has this change had on the premium schedules generated for many early universal life policies?

* Describe the "buy term and invest" sales method. Describe the ethical questions raised by both its proponents and its detractors.

* What does it mean when we say the premium on a traditional whole life policy "vanishes"?

* What happened to the overall level of whole life policy loans in the late 1970's and early 1980's, and why did it happen?

Answers are in the back of the book
Chapter 2

The Agent's Ethical Responsibility to the Prospect or Client

The life insurance industry has gone through a period of enormous shock and increasing change beginning in the late 1970's and extending to the present day. A number of life insurance companies have become insolvent and ceased operating, leading to fear and skepticism on the part of the buying public. Sales illustrations from many of the best companies have apparently failed to achieve what buyers felt they were promised in terms of financial performance. Some of the biggest companies have been sued for sales practices that may have seemed reasonable to agents in the 1970's and 1980's.

The result is that insurance companies, agents and the state insurance commissioners alike, have come to the conclusion that sweeping changes are necessary on the part of all concerned if the life insurance sales industry is to survive. All parties agree that new standards and procedures are required which:

- Safeguard the interests of the policy owner and serve to reassure the public
- Protect the insurance company and the agent from unfounded or opportunistic litigation
- Enable the state insurance commissioners to assure that insurance is sold with appropriate sales materials, terminology, and disclosure of essential information.

Professionalism

The concept of Professionalism, as defined in the fields of law and medicine, has always required that the client's interests come first. The best insurance agents have long believed the same thing, the question being which product will serve the client's interest best. Insurance buyers are more sophisticated than they once were. They are better educated and they have been trained to function in an increasingly complex business environment.

The Modern Life Insurance Buyer

Modern insurance buyers are increasingly exposed to volumes of investment information on numerous television programs and in a number of magazines. They expect to be given a great deal of information and they expect to be spoken to in sophisticated terms. They understand rates of return, loads, expense charges, income taxes, tax deferred qualified plans, limited partnerships and mutual funds. The modern agent has to be able to speak with understanding about such things and to present life insurance favorably in a highly competitive context. The modern insurance buyer can tell when the insurance agent is unsure, when he or she seems to exaggerate the benefits of a policy, or seems to obscure the difference between a policy's guarantees and its non-guaranteed overall potential performance. The modern insurance buyer has the same skepticism that buyers have
always had and needs more information than ever to overcome that skepticism and enter into a professional relationship.

**The Modern Life Insurance Agent**

It is contingent upon the modern agent to do everything in his or her power to become the most well trained, well educated, and professional salesperson possible. The modern agent is in competition with stockbrokers, bankers, insurance policies sold on television. The agent who falls behind the industry in terms of education and training is truly risking his or her career. In today's environment, the clients want to know that the agent is continuing to learn, just as their doctor and lawyer are doing.

It is not only a matter of practicality in maintaining one's clientele, it is also a matter of professional ethics for agents to remain up to date in their field. This is the primary reason the state insurance commissioners have instituted continuing education requirements in almost every state in the union in order for an agent to remain licensed.

**Continuing Education and Self-Improvement**

Agents today have a wide variety of educational opportunities, including programs of study leading to professional designations including Chartered Life Underwriter (CLU), Chartered Financial Consultant (ChFC), Certified Financial Planner (CFP), Certified Employee Benefit Specialist (CEBS), and Registered Health Underwriter (RHU). The attainment of one or more of these designations is often recognized by prospective buyers of an agent's willingness to honor his ethical responsibility to keep up to date in his or her profession.

In addition to these organized programs of study, there are a number of educational seminars presented at regular intervals in urban areas by the local chapter of the American Society of CLU & ChFC, and the local Association of Life Underwriters. There are also professional seminars, designed by continuing education experts in various areas of the insurance industry, and presented throughout the year all over the United States. These seminar courses, along with approved correspondence courses, provide a convenient and effective way for busy insurance agents to keep up to date with important topics and changes in their fields of expertise.

**The Financial Environment**

It is also important today for agents to remain aware of the state of the financial world in general. Life insurance once may have been perceived as a separate world of its own, functioning apart from the areas of securities, accounting, finance, and law. However, today a change in the law, securities, accounting, or securities regulation, to name a few, can resonate across financial boundaries and make unforeseen changes in matters of insurance that may be critical to the welfare of an agent's best clients.

Examples of this phenomena are easy to find. A number of changes in the estate tax law in the early 1980's, including the "One Hundred Percent Marital Deduction", made it essential for many persons to re-think their entire financial plan and have their wills re-drafted. It was
also the single greatest motivation for the insurance industry to develop and market the first "second-to-die" insurance policies, which today enjoy a substantial share of the market for large-case insurance sales. Is it the ethical responsibility of a life insurance agent to be aware of this and to inform his or her clients of the need to consult a lawyer about having current wills?

In the same time frame, accounting procedures were introduced which greatly reduced the suitability of certain types of deferred compensation plans for many small businesses, causing many such businesses which had recently established such plans to terminate them immediately, often at considerable expense. Those agents who became aware of these accounting changes as soon as they occurred and were able to advise their clients accordingly, were perceived as performing in a professional, client-centered manner. Those who did not learn of it until the accountants brought their clients the bad news, did not look as good. Were the clients justified in feeling it was the agent's ethical responsibility to keep them abreast of such things? Many people would say yes.

In the late 1980's, changes in the way the interest on insurance policy loans was treated, for tax purposes, drastically changed the way tax-conscious policy owners paid their premiums. Many agents had sold policies with premium paying programs based on the deductibility of the interest on policy loans. Often the agent had encouraged the policy owner to use policy loans to pay the required premiums in order to enjoy the tax deduction brought to them by the payment of the loan interest. In this limited historical context, the result looked good. The client wrote a check for loan interest, which was tax-deductible, instead of writing a check for the premium itself, which was not tax-deductible.

The problem came years after the original sale when the client lost the deductibility of the loan interest. By that time, many of the older policies sold this way had accrued substantial loans, often approaching the entire policy cash value. This made many of them very unattractive and expensive to keep in the absence of the lost deduction. Those insured persons who wanted to drop them for new policies were inevitably older, requiring higher premiums. At worst, they found themselves highly rated for health problems, sometimes even uninsurable, and unable to make a financially feasible purchase.

Some of the more conservative agents, who had never sold policies this way, felt this sales method was poorly founded and ethically questionable. Some of the policy owners may also have thought so in the end. It is interesting to consider the ethical question in the context of that time. The loan interest was, indeed, tax-deductible, but the concept eventually lost its value with an unpredictable act of congress. Who is to say who was right and who was wrong? However, it is interesting to consider the difference in sales philosophy between those who used that sales method and those who did not, considering the outcome.

The Broad Area of Sales Ethics

These questions and others, including the Vanishing Premium discussed previously, are just a few of the areas covered by the concept of life insurance sales ethics. The following subjects are directly related to the daily operation of a life insurance sales practice. They
involve matters of ethics as they exist between the life insurance agent and prospect or client.

**Sales Methodology**

Most life agents would agree that different prospects require different sales methods. One prospect might seem to have only a single need to be addressed while another might appear to have two or more needs. A third person's situation might demand a comprehensive analysis to discover exactly what his or her various needs were and how to most logically fill them. It is entirely possible that the prospect does not even know exactly what is needed because he or she has never thoroughly analyzed his or her own financial situation with that end in mind.

The life insurance agent should make every effort to determine the need or combination of needs for every product sold and to apply to that need the appropriate product in the appropriate manner. The same product today may fill widely different types of needs.

A policy may be desired by a client for one reason only, for instance:

- to pay off a mortgage or other large debt
- to provide for the education of a child
- to pay final expenses at death
- to provide a fund to generate income to support the insured person's survivors.
- or, in larger estates, to help pay estate and/or inheritance taxes.

Any of these needs or others, may exist alone or they may exist in combination. The agent will not know, unless he or she asks, whether the right single need or the right combination of needs is being addressed. It has happened many times that an agent has sold a policy for the single need described by the prospect, only to find out years later that a number of needs existed that the prospect had not mentioned, but which could have been revealed in a short exploratory conversation. Agents have been called lazy, incompetent and worse for not providing coverage a surviving spouse thought should have been there but wasn't. In today's environment it is justified in expecting a professional insurance person to inquire into all such various needs, and to make sure the survivors will have the assets they need at the insured's death.

**Fact Finding**

That is why a comprehensive analysis of the insured person's financial responsibilities and insurance needs is often important. Only when the agent, the client, and sometimes the client's spouse, have gone through a thorough fact-finding process, can the agent say that all needs have been professionally explored and discussed.
Agent's Responsibility to the Client

The Needs Analysis

Once a comprehensive fact finding interview has been conducted and all necessary notes made, the agent owes it to himself and the clients to do a thorough analysis of the information. A number of computer programs exist which will do this sort of work, which if done by hand would take a very long time and much effort. Any such analysis needs to include certain assumptions for the future rate of inflation, and for the rate at which pledged assets grow.

Such a program will not only explore and quantify all of the various needs for insurance at the time it is done, but it will provide the basis in the future for regular updates of the information and adjustments to the client's insurance plan. In a great many instances, a surviving spouse has asked the agent to go over the plan with him or her after the insured's death, to review with them exactly what amount of insurance money was supposed to be applied to exactly which financial need. This has been described by many agents as the most moving and satisfying service they have ever provided for their clients.

In addition to the practical benefits described above, a comprehensive analysis also safeguards the agent's interests. When kept in the agent's records, it provides evidence that the plan was done thoroughly and in good faith, with full understanding by the clients. Some agents, for all of the reasons above, refuse to work with a new client unless they will agree to go through such an analysis because it is concrete evidence of the agent’s ethical conduct of his or her business.

Product Illustrations

Once the various needs have been explored, analyzed and quantified, it is time for the agent to make a product proposal. The product, or products, proposed should fill all of the financial needs to the extent possible and in a manner that is well understood by the client. The product should also be priced in accordance with what the clients have said they could afford to pay. Sometimes it is not possible to cover all needs with the premium dollars available. In such cases the clients have the choice of either reducing some of their financial goals or deferring them to a later date when the plan may be revised as more money becomes available.

The insurance recommendations must be presented to the clients in a manner they can understand. The clients must be able to understand how the policy works, what guarantees are available, and what features depend on the non-guaranteed financial performance of the recommendations.

Term Life insurance

Most people understand that term insurance is pure insurance with no cash value and that the premium per thousand goes up over a person’s lifetime. It is true that some policies have level premiums for ten or even twenty years but in the long run most such premiums go up a great deal in the years approaching normal mortality.
Most such policies are illustrated either with Gross Premiums and Net Premiums or with Current Premiums (similar to Net) and Maximum Premium (similar to Gross). In either case, the client must be informed that the Gross or Maximum Premium is the actual guaranteed premium for the policy. The Net or Current Premium is generally a lower figure which is used by the insurance company under its current financial circumstances which are more favorable than its higher guaranteed rates. If an insurance company encounters financial difficulties, as many have in recent years, it is possible that the policy owner will find himself or herself paying the higher rate and they must be made aware of that.

**Participating Whole Life Insurance**

There has been a great deal of misunderstanding on the part of policy owners in recent years because of the way whole life policies and their dividend performance have been described. Reductions in the dividend scales of many companies have resulted in premium requirements well beyond the "vanishing" period for which they were originally illustrated.

Whole life insurance has level premiums because of a reserve of money that builds in the policy over time and is credited with a minimum guaranteed rate of interest. As this reserve, or cash value, grows, it displaces a portion of the policy's pure risk element and earns interest to help pay for the portion of the risk element that remains.

A whole life policy has two main guarantees, namely, the guaranteed death benefit and the guaranteed cash value. These two elements only exist if the stated premiums for the policy are paid as scheduled all the way to the end of the premium paying period stated in the policy. If the premiums are paid as scheduled, there are other Non-forfeiture Options, in addition to the cash value, which include a schedule of benefits for Reduced Paid-up Insurance and Paid-up Extended Term Insurance. All of these benefits exist independent of dividends, which are not guaranteed to be paid. The policy owner must be told clearly that these are the only guarantees in the policy.

All of the guaranteed benefits described above are based on certain "worst case" actuarial assumptions used in designing the policy, such as maximum possible policy expenses, maximum mortality costs, and minimum guaranteed rates of interest credited to the policy reserves. Any savings realized in terms of costs or expenses, as well as any excess interest earnings above the guarantee, are returned to the policy owner in the form of a dividend which, again, is not guaranteed. The policy owner needs to be aware of what the policy guarantees are, as opposed to what the dividend is.

Dividends, when paid, may be applied in several ways:
- in cash to reduce the premium
- to purchase paid up additions, which are additional amounts of single pay life insurance which have their own cash value
- to accumulate at interest
- to buy various kinds of term insurance to augment the base policy's death benefit
Agent's Responsibility to the Client

Premiums don't vanish at all. They are still there for as long as the premium paying period lasts. They may be partially or wholly paid for by the policy dividends, but they are still there and they must be paid. When they are said to "vanish", it means that the current dividend, together with money from previous dividends that has been stored as the cash value of dividend additions or as dividends accumulations, have been used to pay the current premium. Also, since dividends depend on a number of factors, part of which are entirely out of the control of the insurance company, they may be expected to vary significantly in the future from the current dividend scale.

Dividend scales before the mid-1980’s had experienced significant increases for several decades, culminating in a dividend scale interest rate for many companies in the range of 11 to 12 percent between 1985 and 1988. Very few agents selling life insurance in the 1980’s had ever experienced a downturn in the level of dividends, much less like the one experienced in this country since 1988. Should the agents and companies have known a downturn was coming? Should they have insisted on agents using a lower assumed rate for ethical reasons? These events are in the past, but they provide the modern agent with a historical context for developing his or her own ethical standards regarding dividend projections.

Universal Life Insurance

Universal life policies were developed in the late 1970’s and early 1980’s in response to the high interest rates of the day, the high volume of policy loans, and the activities of the "buy term and invest" movement. Their design around the ability to invest in secure short term investments was their attractive point in the beginning, enabling them to offer cash value interest rates which ran as high as 12%.

Many policies were sold in the early to mid-1980’s with premium payment levels and "vanish" schedules based on those high rates of interest. Today such policies experience far lower rates of interest, and the premium levels and time frames have had to be increased significantly to compensate. In this way, the experience of universal life policies in terms of premium vanish schedules has been similar to that of whole life, although with somewhat different time frames and levels of severity.

Universal life policies are still very flexible in terms of the ability to vary the face amounts and premiums, but they still do not generally have the policy guarantees associated with whole life. The way to show a death benefit or cash value guarantee on a universal life illustration is to have the computer solve for a premium that will have a specified cash value at age 90 to 100 based on the guaranteed policy expenses and mortality costs, and on the guaranteed interest rate, generally around 4%. Even though it is sometimes unattractive or inconvenient to illustrate, it is the responsibility of the agent that the policy owner should know very clearly what is guaranteed in the policy and what is not.

Variable Whole Life and Variable Universal Life

Variable products may be considered in our discussion to be similar to traditional whole life and universal life, but with two exceptions. First, these policies generally have part or all of their reserves invested in a variety of equity separate accounts for higher potential gains.
Second, there is no guaranteed floor interest rate for the performance of these funds. It is possible for the funds to earn extremely high returns in some years, and it is possible for them to actually lose money in some years.

In the standard form of these policies there is no guaranteed death benefit or cash value because there is no guaranteed interest rate on the invested reserves. The prospective buyer who is "suitable" to buy such a policy under NASD and industry guidelines must have a suitable amount of income and outside savings and must agree that they have a "risk tolerance" appropriate to the purchase of a variable product.

Some recently developed products have been given a guaranteed death benefit feature, based on the payment of a specific premium for every year of the premium paying period. This feature will generally keep the death benefit in force even if the cash value disappears altogether. This benefit varies from company to company.

Nowhere is the concept of agent's ethics and compliance with industry and company regulations more important than in the sale of variable products because there are so many variables involved and so few guarantees. Agents are subject to far more training, NASD registration, special licensing, special compliance regulations, inspections and supervision at the agency and company level.

It is of paramount importance that the agent keep the best records possible in selling variable products. Beyond the normal criteria involved with whole life and universal life, there is the necessity of handling money and paperwork similar to the way that investment dollars and paperwork are handled by a stockbroker. If dollars don't arrive at their investment destination on time, or if transfers are not made from one account to another on time, the client could lose money and hold the agent or the company responsible.

Checking Questions

In selling variable products, as with other insurance products, it is wise for the agent to occasionally ask himself or herself:

"What is the worst that can happen in this situation? Have I prepared my client for it?
Am I prepared to defend my client's interests if things go wrong?
Am I prepared to defend myself and my own interests if things go wrong?
Are my client records and my training and licensing in order?
Is my relationship and my reputation with my company and client as strong as possible?
Record Keeping

The place where many agents get in trouble is record keeping. On occasion a client will call complaining that something was not done correctly, or done on time, or even that something was done contrary to his or her wishes. It is in the interests of the client, as well as in his or her own interests, that the agent keep complete records in order to clarify a situation.

The classic case is that of a life and health agent who sells a group health insurance policy that does not cover certain pre-existing conditions. The client employer buys the coverage and six months later a covered employee files a claim on a pre-existing condition and the claim is denied. How did this happen? What are the possible remedies? Is the agent in someone’s crosshairs?

The agent is in a strong position if he or she has records which indicate that the pre-existing conditions language in the new contract was addressed fully and clearly with the employer. Without such records the agent may be found liable for the amount of the claim.

Records to be kept include:

- Notes of all conversations
- Copies of all correspondence
- Copies of all promotional material
- Copies of all case materials:
  - fact finders
  - sales presentations
  - policy illustrations
- Copies of applications, new account forms, monthly draft forms,
- Copies of service forms, changes of beneficiaries

While the primary purpose of such records is the service of the client, the associated reasons are (1) to assure the insurance company and other regulators (like the state insurance commissioner or the NASD) that the agent is performing his duties ethically and in compliance with company, industry and governmental guidelines, and (2) to assure that the agent is in a strong position in case of a complaint.

Money Handling

The most frequent problems in the area of handling money do not involve actual theft, but rather the mistakes made in the way money is managed once it leaves the client’s hands. It is important to follow agency and company procedures to the letter about:

- How and when money is to be collected from the prospective insured, as well as when it may not be collected
Within what time frame the funds must be transferred to the agency or company

What forms, properly filled out, must accompany the funds, such as monthly bank draft forms and, for variable products, new account forms

The most important rules about accepting money from clients are:

- Discourage the client from giving you cash for a premium payment. Your agency or company may prohibit this entirely. If you must accept cash, be sure to provide a proper receipt.

- Never commingle a client's funds with your own money. If it can be construed in any way that the client’s money has been used for the agent’s own purposes the agent may possibly be charged with theft.

Utmost Good Faith

Probably no business in the world is more dependent on the concept of "utmost good faith" than is the insurance business. It is one of the basic concepts on which the insurance industry is based.

Most business arrangements involve the exchange of money by one party for tangible goods or valuable services in the present time frame. There is an equality implied between the money paid and the value received. Such arrangements do not require a great deal of mutual good faith, at least not for very long.

The insurance industry is unique in that it only works if everyone involved generally tells the truth and does what they say they will do. The insurance company receives a relatively small amount of money, in the form of a premium, from the policy owner in the present time frame, and promises to pay a much larger sum to a beneficiary at some unknown time in the future when and if the covered event occurs. This requires a great deal of faith on the part of the policy owner that the insurance company will remain sound, live up to its fiduciary responsibility, and pay the claim when it is due. Also, below a certain level of coverage, the insurance company accepts the risk involved on the basis of information provided on the application, which is another example of utmost good faith.

It is the agent's ethical responsibility to fulfill their role in the relationship of utmost good faith that must exists between the policy owner and the insurance company.

Maintaining the Relationship

The relationship which the agent seeks to build with the client is sometimes perceived as beginning and ending in the process of the first sale, and being of little importance beyond that except in order to obtain referrals. It may appear to have very little to do with ethics in that context. It does, however, have a great deal to do with ethics, and is perhaps the agent's best insurance against complaints and legal action throughout the agent's career.
It is commonly believed that the relationship with the prospect begins and is built in the fact finding process. When an agent indicates interest in the personal details of a prospect and his or her family, he or she is asking for a great deal of trust. And when the agent follows through by listening closely, asking about their hopes and dreams, and appearing to adopt their financial goals as his or her own, a significant bond of trust is built, at least for a while.

It is up to the agent to maintain that relationship and that quality of trust for the client's own benefit. If the agent provides continuing service, including reviews of the client's plan every year or two, then the client is well served and feels the agent is a valuable resource. Under these circumstances, when a concern arises the client will call the agent first for advice and the agent will have an excellent chance to provide immediate service to the client and, in most cases, ease the situation entirely before it becomes serious. In the absence of such a relationship, the client might delay taking action until the situation has deteriorated beyond hope. It is the agent's ethical responsibility to prevent this from happening primarily for the benefit of the client, but, in fact, for the agent's own benefit as well.
Chapter 2

* TEST PREPARATION QUESTIONS *

* How should the modern life insurance agent's conduct differ from the agent of the 1960's? How have the agent's ethical responsibilities changed since the 1960's?

* What is implied by the term "professionalism"?

* What ethical questions might be raised regarding the "single need" sales method?

* In the "needs analysis" sales method, which is most important, the fact finding interview or the product presentation?

* In what way does the "needs analysis" sales method protect the agent from complaints and possible litigation?

* In terms of the agent's ethical responsibility to the client, give an example of why it is important for the agent to keep good records.
Agent's Responsibility to the Client

* Why is the agent's own continuing education viewed as one of the agent's ethical responsibilities to the client?

* What is the concept of "utmost good faith", and why is it so important in the insurance business?

* In what way is maintaining an excellent agent-client relationship part of an agent's ethical responsibility to the client?

* What common misunderstanding may occur when an agent shows a prospect a life insurance proposal which contains both "gross" and "net" (after dividend) premiums?

* What is the agent's ethical responsibility to the client regarding the guaranteed features of a life insurance policy?

* What are the two main guarantees provided by a traditional whole life policy besides the guaranteed premium?

* What are the guaranteed death benefit and guaranteed cash value features contained in all variable whole life and variable universal life policies?
Chapter 2

* Why is there so much additional scrutiny in terms of ethics and compliance matters imposed on the agent who sells variable-type products?

* How can guaranteed cash values and death benefits be provided by a universal life policy?

Answers are in the back of the book

NOTES:
Chapter 3

The Agent's Ethical Responsibility to the Insurance Company

In the process of providing reliable service to the client, the agent has very clear ethical responsibilities in his or her dealings with the insurance company. The insurance company can only offer its services in an atmosphere of utmost good faith and it is the agent's duty to promote that atmosphere in the following ways, among others:

Persistency

The agent has a responsibility to sell insurance policies in such a way that they remain in force until they have served their ultimate purpose. This will benefit the company, the agent, and the client in the long run.

For the insurance company there is the question of expenses and economy of operation. If an individual policy stays on the books for a long time, it means that the time and expense involved with issuing that policy has to be absorbed only once instead of many times. The financial benefits which inure to the insurance company in the later years are lost in the case of early lapses. There are definite savings and profits for the company involved with having a high "persistency ratio."

A policy that is issued but which never pays benefits contributes little to the company's reputation in the community. Only when the policy has performed as expected, does the company benefit from a good reputation and follow-on sales. Long term clients refer agents to other potential clients, which is highly desirable for everyone.

The agent's sales efficiency, in terms of low lapses, contributes to home office financial efficiency, a commonality of interests in serving and keeping the policies in force, and to the home office's desire to maintain a good relationship with the agent and his clientele.

Policy persistency is actually one way of measuring the strength of an agent's relationships with his clients. When the relationship is strong, the agent and client communicate regularly and there are few surprises. If a dividend scale or policy cash value interest rate is going down, it is communicated gradually and prevents a sudden shock later on. The agent remains the expert and counselor instead of fading into the role of messenger when there is bad news. In this way, the relationship fostered by excellent service not only keeps policies on the books but also tends to reduce the incidence of litigation by policy owners.
The Agent’s Responsibility to the Company

Minimize Litigation

The next ethical responsibility of the agent follows the previous one closely. The agent should sell and service his clients in such a way as to minimize the amount of litigation brought against his company.

Some agents might feel that they are safe no matter what they do because if something goes wrong the big insurance company would have to pay to put things right and not themselves as agents. This attitude displays a lack of concern both for the interests of the client and the insurance company, each of whom has accepted the agent in the spirit of utmost good faith.

This attitude not only sets the stage for a variety of questionable sales practices and a generally low level of client service, but for almost certain litigation at some point in the agent's career. The agent always suffers in the process of litigation, either in the loss of his agent's contract with the company, the loss of his license with the state, or in the inability to purchase Errors and Omissions insurance which is essential to continuing in his or her career.

The same sales and service practices that will keep the agent in good standing with the client will do much to keep the company in good standing as well. This includes the use of only company approved prospecting and sales materials to assure that inappropriate, inadvertently misleading language or terminology does not creep into the sales talk or visual materials.

Ethics involves proper administration of paper work, assuring the handling of all application materials, forms of all types, and monies remanded to the agent in the manner required by company and industry guidelines. Ethical behavior also includes accepting responsibility for one's actions and avoiding the shifting of blame for misleads or errors.

The agent should also present the company's rules, regulations, and even their underwriting decisions to the client in a way that does not reflect badly on the company. When the agent criticizes the company, even mildly, he or she is also criticizing himself or herself for representing that company.

It is also important for the agent to inform the company immediately and fully of any potential problem, complaint, or potential litigation by a policy owner. This allows the company to quickly research the problem and take appropriate measures to either placate the policy owner or to defend its own interests competently in case of actual litigation.

Promote Company Status

It is the agent's responsibility to promote his company's status in his or her own community. A company's reputation for service as a responsible member of the community increases the strength of its relationship with every one of its policy owners in that community, increases policy persistency in general, and reduces the likelihood of litigation.

There are a variety of opportunities for service in one's community. Sometimes the opportunity is within the structure of the local life underwriter's association. Blood drives,
blood pressure screenings, charity golf or tennis events are common, but most often supported by agencies or groups of agents, rather than individually. On an individual basis, an agent might increase their reputation and that of their company by participating in civic clubs, religious groups, literacy action programs or the United Way.

The important thing to remember is that the agent cannot raise the reputation of their company without raising his or her own reputation at the same time. The sales professionalism he or she displays in their practice reflects well on the company and the speed with which the company responds to service requests reflects well on the agent. The agent and the insurance company are often inseparable in the mind of the public.

On those occasions when one’s insurance company comes under public scrutiny or criticism, it is important for the agent to take the initiative in defending the company. Assuming he or she trusts the company and has a good relationship with them, the agent should generally restrict comment to the company’s own approved news releases and publicity. If the agent feels the company is not being entirely candid, he or she has an ethical responsibility to all concerned to work out the details of his or her disagreement with the company behind closed doors before saying or doing things that would make clients and policy owners unnecessarily anxious.

Field Underwriting and the Home Office Underwriter

Underwriters are hired and trained to keep the company from assuming poor risks or acceptable risks at the wrong premium. It is their job to approve applications only when information on the application, from the medical records, and from other sources indicate that it is appropriate. The agent, also, has a responsibility to the company to perform his or her field underwriting duties thoroughly. The company relies strongly on the agent, depending on his or her reputation and relationship with the company, to perform a certain amount of underwriting in the field before sending in an application.

For example, the underwriter needs to know how well the agent knows the prospective insured. Is the person a referral from a long time policy owner or is he someone who responded to a cold call? Is the person in the correct economic circumstances to buy from this company or to buy a particular product? The agent is obligated to assist the underwriter by filling out the application fully and accurately, including the agent’s certificate, with any and all information available about the prospect. The agent is also obligated to use paramedical or medical examiners who have a good reputation for speed and thoroughness and who can be depended upon to represent the insurance company well.

Occasionally an underwriter must request additional information about a client, perhaps blood pressure readings, laboratory tests, or X-rays, etc. It is a temptation for the agent to blame the need on “those guys in the home office”, implying that the underwriter, perhaps, should not have asked for the requirement. The agent has a duty to the underwriter and the company to communicate their request with dignity and to assure the prospect they wouldn’t ask unless it was needed for the underwriting process. If the agent wants the underwriter to treat his cases and prospects with the respect they deserve, then the agent must reciprocate.
The agent should be honest with a prospect about the possibility of a rated premium or a declination. Assuring a prospect that he or she should get a policy with no problem, sometimes sets them up for a great disappointment later on, and an instantaneous reduction of the agent's and company's reputation with that individual and, very likely, everyone they can tell about it.

An agent should deliver policies as soon as he or she receives them. Most states have a 10 or 20 day "free look" period during which the policy owner can return the policy and get the premium back. It is essential for the policy to be delivered, and for these periods to begin as soon as possible. If the policy is not delivered for three months, the "free look" period will last for 10 or 20 days beyond the delivery date and the policy owner will still be able to get the premiums back. Most companies would consider this to be unethical behavior on the part of the agent with respect to the interests of the life insurance company. Today, many companies have required delivery dates and delivery receipts that prevent this from happening.

Company Approved Materials

Although the subject of "company approved sales materials" has been mentioned previously, it deserves a more complete explanation since it is so critical from an Ethical and Legal perspective.

Working as an agent in the life insurance business is a demanding career with many positive and negative features. One of the most positive is the opportunity it gives the agent to be creative in his or her work, and to tailor presentation materials to the specific needs and temperament of a particular prospect. Many agents find this process to be very rewarding and resent any attempt by the insurance company to suppress that creative effort. However, recent years have seen the local development of sales materials getting agents, managers and life insurance companies into a certain amount of trouble. Print technology enables us to produce professional quality materials from local offices. In some cases, the word "deposit" was reportedly used where the word "premium" would have been correct. In some of the same cases, the word "savings" was said to be used instead of "insurance policy cash value." In many such cases the policy owners later claimed they had been misled into thinking they had bought a special type of retirement plan, not knowing they had bought a life insurance policy with all of its associated loads, expenses and commissions. In one particular case, many policy owners were members of the same "target market" who banded together and filed suit against the agents, agency and the life insurance company. The policy owners won!

The life insurance industry took immediate action to restrict the use of locally manufactured sales presentation materials unless they had been approved by "compliance" officials at the home office level. Life insurance home offices all over the country began creating sales materials at the home office, designing them to be extremely clear in their language, eliminating ambiguities, and disclosing more complete information about policy guarantees than locally produced presentations had generally disclosed. Today, these presentation materials are reviewed for appropriateness by the "compliance" officials who make sure
they meet certain legal and ethical standards developed by the company. All of this is intended to protect the consumer from misleading sales presentations, and to safeguard the agent and the life insurance company from unnecessary problems, complaints and litigation.

While they are sometimes regarded as a hindrance to the creative process, the marketing and compliance personnel at insurance home offices are among the agent's most valuable associates. Life insurance products are, by nature, complex and difficult to explain. Insurance professionals are charged with the responsibility of helping the agent do his or her job in an effective, ethical and legally defensible manner.

Agent Training

Let's explore agent training in a little more depth. Many people would agree that the life insurance selling environment today is much more complex than it used to be, and that agents should be grateful for every training opportunity that becomes available.

Each state insurance department requires certain types and amounts of training prior to the agent's taking the licensing exam. Most states also have continuing education requirements for license renewal. In some states these requirements are quite strenuous, requiring the agent to accrue, on average, between one and three hours of training per month, sometimes in specific subjects. Fortunately, there are a variety of sources for attaining these hours and credits, including seminars offered by local associations and CLU chapters, seminars and correspondence courses provided by professional insurance training companies, and professional classes leading to industry designations such as Certified Financial Planner (CFP), Chartered Life Underwriter (CLU), and Chartered Financial Consultant (ChFC).

The designations mentioned above are almost expected by prospects at certain levels of insurance sales as evidence that the agent takes his or her career and responsibilities seriously. One way an agent can fulfill his or her responsibilities to his clients and to the life insurance company, regarding ethical levels of knowledge and competency, is to pursue such professional designations and to promote the value of them within the community.

As an agent becomes well educated and familiar with various areas of law and taxation, it important to remember what the agent's area of expertise is and what it is not. Agents study law, accounting and taxation as they pertain to life insurance, but generally not in the broader context of all business and family financial affairs. That is the appropriate professional territory of the attorney and accountant. Occasionally an agent is asked by a prospect or client about a point of law or accounting that borders on actually practicing that profession. The agent is ethically required to recommend that the individual contact his or her lawyer or accountant about that type of question. Most lawyers and accountants are very easy to get along with once they are reassured that the agent is a well trained life insurance professional, and is not likely to meddle in areas where he or she is not trained or licensed.

Needs Based Selling
"Needs based selling" is a type of selling that involves spending significant time with a client asking questions about all relevant aspects of his or her family situation, income savings, and goals for the future. In the course of this fact-finding interview, the agent and the client eventually develop the beginnings of a trust relationship, which is enhanced during future discussions and meetings.

In needs based selling, the agent takes the information learned about the prospect his family or business, his goals for the future and develops from that information a comprehensive plan describing how insurance can be best used to attain most or all of the individual's financial goals. The agent usually uses a computer to do much of the mathematical work and the resulting presentation can be fairly complex.

Needs based selling takes a lot of time and effort but it generally leads to a more satisfactory conclusion for the client, the agent and the insurance company than the alternative methods of selling that tend to address only one perhaps two needs at a time. Once the initial plan has been done and the first insurance needs filled, it is relatively easy for the agent and client to meet again each year or two to review the plan and make required changes. It is also strong evidence to the client, to the insurance company, and to any regulatory office or court, of the desire of the agent to provide a thorough and accurate service in an entirely ethical manner.

Many insurance trainers would say that needs based selling is the only responsible method of selling life insurance. It surely appears to have many ethical advantages over "single need selling" for most persons who earn at or above the middle income level. It is presented here as the ideal method that covers the most needs and provides the greatest good for most clients.

However, it is also important to acknowledge that there are many different types of life insurance buyers, not all of whom might be well served by a needs based approached. At some economic levels, the maximum role life insurance might reasonably be expected to play might that of a burial policy, or to pay off a mortgage or other indebtedness. It is not always possible, for financial or even cultural reasons, for many people to use life insurance in larger amounts for more and varied purposes. Needs based selling is not the only approach to insurance sales. It was once said that "If the only tool you have is a hammer, then all opportunities will appear as a nail".

**Administration**

Life insurance is a paper-intensive industry. There are no tangible products but there is a tremendous variety of paper items that must be handled effectively and efficiently. This is an easy place for agents to get in trouble. Many agents are, by nature, expressive, outgoing people and some are not detail oriented. They may well spend most of their time developing and enhancing relationships, only to suffer near disasters in the area of administration. Oversights, mistakes, or carelessness in certain areas can destroy a hard-won reputation.

For example, applications for new insurance need to be handled in a timely and efficient manner. They need to be filled out completely and accurately and then be turned in
immediately to the agency or to the insurance company. Medical exams, paramedical exams, and any other medical information must be ordered and obtained as quickly as possible.

Any money accepted with the application, together with associated paperwork, such as monthly draft forms, must also be given to the agency or the company as quickly as possible. In extreme cases the timeliness with which applications, medical, other underwriting information, and money taken with the application reach the office may determine whether the insurance was in force at the death of the insured prior to the issue of the policy.

It is equally important that requests for loans or surrenders, changes in ownership or beneficiary, and other similar forms be handled with appropriate speed and accuracy. Delays or oversights in these areas can cause complaints (and possibly litigation) as quickly as mistakes in any other area.

Most serious problems and complaints having to do with administrative paperwork can be avoided if well designed procedures are installed and followed rigorously. Most insurance companies already have such administrative procedures that they prefer their agents to use.

**Record Keeping**

The associated area of record keeping is another one which can make or break an agent's reputation with his or her clients. Good records of when and how all applications, medicals, other forms and money were handled will save the agent from accusations that they were not handled properly. Poor record keeping by the agent leaves the agent and the company open to such charges without an adequate defense.
* TEST PREPARATION QUESTIONS *

* What is "field underwriting" and why is it a part of an agent's ethical responsibility?

* How does it benefit the life insurance company when the agent consistently uses company-approved sales materials?

* Why is it any of the company's concern whether the agent pursues continuing education or takes advantage of training opportunities?

* What is the relationship between an agent's office procedures and record keeping and their ethical responsibility to their companies.

* How could a long delay by the agent in delivering a new policy be disadvantageous to the life insurance company?

* How is it beneficial to the life insurance company if its agents pursue professional designations?

* Why is the "needs analysis" sales method generally regarded as an ethical way to sell life insurance?
Chapter 3

* Describe a situation in which a "single need" sales method might be just as ethical as a "needs analysis" method?

* What does "persistency" have to do with an agent's ethical responsibilities?

* What impact can an agent's relationship with his or her client have on the life insurance company?

Answers are in the back of the book

NOTES:
Chapter 4

The Life Insurance Company's Ethical Responsibility to the Policy owner

One of the most important concepts in the business of life insurance involves the life insurance company's ethical responsibilities to the policy owner. These responsibilities cover the entire spectrum of company operations from the management of field agents, to providing day-to-day service to policy owners, to maintaining the financial strength of the insurance company.

Design of Approved Sales Materials

As previously mentioned, the insurance company is responsible to the client for the accuracy and completeness of all field sales materials. By so doing, the company can assure the prospective policy owner that all sales materials are free of inadvertently misleading terminology and ambiguous statements. These presentation materials, generally designed in the home office marketing department, benefit from a professional appearance and contain well-written, clear, and useful information. These materials are reviewed by a number of proofreaders and editors before publication. One of these reviews is to ensure that the materials are legally and ethically appropriate for field use, and are in compliance with company and regulatory standards. Because of this, the client is assured that all information is in the words of the company, and not merely in the words of the agent.

Supervision of Field Sales Practices

Life insurance companies which sell variable-type policies have long been in the practice of regularly exercising supervision over agents’ sales, administrative, and record-keeping practices. This is because of the nature of such policies' equity separate accounts, which fall under the jurisdiction of securities industry regulators. However, in recent years it has become increasingly common practice for companies who primarily sell traditional policies and universal life to implement many of the same procedures.

Some of these procedures include annual meetings, generally presented by home office personnel, on the subjects of ethics and compliance.

These meetings are designed to educate agents on common types of mistakes made by agents and the consequences of them, sometimes including fines, loss of licenses, and other types of disciplinary actions. Other procedures sometimes include the review of client files and of sales materials in use.

Agents licensed to sell variable-type products are required to submit signed statements to the effect that they understand and agree to comply with their companies' detailed standards of ethical and procedural behavior.
It is also the company's responsibility to assure that agents receive adequate training in the areas of administrative procedure, record keeping, product knowledge and terminology, and company-approved sales methods and materials. The company should also encourage its agents to participate in professional education opportunities within the industry.

**Insurance Company Administration**

At the insurance company level there is a large volume of paper and electronic information to be handled on a fast and accurate basis. The policy owner deserves reassurance that this is being done effectively in his or her interests. The company has a responsibility to ensure that every application, beneficiary change, ownership change, etc., is handled correctly because of the damage that could be done to a family's or a business's finances if it is not handled correctly.

The maintenance of records is another major area of responsibility. Often a piece of correspondence, such as a split dollar agreement, from thirty years before may be essential to understanding how the death benefits of a policy are to be paid out. This is true of other documents also, including policy ownership changes, loan requests, optional premium payments, etc. As another example, when a policy cash value is used as a form of retirement supplement, accurate records are necessary to determine how much of each retirement income payment is reportable as taxable income to the recipient. If such records are not accurate and readily available, the policy owner or beneficiary could suffer significant financial loss.

**Financial Strength**

Insurance companies exist to provide benefits to clients and their beneficiaries. They often must do this, even though the premium dollars taken in are only the barest fraction of the substantial death benefit that must be paid out. Through the expertise of its actuaries, its investment specialists, and its other management decision makers, an insurance company has as one of its pre-eminent ethical responsibilities, the maintenance of its strength as a financial institution. The insurance company must be able to pay the benefits guaranteed to its policy owners and their beneficiaries, in spite of wars, epidemics, and large-scale financial disasters.
* TEST PREPARATION QUESTIONS *

* Why is it to the client's advantage for a life insurance company to get involved in the design or approval of sales materials to be used in the field?

* Why is it beneficial to the client if the life insurance company periodically inspects the agent's files?

* How is financial strength an ethical obligation of the company, and what impact could greater or lesser financial strength ultimately have on the client?

Answers are in the back of the book

NOTES:
Chapter 5

A Word about Policy Illustrations

Many life insurance policy sales illustrations generated in the 1980's created certain expectations on the part of insurance buyers, and in many cases, failed to fulfill those expectations in later years. While understanding that all of the problems created in the past cannot be solved today, it is an agent's ethical responsibility to the client and the company to try to prevent such problems in the future. There are specific things the agent can do to prevent such disappointments and their associated complaints.

For example, the agent should explain to the prospective policy owner exactly what the guaranteed features are on the illustration in terms of:

- Premiums payable
- Death benefit
- Cash values
- Other non-forfeiture options, if any
- Rate of interest credited to policy reserves
- Policy expenses and loads
- Cost of Insurance tables used.

The agent should also explain which of the above items may vary from the guarantees and what changes may occur because of them.

Items that may vary, with variations expressed as:

- "Current" dividend scale
- "Current" rates of interest credited
- "Current" policy expenses and loads
- "Current" cost of Insurance tables

Yielding:

- Increased/decreased in interest earned
- Increase/decrease in other expenses and/or loads
- Increase/decrease on cost of insurance

Making possible:

- Increased/decreased cash benefits
- Increase/decrease in cash available to pay premiums
- Increased/decreased death benefits
When describing the features of an illustration of Tradition Participating Whole Life, as a minimum the agent should address the following basic points:

- The various mathematical elements are "bundled" and not broken out individually.

- Guaranteed elements of policy. Policy savings and excess earnings are described in terms of a dividend scale.

- Dividend scale interest rate is often the only mathematical element one can manipulate in the illustration.

- Describe policy benefits in terms of the guarantees alone, then at the current dividend scale interest rate, and, when possible, at an intermediate interest rate.

When describing the features of an illustration of Universal Life insurance, as a minimum, the agent should address the following basic points:

- The various mathematical elements are "unbundled" and generally easier to manipulate.

- Policy guarantees are available only at guaranteed policy expenses and loads, guaranteed cost of insurance, and guaranteed rate of interest.

- Policy savings and excess interest are shown in "current" columns separate from policy guarantees.

- Describe policy benefits at the guaranteed criteria, also at "current" criteria and, when possible, at an intermediate "assumed" rate of interest between guaranteed and current.

Variable Whole Life insurance policies and Variable Universal Life insurance policies have historically been more closely governed by company rules and the rules and regulations of the securities industry. They are more complex to illustrate and they generally involve more risk than Traditional Whole Life or Universal Life policies because their cash values are often invested in equity-based "separate accounts".

When describing the features of an illustration of Variable Whole Life insurance or Variable Universal Life insurance, as a minimum the agent should address the following basic points:

- There are few, if any, guarantees in variable-type policies.

- Cash values are based on equity separate accounts, which means the policy owner retains the risk/reward of the separate account performance.

- The death benefit may be guaranteed in some policies by a special rider with its own table of premiums.
Many companies require illustrations to show three different scenarios:

- Zero interest earnings which, after the separate account charges, show a net loss, even before certain policy charges come out.
- An intermediate rate of return, (perhaps six or eight percent) before separate account charges and policy charges are deducted.
- A higher rate, not to exceed 12 percent before separate account charges and policy charges.

Most insurance buyers would agree that it is the agent's ethical responsibility to explain the above criteria as a minimum in proposing the purchase of a life insurance policy.

In the context of a 1980's "product sale", in which the primary goal was either the lowest possible premium or the highest possible cash value, there was a frequent tendency on the part of some agents to go immediately to the current, most favorable figures in the hope of showing the most competitive product. Therefore, the possibility of lower guaranteed returns or higher guaranteed maximum policy expenses were seldom discussed, and many misunderstandings resulted. The ethical responsibility to disclose all important facts regarding potential policy performance was often disregarded.

Many agents feel the alternative to a "product sale" is the "process sale", in which the client's needs are the center of attention and policy performance is secondary. Such a process sale scenario, using a needs based sales method, followed by a thorough explanation of the policy illustration, as outlined above, is beneficial to all parties concerned.

In this way the client knows that his or her financial needs are the most important factor in the sale, and that the policy, as a solution, is secondary. In addition, a valuable trust relationship is developed between the agent and the client.

The agent knows he or she has performed a valuable service and has placed a life insurance policy in force as a result. Also, since a trust relationship has been developed, there is the likelihood of additional sales in the future as well as referrals to other good prospects. As long as the client is well served and the trust relationship remains strong, there is little probability of serious customer complaints or litigation.

The insurance company benefits in several ways. The insurance policies sold in this manner should stay in force for a very long time. The agent, and therefore the company, should benefit from future follow-on sales of equal quality. The trust relationship between the agent and the client will most often extend naturally to the life insurance company itself.
* TEST PREPARATION QUESTIONS *

* What does it mean when we say the mathematical components of a policy are "bundled"?

* What ethical problems have existed in the way insurance policies have been illustrated on sales presentations in the past?

* Which of the guaranteed elements are similar in variable products, traditional whole life, and universal life?

* Which of the following elements are guaranteed in a whole life policy?

  a. Net premiums
  b. Dividends
  c. Vanish Year
  d. Gross premiums

Answers are in the back of the book

NOTES:
Chapter 6

The Long Term Practicality

Conclusion

We have surveyed the subject of ethics and ethical behavior in the life insurance business from three different perspectives: the agent's responsibility to the client, the agent's responsibility to the life insurance company, and the life insurance company's responsibility to the client.

While each party - the agent, the client, and the company - has its own needs and responsibilities, the unifying theme of them all is that of utmost good faith. One party alone cannot create an insuring relationship and if any one party cannot be viewed by the other two as generally acting in good faith, the insurance contract cannot exist. Each party depends on the other two.

There is a striking difference among the interests of the various parties in the short term. The agent needs the commission from the sale, the client often needs a low price, and the company needs a healthy, financially stable, and reputable prospective insured. In the long run, however, they all need the same thing: a well-designed insurance program for the client, sold at an appropriate price, that lasts until the policy owner or the beneficiaries have received their needed benefits. In that context it is possible to characterize ethical behavior in part as that behavior that assists all parties in achieving this mutually beneficial long-term goal.

When all parties are oriented toward the same goal, and each is striving aggressively toward that goal, and all parties are mutually dependent on each other for the attainment of that goal, then there is generally a minimization of conflict and a maximization of cooperation among the parties. In such cases a potential conflict of interests is replaced by a mutuality of interests.

This is a long-term practical goal which seems very idealistic when viewed from a short-term perspective, which is why company and industry regulations are necessary to keep ethical considerations in the forefront of life insurance selling.
Appendix

Industry Codes of Ethics

I. National Association of Life Underwriters Code of Ethics

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

I believe it to be my responsibility:

- to hold my profession in high esteem and strive to maintain its prestige.
- to fulfill the needs of my clients to the best of my ability.
- to maintain my clients’ confidences.
- to adhere to professional standards of conduct in helping my clients to protect insurable obligations and attain their financial security objectives.
- to present accurately and honestly all facts essential to my client’s decision
- to perfect my skills and increase my knowledge through continuing education
- to conduct my business in such a way that my example might help raise the professional standards of our life underwriting
- to keep myself informed with respect to applicable laws and regulations and to observe them in the practice of my profession
- to cooperate with others whose services are constructively related to meeting the needs of my clients.

Adopted April, 1986
NALU Board of Trustees

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II. Code of Ethics of the Million Dollar Round Table

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

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

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III.  *The American College Code of Ethics*

The pledge to which all CLU and ChFC designees subscribe is:

"In all my professional relationships, I pledge myself to the following rule of ethical conduct: I shall, in the light of all conditions surrounding those I serve, which I shall make every conscientious effort to ascertain and understand, render that service which, in the same circumstances, I would apply to myself."

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Chapter 1 Questions:

What is the Primary difference between universal life and variable universal life?
Variable Universal life affords the opportunity for stock market gains by investing in commons stocks and other speculative investment.

What characteristic of the “buy term and invest the difference” sales method was most strongly criticized by sellers of whole life insurance?
The tendency of some agents to replace existing life coverage with term insurance and investing the cash values of the surrendered policies in other types of investments.

What typical interest rate was initially paid on the early universal life policies?
In the range of 12%

Is the same range of interest being paid on universal life cash values today as in the 1980’s? What effect has this change had on the premium schedules generated for many early universal life policies?
No. Interest rates have gone down. This has caused the number and sometimes the size of required premiums to go up considerably.

Describe the “buy term and invest” sales method. Describe the ethical questions raised by both its proponents and detractors.
Buy term & invest advocates purchasing lower priced term insurance instead of level-premium cash value products with the difference in premiums being invested in some other type of investment. Proponents of Buy Term & Invest believe that their strategy is best for the client in the long run whereas the detractors feel that the replacement activity is unethical and not in the best interest of the client.

What does it mean when we say the premium on a traditional whole life policy “vanishes”?
After the premium had “vanished” accumulated cash values and/or dividends would support the policy. Usually “vanishing premium” policies have higher premiums than traditional, but these premiums are paid over a shorter period. It should be noted that premiums never truly “Vanish”.

What happened to the overall level of whole life policy loans in the late 1970’s and early 1980’s, and why did it happen?
Policy loans increased greatly because the policy-owner could borrow cash values at a low guaranteed rate and invest it at a much higher rate.
How should the modern life insurance agent’s conduct differ from the agent of the 1960’s? How have the agent’s ethical responsibilities changed since the 1960’s?
More education is required to stay current. More product diversity requires agent to be knowledgeable about a wider range of insurance options.

What is implied by the term ”Professionalism”?
Putting the consumer’s interest first.

What ethical questions might be raised regarding the “single need” sales method?
The client may have other needs that they are not even aware of and they depend on the agent to uncover these needs.

In the “needs analysis” sales method, which is the most important, the fact finding interview or the product presentation?
Fact finding.

In what way does the “needs analysis” sales method protect the agent from complaints and possible litigation?
A detailed analysis of the client’s financial position helps indicate that the agent attempted to properly identify the client’s need.

In terms of the agent’s ethical responsibility to the client, give an example of why it is important for the agent to keep good records.
To prove (if questioned later) that the agent acted based on the client’s financial position and goals.

Why is the agent’s own continuing education viewed as one of the agent’s ethical responsibilities to the client?
The agent can best serve the client when they keep up to date.

What is the concept of “utmost good faith”, and why is it so important in the insurance business?
Utmost good faith implies that all involved parties (agent included) operate with good faith, avoid conflicts of interest, and live up to their responsibilities. Utmost good faith is especially important in the insurance industry because the product being sold is not tangible.

In what way is maintaining an excellent agent-client relationship part of an agent’s ethical responsibility to the client?
To keep the lines of communication open and serve the client’s needs as those needs change.
What common misunderstanding may occur when an agent shows a prospect a life insurance proposal which contains both “gross” and “net” (after dividend) premiums?
The client may not understand that the premium will not ”vanish” if future dividends fall below current or past dividend levels.

What is the agent’s ethical responsibility to the client regarding the guaranteed features of a life insurance policy?
To fully disclose to the client what is guaranteed and what is not guaranteed

What are the two main guarantees provided by a traditional whole life policy besides the guaranteed premium?
Guaranteed death benefit and, guaranteed cash value.

What are the guaranteed death benefit and guaranteed cash value features contained in all variable life and variable universal life policies?
There is no guarantee

Why is there so much additional scrutiny in terms of ethics and compliance matters imposed on the agent who sells variable-type products?
There are so many variables involved and so few guarantees.

How can guaranteed cash values and death benefits be provided by a universal life policy?
The way to show a death benefit or cash value guarantee on a universal life illustration is to have the computer solve for a premium that will have a specified cash value at age 90 to 100 based on the guaranteed policy expenses and mortality costs, and on the guaranteed interest rate, generally around 4%.

Chapter 3 Questions

What is “field underwriting” and why is it a part of an agent’s ethical responsibility?
Companies strongly rely on the agent to assist in a certain amount of field underwriting by filling out the application fully and accurately including any information available about the prospect. In addition, the agent is obligated to use paramedical or medical examiners who have a good reputation for speed and thoroughness and who can be depended on to represent the company well.

How does it benefit the life insurance company when the agent consistently uses company-approved sales materials?
The usage of company approved prospecting & sales materials prevent inappropriate, inadvertently misleading language or terminology from entering into the sales talk which helps build a better relationship with the client.
Why is it any of the company’s concern whether the agent pursues continuing education or takes advantage of training opportunities?
Most states require that an agent meet continuing education requirements in order to maintain their license and the education and knowledge of the agent benefits the company through better representation.

What is the relationship between an agent’s office procedures and record keeping and their ethical responsibility to their companies?
Being able to access records that are legible and complete helps prevent the agent and the company from any accusations that files were not handled properly.

How could a long delay by the agent in delivering a new policy be disadvantageous to the life insurance company?
*It is essential for a policy to be delivered as soon as possible so the “free look” period can begin and any delays in delivery could extend that time.*

How is it beneficial to the life insurance company if its agents pursue professional designations?
Agents who hold professional designations show evidence that they are serious about their career which in turn makes the company look better.

Why is the “needs analysis” sales method generally regarded as an ethical way to sell life insurance?
Needs based selling is said to provide a thorough and accurate service to the client by covering the most needs and providing the greatest good for all involved.

Describe a situation in which a “single need” sales method might be just as ethical as a “needs analysis” method?
Not all life insurance buyers are equal - For many people the maximum role life insurance may play is that of a burial policy or pay off a mortgage or other indebtedness.

What does “persistency” have to do with an agent’s ethical responsibilities?
*Persistency is one way of increasing the strength of an agent’s relationship with his clients.*

What impact can an agent’s relationship with his or her client have on the life insurance company?
Strong relationships and excellent service keeps policies on the books and also tends to reduce the incidence of litigation by policy owners.

Chapter 4 Questions
Why is it to the client’s advantage for a life insurance company to get involved in the design or approval of sales materials to be used in the field? Companies can ensure that all sales material is free from errors, are legal and ethical and will not inadvertently mislead the client with ambiguous statements. These publications are usually professional in appearance and contain well-written clear up-to-date useful information.

Why is it beneficial to the client if the life insurance company periodically inspects the agent’s files? Proper maintenance or records ensures accuracy and availability. In addition, the policy owner could suffer significant and financial loss if records are not handled properly.

How is financial strength an ethical obligation of the company, and what impact could greater or lesser financial strength ultimately have on a client? The insurance company must be able to pay the benefits guaranteed to its policy owners and their beneficiaries in spite of wars, epidemics and large scale financial disaster.

Chapter 5 Questions

What does it mean when we say the mathematical components of a policy are “bundled”? This means that the allocation of money is not broken out individually and harder to manipulate.

What ethical problems have existed in the way insurance policies have been illustrated on sales presentations in the past? Many life insurance policy sales illustrations generated in the past created certain expectations on the part of the insurance buyer leading to disappointment and complaints.

Which of the guaranteed elements are similar in variable products, traditional whole life, and universal life? All policies in terms of guarantee are based on the rate of interest.

Which of the following elements are guaranteed in a whole life policy? Net premiums, Dividends (correct answer), Vanish Year, Gross Premiums