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The Insurance Business and Its Image in Society: Traditional Issues and New Challenges

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The Insurance Business and its Image in Society: Traditional Issues and New Challenges[1]

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Abstract

This paper aims to investigate the image of the insurance industry in society, at a time when it is confronted with new challenges in the context of globalization, such as the fast pace of environmental devastation, the relentless advance of technological progress, which generate an ever-increasing number of implications in terms of risks and uncertainties. At first sight, one could estimate that the insurance sector enjoys a positive reputation in the public opinion, in so far as it significantly contributes to wealth creation, and as the insurance sector brings a number of positive contributions to society, which will be detailed in the first section of the paper. However on closer inspection, it appears that the image of the insurance industry in the public opinion is not so good - in reality, it appears to be blurred, if not squarely bad. A number of reasons, which will be analyzed in the second part of the paper, account for this negative perception: the opacity of the insurance business with its misrepresentation and mis-selling practices, the dissatisfaction about the insurance agents' reward system, the problems associated with the respect of customers' privacy, and the dilemmas related to the consequences of outsourcing decisions, count among the major determinants of the bad image conveyed by the industry. Moreover, its reputation has been further tarnished by corporate scandals. In its third part, the paper will then focus on the case of one British insurance company, Aviva, and suggest recommendations to improve its public image. Although much has already been accomplished to restore its reputation through the advances described in its CSR Report, a number of ways can still be explored to make further progress.

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Executive summary

At first sight, one could estimate that the insurance sector enjoys a positive reputation in the public opinion, in so far as it significantly contributes to wealth creation: like any other companies, insurance companies create products/services, innovate, provide jobs to a number of people, pay taxes to government, and fuel economic growth in countries where they operate, both in Western industrialized societies and in the developing world. Additionally, the insurance sector brings a number of positive contributions to society: by its very existence, the insurance mechanism is beneficial in many respects, and most companies (as individuals) demonstrate their concern with responsibility issues. Over the past few years, a group of pioneering insurance companies has developed new policies in order to address mounting challenges in important areas.

Through the mechanism of risk analysis and loss compensation, the insurance industry provides a sense of security to all economic and social actors, contributes to enhance the freedom of individuals and to nurture the vitality of the entrepreneurial spirit, and it ensures the smooth running of the economic system. Through its efforts to reduce and prevent risk, it represents a decisive factor of individual and collective welfare. Besides, a number of companies have now adopted a corporate social responsibility policy, which leads them to develop initiatives regarding community involvement, to strive to integrate the environmental concern into their management, and to join the socially responsible investment movement.

It may certainly be asserted that the insurance sector has largely contributed to the edification of our complex and sophisticated economy: without insurance contracts, transactions would be more difficult and costly, and a great part of them would probably never take place. The entrepreneurial spirit would be weakened by fear and inhibition, and a climate of distrust and suspicion would prevail in economic relationships. Finally, the economy would lag behind its potential, the wealth of nations would be sharply curtailed, and social cohesion would fall apart. And as far as ordinary life is concerned, individuals would be much more cautious in all that they do, probably even cancel some of their risky activities. Therefore, it can be said that the insurance sector is almost as indispensable to the functioning of a modern society as is the legal system that protects companies and individuals against wrongdoings and crimes.

Beyond risk analysis and loss compensation, the insurance sector contributes to the reduction of risk in a number of domains. For instance, insurance companies are strongly involved in promoting public health. To sum up, in many respects, the insurance industry contributes to improve our lives: it helps businesses to protect themselves from risk, provides a wide range of services to citizens, and favors the well-being of society as a whole through a variety of initiatives. Insurance companies protect the persons against the accidents of life and provide them with a safety net; they enable entrepreneurs to engage in risk-taking free from the fear of liabilities, thereby allowing new technologies to develop; and their interventions have led to the adoption of higher security standards in several important areas such as car safety for instance.

A number of leading insurance companies are now engaged in community involvement programs. They offer incentives, for instance in the form of paid time off, for community service activities, so that employees can participate in projects which require time and resources. Some companies contribute to the economic revitalization of low-income neighborhoods; others develop long-term partnerships with charities, community groups and other stakeholders; others support education, charitable giving and community regeneration, involving staff and business units. Thousands of employees volunteer to help in their communities, working in schools, local authorities, community agencies, social enterprises, and so on.

Insurance companies also strive to integrate the environmental concern, both internally and externally. They are confronted with enormous external environmental challenges. Economic losses due to natural disasters have risen sharply in recent decades, and are doubling every ten years; should the current trends continue, they could reach almost $ 150 billion per year in the next decade. This of course directly affects the industry, which is confronted with a rise in the claims related to natural events. Therefore, new mechanisms are required to face the increase in extreme meteorological phenomena and their unsettling and destructive effects. Therefore, insurance companies are, and will increasingly be, confronted with the necessity to devise innovative responses to the environmental challenge.

In another respect, insurance companies show a growing interest for socially responsible investment. As big investors focused on the long-term, they have a preference for companies that will deliver long-term value. Being themselves experts in risk analysis, they also take a

growing interest in the way the companies they invest in manage their own risks; increasingly, they play their role as institutional investors, investigating how the boards of these companies handle risk issues, looking at the reporting methods that are implemented, and occasionally advising changes in corporate governance schemes. A group of leading insurance companies have now adopted clear policies of socially responsible investment, and have undertaken to implement them in their asset management practices.

By choosing to integrate environmental and social criteria into their decision-making process, these companies have joined the movement of socially responsible investing, which is gaining momentum worldwide. Three main SRI strategies are available for responsible investors: screening, shareholder activism and community investing. Besides, the choices made by the insurance industry exert an influence on corporate behavior in many other sectors, and thus this industry can act as a lever to encourage positive change in society as a whole. For all these reasons, the investment policies of the insurance sector have a great effect in designing the future of our economic system, and they condition our quality of life and that of our children; therefore the integration of extra-financial concerns and values in the investment choices of insurance companies is of great importance.

In the first part of our report, we conclude that it is clear that the insurance industry brings numerous positive contributions to society, and that a number of pioneering companies in the sector are striving to operate in a more socially responsible way. However, it is also undeniable that the industry suffers from a negative image in the public opinion; on closer inspection, it appears that the image of the insurance industry in the public opinion is blurred, if not squarely bad. A number of reasons account for this negative perception: the opacity of the insurance business with its misrepresentation and mis-selling practices, the dissatisfaction about the insurance agents' reward system, the problems associated with the respect of customers' privacy, and the dilemmas related to the consequences of outsourcing decisions, count among the major determinants of the bad image conveyed by the industry. Moreover, its reputation has been further tarnished by corporate scandals such as the recent AIG affair, where the CEO had, allegedly, institutionalized wrongdoings in his company for decades.

The uncovering of recent scandals has tarnished the industry's image. The world's largest insurers and insurance brokers have been named in corporate scandals, ranging from bid rigging, price fixing, improper accounting methods, to overstating earnings. The adverse

publicity generated by these scandals has obviously hurt the industry's reputation. In the US, the insurance industry has been hit by charges about bid rigging, contingent commissions, and misleading accounting and financial reporting – as in the AIG affair. Illegal and unethical activities involving collusion among major insurance brokers and insurers have been highly publicized in the media. In Great Britain, the Equitable Life scandal has caused hundreds of thousands of policyholders who have invested in annuities to suffer losses amounting to billions of pounds. Furthermore, complaints about mortgage endowment policies reached a crisis level. Problems with the insurance industry also arise in Asia. Even Singapore, a small Asian country famous for its clean image, strong governance and heavy regulations, has experienced problems with life insurance policies with a "critical year" feature, as well as with churning investment-linked insurance plans (ILPs).

The fact that these episodes have happened on three different continents simply reinforces the message that the negative image faced by the insurance industry is a global issue, not limited to a given country. These high-profile cases have given stakeholders the impression that the unethical behavior uncovered does not only apply to a few black sheep in the insurance business, but indicates a bigger problem that concerns the entire industry. The unfavorable media coverage has shaken people's confidence, and led to customer suspicion toward insurance companies.

One of the sources of the negative image conveyed by the insurance sector resides in the perceived opacity of the language and procedures it has developed, as well as in its misrepresentation and mis-selling practices. The insurance industry has been the target of widespread criticism for its commercial practices – especially in the long-term savings and life insurance businesses. A common complaint against the insurance industry is that information about products presented in marketing, advertising or other sales efforts is untruthful, misleading, or incomplete. Besides, numerous complaints against the insurance industry concern agents who sell customers products that are unsuitable to them, in order to meet sales quotas and/or boost their earnings as these products give the agent higher commission. The current mortgage endowment crisis in Britain is an illuminating example of misrepresentation and mis-selling in insurance. Similarly, in Singapore, the insurance industry was under fire in February 2005 for a lack of transparency in the presentation of charges for some regular-premium ILPs sold earlier.

The remuneration system of intermediaries for distributing investment products poses several problems that account for the bad reputation of the savings and life businesses, since it rests on heavily front-end loaded commission structures. The commission-based selling system would generate a bias to over-sell, since this mode of remuneration of advisers can lead them to push a customer to purchase an investment product on the basis of the resulting payment it generates for them, irrespective of the best choice for the customer, who could alternatively prefer to reduce his/her debt or to hold savings in cash. Moreover, this system can also bring about a product bias, which occurs when the adviser has an incentive to recommend a particular investment product that does not necessarily meet the customer's needs.

The structure of remunerations across products and providers is really confusing for customers, who often do not understand the rationale behind it. Whereas an initial cost is associated with the start of the advice process, ongoing commission (renewal and trail) is a current practice, the justification of which is not quite clear. The practice of "churning" of customer's portfolios is also highly questionable: it happens when insurance agents persuade policyholders to terminate their existing policies after a short period of time and switch to new, similar ones for no valid reason. In the process, the insurance agent earns commissions on the new policies sold.

Other problems are associated with the respect of customers' privacy. In particular, concerns have been raised about insurers' practices of asking customers for detailed information about their health, especially genetic test information that is now made available thanks to technological advances. It appears unethical for insurers to ask for information that is more than necessary. Tests on the genetic makeup of individuals can determine a person's chances of contracting a number of diseases; they may also reveal the health of the person's family members. To be able to use genetic test results in insurance underwriting is definitely an attractive business proposition for insurers, as it will help them lower their costs; but it is a highly controversial issue and appears as unacceptable to a large number of citizens. In the UK, it now seems that a balance has been set up between the company's legitimate right to information and the customer's legitimate right to preserve his/her privacy. However, the fast pace of advances in the field of information technology poses other kinds of problems regarding the customers' right to privacy, which is a multifaceted issue.

In recent years, some UK insurance companies have significantly delocalized jobs to India – starting often with call centers and then moving back-office jobs – or to countries where labor costs are significantly lower but having an educated labor force, diligent, committed and keen to learn. However, this offshoring trend (part of the current outsourcing trend) raises many complex questions (to be explored in another study, forthcoming). Certainly, it contributes to the development of host-country economies (though this is not the primary corporate motivation or strategic driver) but it has consequences in terms of employment in the home country and may impact upon the corporate image of the outsourcing company. The BPO trend (in its offshoring dimension) – increasingly visible in Europe – is often not understood by the civil society that experiences difficulties to reconcile the local downsizing and delocalization to low labor cost countries with the growing profit announced to the City or Wall Street, for the great satisfaction of shareholders and options owners.

In its third section, the paper focused on the case of the British insurance company Aviva, and suggested recommendations to further improve its public image through CSR. Although much has already been accomplished to boost its reputation through the advances described in its CSR Report, we suggest that several ways could still be explored to make further progress. Over the past few years, Aviva has leveraged its comprehensive understanding of CSR-related issues, defined a clear policy and devoted significant resources to implement a corporate social responsibility approach. It has committed itself to develop processes and practices that change the way it carries on its operations across all its businesses. Aviva is now deepening the embedment of the responsibility dimension into all aspects of the group's management, and appears to be well advanced on the path to sustainability with respect to the best standards of conduct in the insurance sector. More generally, its achievements account for the fact that the company is ranked among the leading multinationals worldwide in sustainability rankings and indices.

However, it seems that Aviva – as all other financial services providers – is still experiencing some problems regarding its public image. These problems are a concern for the company, which therefore keeps searching new ideas to remedy this weakness and to improve its reputation. We explore three main paths to handle this reputation issue:

- clarifying commercial practices and enhancing employees' competences and ethical awareness;

- further developing communication on behavioral, transparency and responsibility issues;
- acting as a lever for change in society.

Legitimate concerns about mis-selling practices and problems linked to insurance agents' remuneration model have led the British Treasury Select Committee to recommend a clarification, a simplification and a standardization of the system, in order to reach a greater transparency and to restore customer confidence. It has expressed its position recently, recommending a change in the sales system of the long-term savings business, and a greater transparency on fees and commissions. In particular, *"shifting away from the current commission based sales system common in much of the industry is likely to be a key component of any strategy to rebuild consumer confidence in the industry […] Full and open disclosure of fees and commissions"* is also a necessity.

A recent report for the Association of British Insurers similarly insists that initial and ongoing charges should be clearly distinguished and explained to subscribers, so as to ensure consumer-friendly selling practices: *"There needs to be an explicit ongoing charge for the ongoing relationship with the adviser that is transparent to consumers"*. The cost of initial advice should be separated from the cost of on-going advice, and customers should not be forced to pay up-front for financial advice, or if they decide not to purchase a product. Hence, there is a need for insurers to incorporate behavioral control measures, such as incentives to encourage customer-oriented attitudes, into their agents' compensation system. It seems that a balance of outcome-based and behavioral-based control measures would be the best approach to adopt. Perhaps Aviva could consider granting awards to its agents for delivering long-term customer satisfaction. Such awards would act as strong incentives for agents to devote their efforts to building good, long-lasting relationships with policyholders.

Customers' trust in the insurance industry is not only dependent on the quality of the products' design, but very importantly, on the insurers' and their sales forces' level of integrity and professionalism when dealing with the public. All these factors affect a company's image. To gain public confidence, Aviva adopts commercial practices that are considered as fair and customer-friendly. Policyholders should be able to see that channels are readily available for them to voice their dissatisfaction or file complaints, if this becomes necessary. Aviva is committed to deal with customers' complaints fairly and swiftly, since a good handling of complaints is an essential component of service quality. Furthermore, Aviva

encourages policyholders to provide their feedback on its products and service quality. This initiative shows that the Group truly and sincerely values customers' views. More generally, the professional skills of insurance agents is a very important issue for the industry. There may also be a need for improvement in the overall quality of advice given by insurance agents to customers.

Therefore, Aviva sets high expectations in both the technical competence and ethical behavior of its agents. Close attention is paid to staff training, so as to make sure that the sales force is technically competent to make the correct product recommendations to customers. Improving – on a continuous basis – the competence and professional standards of its agents helps Aviva win the public's trust and confidence. CSR-related training programs are also available to employees. One of the strengths of Aviva is that they had very active CSR programs in all their businesses around the world for some years. But because Aviva's head office is based in the UK, one of the countries where CSR has been a topic for a long time, Aviva must constantly keep an eye on maintaining the international mix of the program and must focus on spreading its responsible practices across the countries where it operates. To deepen the incorporation of corporate social responsibility into the Group as a whole, Aviva continues also to mobilize its employees in this regard, by including this dimension into internal company training programs. The board and senior management are clearly supporting and fully committed to the CSR program as well as conscious of the need to lead by example.

Aviva could also communicate more on behavioral, transparency and responsibility aspects. After the official launch of its CSR policy at the beginning of 2002, Aviva has published its first CSR Report in 2003, followed by the 2004 and 2005 Reports, confirming the reality of the Group's commitment to continuous progress in this field. Although these reports are quite substantial and useful to bring Aviva's achievements to light, it seems that some additional materials could enhance the efficiency of the Group's communication. In addition to the full online CSR Report and the printed summary of the report, Aviva could also develop a number of brochures or leaflets on some important issues, with a view to distributing them to various categories of stakeholders. Therefore it could prove useful for Aviva to produce and distribute brochures on the following issues to its stakeholders and customers: the quintessence of Aviva's CSR approach; complaining procedure; community involvement; and socially responsible investment. However, it should be taken into account that Aviva operates in different countries, in which CSR priorities are different. Aviva's CSR

program stimulates the business units to engage in the issues that are relevant for their stakeholders and therefore this could lead to local brochures.

Aviva should also continue to engage boldly in new avenues and act as a lever for change in society, firstly by devising and implementing new methodologies of risk assessment that integrate sustainability-related issues and innovate in risk prevention. Methodologies currently used by the insurance industry are not adapted to the mounting global ecological threat that is looming ahead. Innovative insurance mechanisms are urgently needed to tackle the environmental challenge, and insurers will have to devise new ways to integrate social and environmental concerns into their risk management and product pricing methods. Since financial institutions play an essential part in shaping the future of this planet, they are called to play a key role in creating market solutions that keep it a livable place.

With respect to societal issues, new methods are also required to prevent social exclusion and the dislocation of society, as it happens in some Western developed countries where the social divide has become a reality. Additionally, insurance companies could also devote more efforts to foster risk prevention, in connection with the rise of some new public health concerns such as the obesity phenomenon for instance. To a large extent, the future of insurance is to be found in prevention programs. Insurance firms can play a role for the education of the public regarding a number of important issues, as some of them (e.g. Norwich Union Insurance) already do for the improvement of driving abilities and the avoidance of road accidents. The RAC acquisition could be an additional opportunity on this road.

Besides, it is important for Aviva to maintain the proactive stance it has adopted in the UN Global Compact's "Who Cares Wins" Initiative and in the UNEP Finance Initiative's working groups, which strive to achieve a methodological breakthrough. The UNEP FI also plays an important role by fostering international dialogue on the regulation of global risk and environmental issues between the insurance industry, governmental bodies and financial regulators. It is thus coherent that Aviva has decided to get involved in both networks simultaneously; the Group should definitely play an active role in each of them, if it wants to reinforce its position as a pioneer and keep pace with its most advanced competitors.

Eventually, Aviva has the possibility to encourage the incorporation of CSR-related issues by all the industry's business stakeholders. Globally considered, insurance companies have repeated interactions with almost all economic sectors, with all kinds of organizations, and with all the citizens of the countries in which they operate, through the myriads of insurance contracts that are signed every year. Therefore, the insurance industry can bring an essential contribution to the rise of the awareness of its business stakeholders on societal and environmental concerns, and to promote sound practices on the part of its customers and suppliers. A proactive attitude is essential to foster significant progress, which implies to create and market insurance products and services that encourage responsible organizational and individual behavior.

Introduction

This paper aims to investigate the image of the insurance industry in society, at a time when it is confronted with new challenges in the context of globalization, and to make explicit some of the most pressing ethical issues that it needs to deal with. The German sociologist Beck (1992, 1999) argues that a new frame of reference is needed to understand the world in which we have entered: that of a risk society on the global setting. The fast pace of environmental devastation, as well as the relentless advance of technological progress, generate an ever-increasing number of implications in terms of risks and uncertainties. We thus need to learn how to address these new problems posed to our culture, for instance by the mounting threats on ecosystems or by the development of genetics or nanotechnologies. The advent of this "world risk society" with all its consequences provides new opportunities for insurance companies, which can find in this evolution new fields to apply their expertise in assessing and managing risks.

At first sight, one could estimate that the insurance sector enjoys a positive reputation in the public opinion, in so far as it significantly contributes to wealth creation: beyond offering services useful to society, insurance firms - like any other companies - provide jobs to a number of people, pay taxes to government, and fuel economic growth in countries where they operate, both in Western industrialized societies and in the developing world. In the UK for instance, the financial services industry at large (which includes insurance) is the biggest economic sector of the country, both in terms of jobs and contribution to GDP. More specifically, British insurers employed about 354,000 people as of 31st December 2004, either directly or indirectly. The British insurance industry - the largest in Europe - is a huge investor, owning about 20% of all national listed companies' ordinary shares. Its contribution to British exports (defined as overseas premiums minus claims) amounts to just under £ 4 billion a year, and it pays an annual tax bill of £ 3.6 billion to government. It provides almost £ 250 million a day in pension and life insurance benefits and £ 50 million a day in general insurance claims[2]. The UK insurance industry is thus an important contributor to the national economy, a major employer and a significant source of overseas earnings; and the same could also be said in other countries.

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[2] Source: The Association of British Insurers' website: http://www.abi.org.uk/.

Additionally, the insurance sector brings a number of positive contributions to society: by its very existence, the insurance mechanism is beneficial in many respects, and most companies are concerned with risk reduction and prevention. Moreover, insurance companies increasingly tend to be concerned with responsibility issues. In this, they follow the example of a number of multinationals worldwide, which have now become familiar with the notions of sustainable development, corporate social responsibility, or triple bottom line. Over the past few years, a group of pioneering insurance companies such as AGF, Allianz, Aviva, AXA, the Co-operative Insurance Society, Friends Provident, ING Group, the Insurance Australia Group, Lloyds TSB, Prudential, the Royal Bank of Scotland Group, Storebrand and Swiss Re, has developed new policies in order to address mounting challenges in important areas. They have undertaken community involvement programs; they strive to integrate the environmental concern, both internally and externally; and they also show a growing interest for socially responsible investment. Besides, the insurance industry generates indirect positive effects on the functioning of the economic system: firstly, because it tackles the factors of insecurity which would otherwise lead agents to adopt a more cautious behavior; secondly, because it reduces the number of legal actions that would otherwise take place; and thirdly, because it alleviates the need for regulation in a vast number of areas.

However, on closer inspection, it appears that the image of the insurance industry in the public opinion is not so good. In reality, it appears to be blurred, if not squarely bad. A number of reasons account for this negative perception: the opacity of the insurance business with its misrepresentation and mis-selling practices, the dissatisfaction about the insurance agents' reward system, the problems associated with the respect of customers' privacy, and the dilemmas related to the consequences of outsourcing decisions, count among the major determinants of the bad image conveyed by the industry. Moreover, its reputation has been further tarnished by corporate scandals such as the recent AIG affair, where the CEO had institutionalized wrongdoings in his company for decades.

The main factors of positive perception of the industry will be analyzed in the first section of the paper, while the main factors of negative perception will be examined in the second section. In its third part, the paper will then focus on the case of the British insurance company Aviva, and suggest recommendations to improve its public image. Although much has already been accomplished to improve its reputation through the advances described in its CSR Report, a number of ways can still be explored to make further progress.

I.- The insurance industry: factors of positive perception

The insurance industry brings multiple benefits to society. Through the mechanism of risk analysis and loss compensation, it ensures the smooth running of the economic system. Through its efforts to reduce and prevent risk, it represents a decisive factor of individual and collective welfare. Besides, a number of companies have now adopted a corporate social responsibility policy, which leads them to develop initiatives regarding community involvement, to strive to integrate the environmental concern into their management, and to join the socially responsible investment movement.

I.1.- The insurance mechanism benefits society in many respects

The basic function of the insurance sector in modern societies is to cover a large number of risks through the mediation of contracts that guarantee compensation to the insured, be they individuals or organizations, when they experience losses due to a huge variety of causes. For instance, private health insurance contracts complement national health systems and enable policyholders to cover escalating medical costs – which is important in several countries that are facing an ageing population; life and disability insurance contracts provide the beneficiaries with financial amounts that allow them to live decently; home insurance contracts protect individual property against theft, fire and other natural hazards. Public liability insurance covers the potential damage one could cause to others, e.g. by driving a car; other contracts protect the subscribers against the accidents of life. Credit insurance and travel insurance contracts provide the consumer with a safety net in a number of situations. Some contracts even provide assistance services to subscribers, such as legal advice. The insurance mechanism is thus essential for individuals: it enables all of us as citizens to lead our lives free from the fear of being left with nothing after a tragic event, and to feel a relative sense of security in our everyday activities.

But the insurance mechanism is also vital for businesses. Accident, fire and theft insurance policies protect companies against these three basic dangers, thereby enabling the entrepreneurial spirit to express itself fully. Accident insurance contracts cover the potential harm a company may cause to its employees. By compensating injured employees in the case of an accident in the workplace, employers' liability insurance avoids the bankruptcy of the

responsible firm should the cost of the claims be too high. Similarly, customers harmed by a defective product can be compensated by an appropriate contract of manufacturer's guarantee insurance. Insurance for loss of trade can also prove useful, should the company be unable to carry on its operations after a dreadful event. Group insurance, transportation insurance, market exploration insurance, or comprehensive site insurance, are other examples of contracts which facilitate transactions among economic actors and the running of firms of all kinds. The insurance mechanism is thus also essential for businesses: it enables the entrepreneur to develop his/her business without permanently having a sword of Damocles hanging over his head. It releases entrepreneurial energies and initiatives and allows economic agents to create and develop their activities without feeling paralyzed by liabilities and their potential consequences.

The insurance mechanism therefore ensures the smooth running of the economic system, and decisively contributes to the freedom of individuals and to the vitality of the entrepreneurial spirit. Through its expertise in analyzing risks and compensating losses, the insurance industry provides a sense of security to all economic and social actors. Of course, it does not suppress the multiple dangers of life, but it significantly reduces the fears associated with them, and therefore permits everyone to lead their lives with the ability to cope with the sense of danger. Individuals and businesses alike do not need to hoard excessive cash reserves to face risk, which releases them to spend and invest. Without the insurance mechanism, a number of professionals and businesses would be at a loss to carry out their duties: surgeons, for instance, wouldn't be able to practice, due to the enormity of the financial consequences of a lawsuit if a problem happened during an operation. Similarly, transport companies dealing with dangerous materials, or the most toxic chemical industries, would find themselves in great difficulty if an accident happened, since the compensations granted to victims of such accidents by the courts now usually reach millions of dollars in the United States and elsewhere. Besides, even if it cannot assume all the costs of a natural disaster, the insurance sector plays a role of solidarity in case of catastrophes and helps the economy to recover. In sum, this industry has taken such an important place in our modern lives that we can hardly imagine a developed society without insurance companies.

To conclude, it may be asserted that the insurance sector has largely contributed to the edification of our complex and sophisticated economy: without insurance contracts, transactions would be more difficult and costly, and a great part of them would probably

never take place. The entrepreneurial spirit would be weakened by fear and inhibition, and a climate of distrust and suspicion would prevail in economic relationships. Finally, the economy would lag behind its potential, the wealth of nations would be sharply curtailed, and social cohesion would fall apart. And as far as ordinary life is concerned, individuals would be much more cautious in all that they do, less willing to engage in some of their risky activities – such as driving a car for instance. Therefore, it can be said that the insurance sector is almost as indispensable to the functioning of a modern society as is the legal system that protects companies and individuals against wrongdoings and crimes.

I.2.- Insurance companies' efforts to foster risk reduction and prevention

Beyond risk analysis and loss compensation, the insurance sector contributes to the reduction of risk in a number of domains. Insurance companies are interested in reducing risk and avoiding loss for profitability reasons in the first place: prevention is not only better but also cheaper than cure. Since insurers – often – bear most of the cost if a risk happens to become an actual event, they devote considerable efforts to minimize risks – and potential costs associated with them. Insurers have applied this sound principle to many areas of their activity. For individual subscribers, they offer incentives (in the form of discounts on premiums) to householders who install efficient door locks and alarms, and to motorists who possess car alarms, immobilizers or central locking systems; they encourage in the same way those car owners who take additional safe driving instruction.

As regards insurance for businesses, insurers educate employers to view risk management as a useful concern that improves safety; they inspect hundreds of business and public buildings everyday to check fire safety; they fund research to improve building security standards (both against fire and crime); they audit company fleets to monitor the way commercial vehicles are maintained and to improve driving practices. They also exert continuous pressure on car manufacturers to influence vehicle design in a sense that improves security, and have elaborated a rating system which classifies vehicles according to a number of criteria; manufacturers have a clear interest to follow insurers' recommendations, since a good ranking for their vehicles means lower insurance premiums, and consequently a lower cost of car ownership for the buyers, who in turn will have a financial incentive to buy these cars.

Moreover, insurance companies are strongly involved in promoting public health: they have started years ago to offer lower premiums for non-smokers and moderate drinkers. They are now placing the emphasis on the rehabilitation of individuals who have experienced an accident, including getting them back to work within a reasonable time, which is essential for their personal psychological health as well as for their quality of life. To help severely injured employees to lead effective working lives, the Association of British Insurers has cooperated with individual insurance companies, governmental bodies and other authorities to break down most of the barriers that hampered the rehabilitation process. In another respect, insurers are also concerned with patients at risk of going chronic, and they have developed a training pack for the medical staff to provide preventive care at an early stage of the disease.

In their efforts to foster risk reduction and prevention, insurance companies are helped by policyholders themselves, due to a key principle of the insurance mechanism: the greater the risk, the higher the premium. In other words, the insured, simple individuals and large multinationals alike, and whatever the kind of contract they have signed, have an incentive to reduce the possibility of loss and to take precautions, in order to minimize the level of the premium they will pay. On the contrary, should an accident happen, this would result in a higher price of the premium, especially when the policyholder is responsible for it.

To sum up, it seems that in many respects, the insurance industry contributes to improve our lives: it helps businesses to protect themselves from risk, provides a wide range of services to citizens, and favors the well-being of society as a whole through a variety of initiatives. Insurance companies protect the persons against the accidents of life and provide them with a safety net; they enable entrepreneurs to engage in risk-taking free from the fear of liabilities, thereby possibly allowing new technologies to develop; and their interventions have led to the adoption of higher security standards in several important areas such as car safety for instance. They also promote public health through incentives for customers and investments in medical care and rehabilitation schemes; they conduct inspections in industrial establishments on a regular basis to reduce risks and prevent accidents; they are also involved in research efforts for the prevention of fire and crime.

I.3.- Insurance companies' initiatives in the field of community involvement

A number of leading insurance companies are now engaged in community involvement programs. Some of them (including Aviva) offer incentives, for instance in the form of paid time off, for community service activities, so that employees can participate in projects which require time and resources. In addition to encouraging volunteering, companies make contributions to nonprofit groups in which employees are involved; these gifts are usually referred to as "Dollars for Doers" programs – an expression forged at Aetna Insurance Company several years ago. Some companies measure the direct and indirect cost savings and benefits realized by both the company and the community, and include such information in their annual report to employees and other stakeholders.

Among many other examples of community investment programs led by insurance companies, that of State Farm Insurance Co., the largest casualty and property insurer in the United States, is of special interest: the company has endeavored to contribute to the economic revitalization of low-income neighborhoods, and expects to gain market opportunities from the experience. State Farm has invested more than $ 100 million in this program, and has developed a long-term business relationship with Neighborhood Reinvestment Corporation and the NeighborWorks network – composed of community-based nonprofit organizations that are typically called Neighborhood Housing Services, community development corporations, or mutual housing associations. In Chicago, for example, State Farm has launched a Home Safety Program in cooperation with the fire department and the NHS to sponsor inspections of potential safety hazards such as furnaces and electrical systems, and provides loans if repairs or replacements are needed.

Similarly, the Royal Bank of Scotland Group, which is involved in the insurance business in Europe through its subsidiary RBS Insurance – the second largest general insurer in the UK, has invested £ 46 million in community investment programs in 2004. Beyond financial donations, the Group aims to develop long-term partnerships with charities, community groups and other stakeholders; through an employee-volunteering scheme, the RBS staff have the opportunity to put their skills and competences at the disposal of various community partners. Three main programs have been set up: "Money Matters", designed to help people of all ages and backgrounds to be financially aware and capable; "Moving On", which promotes wider access to education, employment and enterprise creation for individuals

experiencing difficulties; and “Supporting Staff Giving”, whereby the Group acknowledges that, at the local level, its staff are best placed to identify and respond to the needs of the communities in which they live and work. The RBS Group continually monitors the performance of its partnerships, in order to make sure that its contribution is used in an effective way and achieves worthwhile results; it works closely with charities and voluntary organizations to develop projects that meet its objectives as well as those of its key partners (Royal Bank of Scotland Group, 2005).

Lloyds TSB, a major UK-based banking and insurance group, has also developed one of the largest community investment programs in the UK, and focuses its support on three areas: education, charitable giving and community regeneration. Its charitable giving activities involve its staff, its business units, and the four independent Lloyds TSB Foundations. Thousands of employees volunteer to help in their communities, working in schools, local authorities, community agencies and social enterprises; these volunteering activities benefit the community, the employees involved who find opportunities of personal development, and the company itself, through the enhancement of team-building and skill-sharing abilities of its staff and the positive impact on its reputation. In 2004, the total contribution of the company in the field of community investment amounted to £ 35 million (Lloyds TSB, 2005).

I.4.- The integration of the environmental concern: internal and external aspects

First of all, like any other organization, insurance companies have an impact on the environment: they release CO_2 emissions, produce waste, consume paper, water and electricity, use computers, and so on. They can choose either to take this impact into consideration, or to ignore it and do as if the degradation of the environment does not exist, or is not their problem. Those who choose to handle the problem seriously find themselves faced with internal environmental management issues, such as the reduction of their greenhouse gas emissions or the limitation of their consumption of a number of goods. Therefore, a sound objective for these companies would consist in becoming gradually greenhouse neutral within a certain period of time, and in developing intelligent waste management systems so as to minimize their negative impact on the environment. An adequate stimulation to reach that end would be to have their progress verified by an independent auditor on a regular basis, e.g. every year, and to disclose the figures publicly in their sustainability report, with time comparisons.

But of course, these internal aspects are only a small part of the problem, and insurance companies are confronted with external environmental challenges of a much bigger importance. The biosphere itself is deteriorating at a rapid pace; many scientists have already sounded the alarm on the seriousness of the global ecological crisis and the catastrophes that are looming ahead (Speth, 2005). For more than 15 years already, environmental experts from all around the world have worked together within the Intergovernmental Panel on Climate Change, and they have come to the conclusion that *climate change is a reality and is caused by human activities.* Besides, the "Millennium Ecosystem Assessment" Report issued in March 2005 has confirmed that 60% of the world's ecosystems are being deteriorated by a variety of causes. The scientists who authored the report have concluded that water, air and the soil are being treated unsustainably, and that human activities exert such a pressure on the natural functions of the Earth that the ability of ecosystems to support future generations is not guaranteed anymore (Millennium Ecosystem Assessment, 2005).

Global warming has many effects, including the rise of the sea level (Motavalli, 2004), the alteration of ecosystems, and the multiplication of extreme meteorological events, such as floods, storms, droughts, hurricanes, tsunamis, and so on. The destruction of the stratospheric ozone layer, another burning environmental issue, threatens the conditions of life on Earth; although steps have been taken to slow down the phenomenon at the international level, it is still a matter of grave concern (Andersen and Sarma, 2005). The process of desertification, which directly affects the livelihood of more than one billion people, is still going on (see Middleton and Thomas, 1997). Deforestation, another facet of ecological devastation, is especially visible in the case of tropical rainforests, which play a crucial role in the world's ecology and yet are being destroyed by timber extraction, slash and burn migration agriculture, mining, pollution, and other causes (Newman, 2001). Last but not least, biodiversity is vanishing: the expansion of human activities over the planet is causing the destruction of ecosystems and the loss of species of wild flora and fauna at an extremely high rate, which has no bearing on the natural rate of extinction (United Nations Environment Programme, 2005).

The gigantic, unprecedented hurricane Katrina which has just devastated the South of the United States, a disaster of biblical proportions, is a good example of the extreme meteorological events whose frequency is likely to grow in the coming decades; New Orleans

and its surroundings have been largely destroyed, the States of Louisiana and Mississippi have experienced huge flooding, and it will take years for the region's economic system to recover. The most striking images of the impact of this natural catastrophe appeared in the City of New Orleans, which in the days after the hurricane looked like a Third-World country after a civil war, with thousands of evacuees wandering about like lost souls, searching for water, food and a place to go. According to current estimates, insurance losses due to Katrina could reach enormous figures, probably between $ 40 billion and $ 60 billion, which represents the cost of compensating damage to property, vehicles and business interruption, and makes this hurricane the largest insured event on record. Moreover, the US Government's federal insurance program for flood cover could pay out an additional amount comprised between $ 10 billion and $ 12 billion, since about half of the households in New Orleans had subscribed flood cover through this program[3].

This catastrophe, followed by the hurricane Rita a few weeks after, is certainly not the last one in relation to climate change; it should rather be considered as a forewarning sign of other catastrophes of various kinds, with even more severe potential consequences. It is thus no surprise that economic losses due to natural disasters have risen sharply in recent decades, and are doubling every ten years; should the current trends continue, they could reach almost $ 150 billion per year in the next decade (UNEP Finance Initiative, 2002). This of course directly affects the insurance industry, which is confronted with a rise in the claims related to natural events. But there is a limit to the financial compensations companies can grant; to manage increases or uncertainty in risk, traditional insurance and reinsurance mechanisms can only extend until the point where they become inadequate to meet the needs of the victims. Therefore, new mechanisms are required to face the increase in extreme meteorological phenomena and their unsettling and destructive effects.

As explained by Clements-Hunt (2004, p.192-193):

> *"Already, as much as 80% of the global economic damage from natural events is not remedied through insurance but has to be borne by the victims or alleviated with ad hoc disaster relief. This indicates that a radical rethink is needed to ensure that the approach to managing environmental perils involves all the*

[3] Source: The Association of British Insurers' website.

stakeholders in a way that improves overall efficiency. The insurance industry response must extend far beyond the traditional underwriting area, into the comprehensive adoption of environmental management systems that ensure the application of sustainability principles to all business processes."

Therefore, insurance companies are, and will increasingly be, confronted with the necessity to devise innovative responses to the environmental challenge. For instance Swiss Reinsurance Company's environmental expertise, founded in its traditional lines of business, is now expanding into more contemporary areas of alternative risk transfer. Swiss Re's Greenhouse Gas Risk Solutions team builds innovative mechanisms for risk transfer of carbon-related liabilities and carbon mitigation (Swiss Reinsurance Company, 2005).

I.5.- Insurance companies' growing interest for socially responsible investment

Besides, insurance companies are financial institutions, and as such, they are involved in the management of financial investments. How do they manage their financial assets? Do they simply adhere to the dominant conception of the maximization of shareholder value as the unique objective of the firm, and expect quarterly results of companies they invest in to be always higher? Insurance companies are big investors focused on the long-term, and therefore have a preference for companies that will deliver long-term value. Being themselves experts in risk analysis, they also take a growing interest in the way the companies they invest in manage their own risks; increasingly, they play their role as institutional investors, investigating how the boards of these companies handle risk issues, looking at the reporting methods that are implemented, and occasionally advising changes in corporate governance schemes.

Additionally, some leading insurance companies have also started to incorporate sustainability-related issues into their investment decisions. In this regard, it seems that minds are changing at a relatively fast pace. For the past two decades, the movement of socially responsible investing (SRI) has kept continuously increasing, in relation with the alarming visibility of global warming and other environmental threats, but also with some pressing societal issues such as the rise of social inequalities and exclusion, child labor in overseas factories, or human rights violations. These pioneering, sustainability-oriented insurance companies, have understood that businesses which deliberately ignore the societal and

environmental dimensions do so at their own peril: they may experience lawsuits, tarnished reputations, and see their possibility to operate in important markets significantly reduced.

A group of leading insurance companies have now adopted clear policies of socially responsible investment, and have undertaken to implement them in their asset management practices. By choosing to integrate environmental and social criteria into their decision-making process, these companies have joined the movement of socially responsible investing, which is gaining momentum worldwide. This movement is backed by the mushrooming of extra-financial rating agencies, such as KLD in the US or Vigeo in Europe, and by the creation of new sustainability indices – e.g. the Dow Jones Sustainability Group Indices or the FTSE4Good Indices. In the Insurance Industry Group of the Dow Jones Sustainability World Index, six companies are positioned in the most advanced category, based on aggregate scores reflecting the economic, social and environmental dimensions: Swiss Re, AGF, Allianz, Friends Provident, ING Group and Storebrand. Aviva appears in the second group, jointly with five other companies (SAM Indices, 2004).

Socially responsible investing (SRI) consists in the inclusion of non-financial criteria, such as environmental, social and governance considerations, into the process of investment decision-making. It thus aims at achieving non-financial results as well as a financial return. In today's society, a number of observers – and scientists alike – suggest that there is no fundamental contradiction between the promotion of social or environmental values on the one hand, and the search for financial gains on the other; on the contrary, the good performance of socially responsible indices and mutual funds, as well as several recent studies, support the idea that values-led investing does not compromise financial gains. After reviewing 95 studies dealing with the corporate social performance – financial performance link published since 1972, Margolis and Walsh (2001) have arrived at the conclusion that the majority of results point to a positive relationship between the two variables – although more research needs to be done to illuminate the causal mechanism. In 2004, a study requested by the UNEP Finance Initiative bearing on the materiality of social, environmental and corporate governance issues to equity pricing has provided strong support for the thesis that effective management of these issues will contribute to an increase in shareholder value (UNEP Finance Initiative, 2004/2). Although they do not represent the majority of the profession yet, a growing number of financial analysts now suggest that companies that pay close attention to social and environmental risks and opportunities will be more competitive in the long run.

Three main SRI strategies are available for responsible investors: screening, shareholder activism and community investing. The practice of screening, the first SRI strategy, consists in choosing securities based on social or environmental criteria; the choice process may be negative, positive, or a combination of both. For instance, negative screening implies the exclusion of companies that manufacture harmful products such as tobacco, alcohol or weapons, or that have developed management practices considered negatively. Alternatively, positive screening implies buying shares of companies that bring a positive contribution to society, such as developing renewable energies, sustainable buildings and organic agriculture, fostering diversity in the workplace and social inclusion, or other beneficial practices. And of course, any combination of both strategies is possible. Screening is thus a selection process, whereby the investor filters the shares that he prefers to buy or to avoid. However, since the process requires extensive research into company policies and practices, most socially responsible investors rely on mutual funds to manage their investments.

The ING Group, one of the 20 largest financial institutions worldwide and in the top-10 in Europe, which provides a wide array of banking, insurance and asset management services in more than 50 countries, provides a good example of a combination of various forms of screening. The Group offers a range of sustainable investment opportunities that are marketed through its business units in Europe and Australia under various names; the sustainable assets under management at ING amounted to €1,823 million by the end of 2004. Postbank Green, a subsidiary of ING Netherlands, applies a positive screening approach: it invests the savings of its customers in environmentally-friendly projects only, and its portfolio totaled € 720 million at the end of 2004. Conversely, following a report issued by a Belgian NGO which asked information about investments in a Singapore-based company that allegedly produced anti-personnel landmines, ING reviewed its investment policy regarding the defense sector in 2005, and decided to apply strict exclusion criteria for companies directly involved in the manufacturing, maintenance and/or trade of anti-personnel landmines, cluster bombs, depleted uranium ammunition and biological, chemical or nuclear weapons (ING Group, 2005).

The second option open to socially responsible investors is shareholder activism. The ownership of company shares provides investors with rights and responsibilities, and a growing number of them are using their rights as corporate owners to advocate whatever

cause they deem appropriate – ranging from animal protection to access for the disabled, for instance. Socially responsible investors can use three main approaches to express themselves, which represent three levels of engagement: dialogue with company management, supporting shareholder resolutions, and eventually divesting from the company. By utilizing one of these three levers, shareholders aim at raising the awareness of the management of the target company as to how the way it conducts its business affect all stakeholders, including customers, employees, the supply chain, the surrounding communities, as well as civil society and the environment. For instance, Morley Fund Management, a subsidiary of Aviva, engages with companies in which it has invested to raise social, environmental, ethical and governance issues with the management, and especially to advocate human rights; it has exerted its shareholder voting rights in a number of cases in 2004, and is currently extending its voting policy to encompass all FTSE350 companies (Aviva, 2005).

Lastly, the third identified SRI strategy resides in community investing. For instance, financial institutions choosing this path can propose low interest rate loans to people who earn a low or moderate income, and who would otherwise be at a loss to finance affordable housing; they can develop such programs either in poor areas of the cities of rich countries, or in villages in developing countries. Small business loans can also help finance local projects, following the well-known example of the Grameen Bank that has implemented a well-known and successful micro-credit system in Bangladesh. Community investing provides socially-oriented investors with a concrete way to improve people's lives, and to see tangible social results in the medium term; therefore it is a very satisfying investment strategy. Although the financial return generated by these projects is usually lower than that of "blue chips" for instance, these investments have nevertheless their place in a well-diversified portfolio; but what counts most here is that the negative return gap is largely outweighed by the benefits at the community level, which can themselves entail new opportunities for the activity of the financial institution involved. In 2005, the ING Group has stated its willingness to engage in microfinance activities, aimed at helping about 150,000 small enterprises in developing countries, through its Dutch entity Postbank Green (ING Group, 2005). The logic of community investing can also be applied through micro-insurance for the economically deprived: for instance in India, Aviva has insured 450,000 people belonging to this category, almost exclusively poor women, thereby enabling them to commence productive activities, for if they are ensured, they can get a loan, etc.

Today, investments using at least one SRI strategy represent over $ 2 trillion in assets (to be compared with $ 40 billion in 1984), and account for about 11.3% of the estimated $ 19.2 trillion under professional management in the US, according to the latest Trends Report by the Social Investment Forum (Social Investment Forum, 2003). In other words, more than one out of every nine dollars under professional management in the United States – including pension funds, mutual funds, foundations, religious organizations and community development financial institutions – is involved in socially responsible investing. The SRI trend is gradually influencing mainstream investment: the number of mutual funds using one or more social criteria has grown to nearly 200 in the United States, and hundreds of financial institutions of all kinds have used their voting rights in publicly held companies to support shareholder resolutions or vote their proxies on corporate social responsibility issues.

To a certain extent, the choice of insurance companies to adopt SRI policies is a matter of consistency between risk management and financial management: is it appropriate for an insurance company to invest in tobacco firms with a view to reaping high short-term benefits, knowing that at the same time these firms manufacture products that increase public health risks and will generate heavy compensations for the victims? Belth and Dorfman (1996) are right when they claim that insurance companies should divest their tobacco investments, not only on moral grounds, but also for good economic reasons. The acknowledgement of this simple reality has led some insurance companies to extend the logic of divesting from “bad” sectors, and instead, to invest in sustainable or socially responsible companies. Some of them are also engaged now in shareholder advocacy and community development, thereby paving the way for the whole industry. Besides, the choices made by the insurance industry exert an influence on corporate behavior in many other sectors, and thus this industry can act as a lever to encourage positive change in society as a whole. For all these reasons, the investment policies of the insurance sector have a great effect in designing the future of our economic system, and they condition our quality of life and that of our children; therefore the integration of extra-financial concerns and values in the investment choices of insurance companies is of great importance.

To conclude this first section, it is undeniable that the insurance industry brings numerous positive contributions to society, and that some pioneering companies are striving to operate in a more socially responsible way. However, it is also undeniable that the industry suffers from a negative image in the public opinion, which may be ascribed to a variety of causes; the

second section of the paper will precisely investigate the underlying causes of this negative perception problem.

II.- The insurance industry: factors of negative perception

The insurance business is faced with several kinds of ethical issues. Some of these issues are common to all economic sectors, such as for instance operations localization, social inclusion, diversity in the workplace, governance mechanisms, and so on. We will concentrate here on those issues that are the most pressing for the insurance industry and that account most for its being negatively perceived by the public opinion: the uncovering of corporate scandals, misrepresentation and mis-selling practices, the agents' remuneration system, the respect of customers privacy, and the consequences of outsourcing.

II.1.- The uncovering of recent scandals has tarnished the industry's image

Amid the spate of highly publicized accounting and corruption scandals that have been uncovered in several high-profile corporations around the world in recent years, the insurance business has not been spared. Some of the world's largest insurers and insurance brokers have been named in corporate scandals, ranging from bid rigging, price fixing, improper accounting methods, to overstating earnings. The adverse publicity generated by these scandals has obviously hurt the industry's reputation. Customers, both corporations and individuals, have criticized the market conduct in the industry. The two main sectors of the insurance industry – the life insurance business, and the property and casualty insurance business – have received their fair share of criticism.

In the US, the insurance industry has been hit by charges about bid rigging, contingent commissions, and misleading accounting and financial reporting. Illegal and unethical activities involving collusion among major insurance brokers and insurers have been highly publicized in the media. In Great Britain, the Equitable Life scandal has caused hundreds of thousands of policyholders – many of whom are retirees – who have invested in annuities to suffer losses amounting to billions of pounds. Furthermore, complaints about mortgage endowment policies reached a crisis level. Problems with the insurance industry also arise in

Asia. Even Singapore, a small Asian country famous for its clean image, strong governance and heavy regulations, has not been spared.

Since late 2004, the American insurance industry has been shaken by the uncovering of a series of scandals of bid rigging and price fixing between insurance companies and brokers that provide property and casualty insurance. It all began in October 2004 when Mr. Eliot Spitzer, New York Attorney General, filed a civil suit against Marsh & McLennan, the world's largest insurance broker. The American company was charged for rigging bids and steering business that boosted its income at the expense of its clients' interests since at least the late 1990s. Specifically, Marsh & McLennan solicited fictitious bids for insurance contracts from insurers including American International Group (AIG), ACE Ltd, The Hartford Financial Services Group, and Munich-American Risk Partners. These actions were to give its corporate customers the illusion of competition. It then steered these customers to those insurers that paid it the largest incentives (known as "contingent commissions"), which were effectively bribes, for the business. Such practices resulted in Marsh & McLennan's corporate customers overpaying for property and casualty insurance, which means that they have been cheated. Besides Marsh & McLennan, Aon Corporation and Willis North America, the country's second and third largest insurance brokers respectively, were also investigated for receiving contingent commissions from insurers.

Mr. Spitzer's subsequent sweeping investigations on bid rigging and other illegal activities across the insurance industry have already led to a number of former employees of Marsh & McLennan and major insurers such as AIG, ACE Ltd and Zurich American Insurance being convicted of criminal offences. More individuals are expected to plead guilty to criminal charges as investigations continue. Under settlement agreements with New York authorities, Marsh & McLennan, Aon Corp. and Willis North America agreed to pay $ 850 million, $ 190 million and $ 50 million respectively in restitution to policyholders, so as to avoid criminal sanctions for the corporations themselves.

Besides being mentioned as a participant of alleged bid rigging in this case, AIG itself has faced other investigations in recent years, in particular with respect to a reinsurance transaction conducted in late 2000 between the firm and General Re, a reinsurance company owned by Berkshire Hathaway. That transaction enabled AIG to falsely inflate its reserves by $ 500 million in 2000 and 2001. In the midst of the investigations, Mr. Maurice Greenberg

was forced to step down in March 2005. Following his forced exit, Mr. Spitzer filed a lawsuit against him, AIG's former chief financial officer, and AIG itself, alleging that the firm's accounts were manipulated to deceive regulators and investors. Numerous illegal transactions were mentioned in the suit. AIG admitted that it had overstated its net income by $ 3.9 billion over 2000-2004, and restated its earnings for these years. For Berkshire Hathaway, besides being investigated by American authorities, its reinsurance businesses were also scrutinized by regulators in Australia, Great Britain and Germany. These investigations, which are still ongoing, have not only harmed the reputation of the companies involved, but also raised important issues of conduct toward investors, regulators and external auditors, and tarnished the insurance industry's image.

Similarly, scandals have shocked Britain's insurance industry. Equitable Life, the world's oldest mutual insurer, had sold numerous guaranteed annuity rate policies since the 1950s. Such policies guarantee investors a minimum annuity rate upon their retirement. But the decline in investment returns in the 1990s weakened Equitable Life's ability to honor such guaranteed payments, and it had to close its doors to new business in December 2000. Investigators of the saga condemned the insurer as being the "author of its own misfortunes". Incompetent management, dubious actuarial techniques, manipulation and concealment of the insurer's actual financial position and the true risks that it faced, as well as unsustainable payouts, were pinpointed as primary causes of the crisis. Although regulatory system failures on the part of the government also played a role, these were considered to be secondary reasons (Penrose, 2004).

Moreover, several insurance companies have been fined by the Financial Services Authority (FSA), Britain's regulator of financial services providers, since 2000 for offences related to mortgage endowments:

- Royal Scottish Assurance for flaws in product premium pricing;
- Winterthur Life, Abbey Life, Royal & Sun Alliance, and Scottish Amicable for mis-selling practices;
- Legal & General for procedural deficiencies likely to have caused mis-sales;
- Friends Provident, Allied Dunbar, and Abbey National for shortcomings in the handling of customer complaints on the issue.

Although insurers have agreed to compensate customers through a process set up with the FSA, the episode has certainly put the British industry in a very negative light.

Likewise, over the past few years, the Singapore's insurance industry was rocked by a series of controversies over questionable practices. The saga started in March 2003 when life insurance policies with a "critical year" feature sold in the 1980s and early 1990s were under public scrutiny. American International Assurance (AIA)[4] was named as the main insurer which had aggressively marketed such policies. Its policyholders alleged that they had been misled as they had purchased the policies based on promises from the insurer's agents that they only needed to pay premiums till a so-called "critical year"[5], and would enjoy free insurance coverage after that. But gloomy global economic conditions and events such as the Asian financial crisis resulted in weak returns from equity investments, and dividend cuts for the policies. As the actual return of the policies failed to meet earlier projections, AIA asked its policyholders to continue paying premiums even after the "critical year" was reached. The policyholders claimed that at the point of purchase, they were not informed that the "critical year" was not guaranteed and could be delayed. It was estimated that there were more than 100,000 individuals in Singapore who had bought AIA policies with a "critical year" feature. By October 2003, the Consumer Association of Singapore had received complaints from almost 700 AIA policyholders on the subject. While AIA was struggling to cope with angry customers in Singapore, its policyholders in the neighboring Malaysia were also upset for the same issue, as 70% of AIA policies sold there over the past 15 years had the "critical year" feature.

Then in December 2003, it was reported in the media that AIA had discovered that about 600 of its Singapore-based agents, who made up 15% of its agency force in the country, had been churning customers' single-premium investment-linked insurance plans (ILPs) since June 2003. ILPs are insurance policies that offer a policyholder life protection, as well as investment returns from the premiums invested in financial instruments. For each new single-premium ILP purchased, the customer incurs a sales charge, and the agent earns a commission. Apparently, AIA's agents did not inform customers that they were entitled to a few free switches between funds each year. Instead, they sold new ILPs to the policyholders,

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[4] AIA is a wholly-owned subsidiary of American International Group (AIG); it is one of the largest insurance companies operating in Singapore.

[5] The critical year is the point at which a policy has built up sufficient cash value to fund future premium payments and an annual interest cost. It was stated as the 13th year for a number of the policies sold.

who ended up paying sales charges again with each new purchase, while the agents earned fresh commissions.

A few months later, the British insurer Prudential Assurance[6] sacked some agents for churning policies. Great Eastern, a Singapore insurer, also asked some of its agents who were caught churning to return their commissions. In October 2004, it was further brought to the public's attention that 12 insurers in the country were taking action against insurance advisers who had churned ILPs and unit trusts purchased with Central Provident Fund (CPF) savings[7]. It was revealed that thousands of such churning cases might have taken place from July 2003 to March 2004. The occurrence of such illegal sales practices is an indication of serious lapses in the insurers' monitoring of their agents' ethical conduct.

To sum up, the fact that these episodes have happened on three different continents simply reinforces the message that the negative image faced by the insurance industry is a global issue, not limited to a given country. These high-profile cases have given stakeholders the impression that the unethical behavior uncovered does not only apply to a few black sheep in the insurance business, but indicates a bigger problem that concerns the entire industry. The unfavorable media coverage has shaken people's confidence, and led to customer suspicion toward insurance companies.

This widely spread distrust is confirmed by the results of the annual survey conducted by Gallup on the American public's perception of the honesty and ethics of various professions, with a rotating list of about 20 occupations investigated yearly. Telephone interviews with about 1,000 adults aged 18 years and older are conducted each time. In every recent year from 1995 to 2003 when the public was asked to rate insurance salesmen, the profession was among the jobs rated the least honest and ethical. Only 10% to 13% of respondents rated insurance salesmen's honesty and ethics as "very high" or "high" (Moore, 2001; Gallup, 2003). Clearly, the American public does not think highly of the ethical conduct of insurance salespeople.

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[6] Prudential Assurance is a wholly-owned subsidiary of Prudential plc.

[7] Established by the Singapore government in 1955, the Central Provident Fund (CPF) is a compulsory social security savings scheme for working Singaporeans. Under the scheme, workers have to contribute a stipulated proportion of their monthly salary into their CPF accounts. Their employers are required by law to contribute another set percentage. CPF savings are intended to meet workers' retirement, home ownership and healthcare needs. Workers are allowed to invest their CPF savings in selected insurance products and other financial instruments such as unit trusts.

II.2.- The opacity of the insurance business: misrepresentation and mis-selling practices

One of the sources of the negative image conveyed by the insurance sector resides in the perceived opacity of the language and procedures it has developed. For ordinary citizens, insurance professionals are viewed as specialists in financial techniques, who often use – and hide themselves behind – an unintelligible jargon. Contracts are usually fraught with a myriad of obscure clauses, often written in small print, which prove difficult to understand for the layman. The insurance industry is associated with forms, papers and red tape relating to immaterial services; as a result, it is often seen as unattractive, including for young Business schools graduates who do not place it on top of their preference list when seeking a first job[8].

More generally, the complexity of the market makes comparisons difficult for customers. Due to the large number of existing companies and to the variability of available contracts, the insurance arena is very sophisticated and looks like a jungle; individual customers often lack reliable elements to assess the offers of different companies. Besides, it is an obligation for customers – individuals or businesses – to subscribe various policies (e.g. against fire, accidents, etc.) and they often sense that the level of the premiums is too high compared to the risks at stake; they don't have the necessary knowledge to check that they pay the right level of price for the service they receive. In sum, subscribers may have the impression of being trapped in a system that is organized to take their money without caring very much about their real insurance needs.

It is no surprise then that the insurance industry has been the target of widespread criticism for its commercial practices, often characterized by misleading advertising, misrepresentation, and mis-selling – especially in the long-term savings and life insurance businesses. The problem is particularly acute in the UK, due to the popularity of insurance as a savings vehicle in this country, which has the highest per capita insurance expenditure in the European Union and the third highest in the world. As customers experience difficulties to understand the products a frequent complaint against the insurance industry is that information about products presented in marketing, advertising or other sales efforts is untruthful, misleading, or incomplete: this is misrepresentation. For instance, insurers use

[8] Although it is true too that young graduates from actuary schools entering the profession are both very demanded and eager to join large insurance companies, where they are offered quite comfortable remunerations.

bullish growth projections in the benefits illustrations of investment-linked life insurance products, to lure consumers to buy the policies. But at the end of the day, is the initially projected performance of an investment product really met?

A number of financial institutions – not only insurance companies – have been confronted to consumer protest for not giving enough information about the products they sold, in particular relating to the risky aspect of variable income, stock-based investments. Sometimes, misrepresentations are not deliberately done to deceive buyers, but are instead due to agents' lack of product knowledge and training. Besides, numerous complaints against the insurance industry concern agents who sell customers products that are unsuitable to them, in order to meet sales quotas and/or boost their earnings as these products give the agent higher commission: this is mis-selling. Mis-selling could also be due to agents giving wrong advice to customers. The policies are considered mis-sold because they do not meet customers' needs. Moreover, it happens frequently in insurance contracts that charges are hidden, or disclosed only in small print in advertisements, brochures or policy documents. There are also instances where insurance agents do not highlight exclusions of the coverage to customers.

The recent mortgage endowment crisis in Britain is an illuminating example of customers misunderstanding the nature of the products or of the market variations, or of misrepresentation and mis-selling in insurance. It was alleged that thousands of customers were mis-sold mortgage endowment policies in the 1980s and 1990s. Basically, these customers were, at the time of sale, told or given a guarantee that there was no risk involved and/or their mortgage would be paid off by their endowment policy when it matured. However, low returns on endowment policies have resulted in shortfalls on their mortgage endowments. Although the endowment shortfall was partly attributed to the decline of the stock market in 2000-2003 which had depressed the investment performance of endowment policies, customers were mis-sold policies as they were not warned that the investment's return might not be large enough to repay their mortgage when it matured. This was especially the case for customers who had a low appetite for risk, and therefore were actually unsuitable for such policies. At the same time, there was misrepresentation as marketing materials depicting unrealistic future returns misled customers into believing that their mortgages would be paid off at maturity, when this was actually highly unlikely.

According to evidence presented earlier to the House of Commons' Treasury Select Committee, 50% to 60% of holders of endowment policies believed that they were told at the point of sales that their endowment policy "would definitely" or "was guaranteed to" pay off their mortgage. These figures showed that there was widespread misrepresentation and mis-selling of policies if consumers were telling the truth (House of Commons Treasury Committee, 2004/1, p.15-16). Based on a recent survey of 1,242 households[9] in a study commissioned by the Financial Services Authority (FSA), it was estimated that 2,2 million households, which constituted 82% of households that still had an endowment-linked mortgage, faced an average projected shortfall of £ 7,200 (Financial Services Authority, 2005, p.2). The Financial Ombudsman Service (FOS), which is an independent, central organization created in 1999 to help consumers settle unresolved disputes with financial institutions in Britain, received a record number of 69,737 new complaint cases about mortgage endowment mis-selling from April 2004 to March 2005. This represented a 34% increase over the previous year's figure, and accounted for 63% of all complaints received by the FOS in that period. This clearly shows the seriousness of the problem (Financial Ombudsman Service, 2005, p.8-9).

Similarly, in Singapore, the insurance industry was under fire in February 2005 for a lack of transparency in the presentation of charges for some regular-premium investment-linked insurance plans (ILPs) sold earlier. For such ILPs, the cost of insurance coverage increases with the policyholder's age. It can be paid for with investment gains made by the policy and by regular premiums. According to a number of policyholders, they were unaware that escalating charges on their insurance coverage could outstrip investment gains and the regular premiums they pay as their age increases. Policyholders in such situations would have to pay more premiums. If not, the sum assured would fall or the policies would lapse. These consumers claimed that they were not informed about such risks when they bought the policies. Due to the lack of disclosure on charges, they were misled into buying products unsuitable to their needs. Insurance practitioners also commented that the high growth projections in the benefits illustrations shown to buyers were unrealistic. Moreover, some agents had sold regular-premium ILPs to older consumers, when such products were actually unsuitable for that customer segment.

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[9] The survey was conducted between September and December 2004.

Prudential Assurance was the first insurer to introduce regular-premium ILPs in Singapore in 1992. Since then, the industry had sold about 350,000 such policies in the country. The Consumer Association of Singapore received 67 customer complaints on ILPs in the first six months of 2005, compared with only six in the whole of the previous year. A majority of the complainants alleged that they were misrepresented to and misled into purchasing the policies, and were dissatisfied with the agents' service (Tan, 2005). The number of complaints is likely to increase further as more consumers who have been sold such polices become aware of the situation. The seriousness of misrepresentation and mis-selling in insurance is also reinforced by statistics from the Insurance Disputes Resolution Organization (IDRO)[10] in Singapore: 63% of complaints relating to life insurance that IDRO received for the year ended 31st March 2004 concerned alleged misrepresentation or mis-selling (Cua, 2004).

II.3.- Issues linked to the insurance agents' reward system

The remuneration system of intermediaries for distributing investment products poses several problems that account for the bad reputation of the savings and life businesses, since it rests on heavily front-end loaded commission structures. Salespeople in the industry are often paid commission upfront for the sale of products. Some critics believe that such a way of rewarding insurance agents is the underlying cause of unethical behavior as it gives rise to a conflict between the agent's and the client's interests. The commission-based selling system would generate a bias to over-sell, since this mode of remuneration of advisers can lead them to push a customer to purchase an investment product on the basis of the resulting payment it generates for them, irrespective of the best choice for the customer, who could alternatively prefer to reduce his/her debt or to hold savings in cash. Moreover, this system can also bring about a product bias, which occurs when the adviser has an incentive to recommend a particular investment product that does not necessarily meet the customer's needs (supposing that this time he/she is willing to purchase an investment product), but that grants them a higher remuneration. For instance, agents are usually paid more commission for the sale of full life insurance products than term life ones; it has been alleged that in order to earn more

[10] The Insurance Disputes Resolution Organization (IDRO) was launched by the Life Insurance Association of Singapore and the General Insurance Association of Singapore in February 2003, to provide an independent and affordable channel for consumers to resolve disputes with insurers in Singapore. In August 2005, the Financial Industry Disputes Resolution Centre (FIDReC) was established as a one-stop centre to resolve disputes between consumers and financial institutions such as banks and insurers. IDRO was therefore merged into FIDReC.

commission, agents would have a higher tendency to recommend full life insurance to their clients, whereas term life insurance is much cheaper for the customer to buy.

The structure of remunerations across products and providers is really confusing for customers, who often do not understand the rationale behind it. Whereas an initial cost is associated with the start of the advice process, ongoing commission (renewal and trail) is a current practice, the justification of which is not quite clear; the customer is not always aware of its purpose. As a matter of fact, it is hard to understand if trail commissions correspond to a deferred initial commission, or if they imply the provision of ongoing advice. The practice of "churning" customers' portfolios is also highly questionable. Churning refers to a sales method in which insurance agents persuade policyholders to terminate their existing policies after a short period of time and switch to new, similar ones for no valid reason. In the process, the insurance agent earns commissions on the new policies sold. Other problems happen to occur in the customer-advisor relationship, for instance when the latter refuses to provide feature documents and personal illustrations if the former does not go through with the transaction.

In view of concerns in the UK that financial advisers do not act in the interests of their clients and, more specifically, to address the accusation that commission leads to bias, the Association of British Insurers recently commissioned Charles River Associates, a consulting firm, to conduct a study to examine intermediary remuneration in Britain's life insurance industry. The objective was to understand whether the existing remuneration model, which primarily pays financial advisers commission based on the amount of sales they bring in, leads to consumer detriment and whether changes could be implemented to restore consumers' confidence in the insurance industry. A "mystery shopping" exercise of financial advisers, and a survey to collect data on the commissions paid by member insurance companies, were carried out. In that research, it was found that there was evidence of some limited commission-related bias toward particular insurance companies and types of products. However, there was no evidence that commission was inducing advisers to sell where no sale was appropriate (at least relative to fees).

Research conducted by academics to study the influence of reward systems on financial sales agents' ethics has produced empirical evidence that is mixed. In Kurland (1995), a sample of independent, insurance agents in the US who were licensed to sell products

distributed by a marketing organization were put on a hypothetical scenario to test whether they would disclose all the available information about a new life insurance product to clients before recommending it. The agents were also asked to indicate the percentage of their income that was earned in commission in the previous year. It was found that there was no significant relationship between the 145 respondents' compensation earned in commission and their willingness to disclose all the available product information. In other words, commission did not significantly affect the agents' ethical intentions, either positively or negatively.

However, the sample of the study was unique in that (i) all the agents were affiliated with the same marketing organization that clearly stayed away from recruiting agents who appeared to be commission-driven; (ii) the organization's president emphasized ethics, especially in his monthly newsletters to the agents, and this ethics emphasis could have tempered the potential negative effect of commission; and (iii) the organization developed and marketed only products which aligned the agent's, firm's and client's interests, i.e. products which provided quality to the client and a respectable commission to the agent. These are important limitations of the study. But it also means that the company concerned appears to have found a practical solution to temper the potential negative effects of the straight commission compensation system in its commitment to selective hiring, ethics emphasis, and marketing products which benefit both the client and the agent. Hence, these limitations offer Aviva ways to temper the potentially negative influence that the straight commission compensation system can have on agents' ethical intentions toward their customers.

A conclusion similar to that obtained in Kurland (1995) was arrived at in a more recent study conducted in the US: Cupach and Carson (2002) analyzed survey responses from 336 insurance agents who were asked to recommend a life insurance product, from a specified list of products with different insurance coverage, to a hypothetical client. It was found that neither the amount of insurance coverage nor the type of coverage (i.e. term life versus cash value) recommended was associated with the compensation amount – either in the form of a commission or a fee – which the agents already knew they would receive for each product.

But other studies contradict these results: in a research based on survey responses from 182 financial sales representatives in the US, Schwepker and Good (1999) found that the more negative salespeople foresaw the consequences for failing to achieve sales quota, the

greater the impact of perceived quota difficulty on moral judgment. As a result, if salespeople believe that they will suffer negative consequences for failing to achieve sales quota, they are more likely to behave unethically. Furthermore, Howe, Hoffman and Hardigree (1994) examined the relationship between the ethical behavior and customer orientation of insurance sales agents engaged in the selling of complex services such as health, life, auto and property insurance, and the annual premiums generated by these agents. Using data collected from 254 insurance sales agents in a survey conducted in the US, the study found that customer-oriented sales agents engaged in less unethical behavior than their sales-oriented counterparts. Furthermore, sales-oriented agents perceived greater levels of unethical behavior among other professionals with whom they interacted and whose behavior they might emulate, such as their agency co-workers, successful agents, and other agents in the industry. This supports the belief that agents can learn unethical behavior from other individuals in the industry. Moreover, it was found that top producing agents, in terms of insurance premiums generated, engaged in more unethical behavior than less productive agents, underlining a cause of concern.

II.4.- Problems associated with the respect of customers' privacy

The image of the insurance industry has also been dented by practices or initiatives that are seen to constitute an invasion of customers' privacy. In particular, concerns have been raised about insurers' practices of asking customers for detailed information about their health, especially genetic test information that is now made available thanks to technological advances. Insurers argue that if they do not have access to genetic test information, individuals who learn that their test results indicate an increased risk for serious adult-onset diseases would purchase more insurance coverage at prices that are below an actuarially fair rate. As a result, the denial of access to the results of genetic tests for insurers may lead to adverse selection on the insurance market (Zick et al., 2005). But in several countries, consumers have expressed strong objections to the use of genetic test information in insurance. Consumer groups contend that granting insurers access to genetic information will increase discrimination in life insurance premiums and discourage individuals from undergoing genetic testing that may benefit their health (Armstrong et al., 2003).

According to a telephone poll conducted by Gallup in 2001 in the US, 74% of 494 adults, aged at least 18 years, interviewed felt that medical insurance companies should not have

access to information about the genetic makeup of individuals when deciding about health care coverage for individuals (Carroll, 2001). Similarly, a vast majority of consumers in the UK expressed a high level of discomfort with the use of genetic information in insurance. In 2000, the Human Genetics Commission, which was established by the British government to advise it on issues relating to human genetics, commissioned the market research firm MORI to carry out a survey of public attitudes to the use of human genetic information in areas such as employment, insurance, and police forensic purposes in Britain. 1,038 people aged 16 and above, representative of the nation's population, were interviewed. 78% of the respondents disagreed with the suggestion that insurance companies should be able to ask to see the results of genetic tests to assess premium levels. Respondents with strong knowledge of genetics were more aware that genetic information could be used for setting insurance premiums. However, they were also more likely to oppose to its use in this way. Furthermore, only 7% of the respondents trusted insurance companies to use the human genetic information held on medical databases responsibly (Human Genetics Commission, 2001).

However, a distinction needs to be made between what constitutes necessary information and what may be viewed as excessive information. It appears reasonable for insurers to ask applicants of life and health insurance questions about their health currently and in the past, for the purpose of evaluating whether insurance coverage should be extended to the individual, and for deciding the fair premium level to charge the individual. If not, it will lead to adverse selection in which individuals who are aware of their known illnesses hide their conditions and succeed in obtaining insurance coverage, leading to higher insurance payout costs incurred by insurers. The consequence is higher premiums for all policyholders, which could be seen as unfair to those who are in good health.

On the other hand, it appears unethical for insurers to ask for information that is more than necessary. Tests on the genetic makeup of individuals can determine a person's chances of contracting a number of diseases; they may also reveal the health of the person's family members. If genetic test results are made available to insurers, it can enable them to identify consumers who are more likely to contract certain diseases, and keep such high-risk individuals out of insurance or charge them higher premiums. To be able to use genetic test results in insurance underwriting is definitely an attractive business proposition for insurers, as it will help them lower their costs. But it is a highly controversial issue and appears as unacceptable to a large number of citizens.

Recent studies have tackled this issue. On the contention that individuals with genetic disorders may be denied insurance when insurers have access to genetic test results, empirical evidence has been mixed. Lapham et al. (1996) surveyed 332 individuals in the US who had one or more family members with a genetic disorder. 25% and 22% of the respondents believed that they or a family member had been refused life insurance and health insurance respectively as a result of the genetic condition in their family. In addition, 9% of the respondents reported that they or a family member had refused to be tested for genetic conditions for fear of their insurance coverage being dropped, and 18% informed that they or a family member had not revealed genetic information to insurers as a result of fear of genetic discrimination. On the other hand, Wingrove et al. (1996), Steinbart et al. (2001) and Armstrong et al. (2003) found no evidence of actual insurance denial from genetic testing.

Moreover, studies that examined consumers' insurance purchase behavior after they had tested positive in genetic tests also gave mixed results. Zick et al. (2000) and Armstrong et al. (2003) investigated the impact of test results of breast cancer gene mutation on women's life insurance purchasing behavior. In Zick et al. (2000), women who tested positive for breast cancer gene mutation did not capitalize on their informational advantage by buying more life insurance than women who had not undergone genetic testing. In contrast, Armstrong et al. (2003) found that information about increased breast cancer risk was associated with an increase in life insurance purchasing, raising the possibility of adverse selection. A third empirical study, Zick et al. (2005), surveyed individuals who had undergone genetic testing for Alzheimer's disease in the US. It found no significant differences in health, life, and disability insurance purchases between individuals who tested positive and those who did not receive the genetic disclosure information. But individuals who tested positive were 5.76 times more likely to have altered their long-term care insurance than those who did not receive the genetic disclosure information. This finding suggests that if genetic testing for Alzheimer's risk assessment becomes common, it may trigger adverse selection in long-term care insurance.

Due to widespread concerns about privacy and confidentiality implications of the use of genetic information in insurance, several countries have imposed restrictions on the access to that kind of information for insurance underwriting (Knoppers et al., 2004). In the UK, the Association of British Insurers launched its code of practice on genetic testing in December

1997 as a form of self-regulation, and revised it in August 1999. The code states that ABI member companies must not ask applicants to undergo a genetic test in order to obtain insurance. But when a test has already been taken for medical reasons, insurers may ask for the result, in a limited number of cases. The code also includes a moratorium that states that genetic test results need not be disclosed (and should be ignored if disclosed) in applications for life insurance up to a value of £ 100,000 that are linked to a new mortgage for the purchase of a house.

In October 2001, the British government and ABI reached an agreement to institute a five-year moratorium on the use of genetic test results in assessing applications for insurance. In March 2005, the moratorium was extended by an extra five years to November 2011. It specifies that consumers can obtain up to £ 500,000 of life insurance, £ 300,000 of critical illness insurance and £ 30,000 annual benefit of income protection insurance, without having to disclose the results of any predictive genetic tests[11] that they have previously taken. For insurance above these levels, individuals only need to disclose the results of those genetic tests that the Genetics and Insurance Committee[12] has approved as relevant for use for a particular insurance product (Association of British Insurers, 2005). It now seems that a balance has been set up between the company's legitimate right to information and the customer's legitimate right to preserve his/her privacy.

However, the fast pace of advances in the field of information technology poses other kinds of problems regarding the customers' right to privacy. Until what point is it legitimate for insurance companies, and more generally for financial institutions, to gather information through "data mining" techniques, using for instance payments by credit card to trace the consuming behavior of a target population, to define individual profiles, and to customize the marketing plans? Is there a limit to the knowledge a company can gain of the habits of a given

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[11] If an individual takes a genetic test before he shows any symptoms, the test is known as a *predictive genetic test*. In contrast, if he takes a genetic test to confirm his condition after he has begun to show symptoms of the illness, the test is known as a *diagnostic genetic test*.

[12] The Genetics and Insurance Committee (GAIC) was established by the British government in April 1999 to develop criteria for evaluation of the scientific and actuarial evidence presented to support the use of specific genetic tests in insurance risk assessment, and to evaluate particular tests against those criteria. Its members include representatives from the insurance industry, clinical genetics and patient support groups. Prior to the setting up of the GAIC, some insurance companies were already using results of a small number of genetic tests which insurers were permitted to take into account for insurance purposes under the ABI's code of practice. After the establishment of the GAIC, the ABI has agreed to stop using a particular test if the GAIC decides that the evidence on the reliability and relevance of the test is insufficient to justify its use.

customer? In this arena too, a balance needs to be found, since the insurance sector is one of those where information asymmetry is the highest between companies and their customers.

Other privacy-related problems may arise if for instance a fire or an accident happens: the individual or the organization involved may be the subject of a thorough investigation on the part of the insurance company which wants to make sure that the disaster is not criminal or fraudulent; as a result, if the subscriber is a truthful victim, he may feel unduly suspected and doubly victimized – even if the verifications conducted by the insurer are legitimate and necessary. The respect of customers' privacy is thus a very complex and multifaceted issue.

II.5.- Dilemmas related to the consequences of outsourcing decisions

Another determinant of the bad image conveyed by the insurance industry may be ascribed to the offshoring trend that has been rapidly developing during the past few years: insurance companies have massively delocalized jobs to India, especially to operate their call centers in this country where wages are largely lower than in the Western developed world, and also to transfer thousands of back office staff to separate companies. For instance Aviva has already delocalized 6,000 jobs in India – in the cities of Poona, Bangalore and New Delhi – and plans to create 3,000 more jobs while implementing a BOT model, entering into new types of relationship and governance with Indian partners. It has also offshored jobs to Colombo in Sri Lanka. Jobs concerned are not anymore those of phone operators, but are now extending to back office functions.

Similarly, Scottish Widows, an insurance business belonging to Lloyds TSB, transferred 125 jobs to New Delhi in September 2005, following a first wave of 40 delocalized jobs in 2004; Standard Life Investments has transferred administration jobs to Citigroup and Bank of New York recently, and several other examples could be quoted here. In the UK, the process of offshoring jobs to India might become even more widespread, according to the Association of British Insurers, if the government decided to introduce VAT on outsourced insurance services within Europe, as it has announced it would do on 1st January 2006; this decision would further incentivize British insurance companies to move to low-cost economies outside Europe such as India, where the new VAT ruling would not apply.

However, this offshoring and outsourcing trend raises many complex questions (to be explored elsewhere). Certainly, while reducing operating costs in home countries, it contributes to the development of host-country economies (creating jobs, transferring know-how, developing skills, paying some taxes, etc…), and in some specific cases it may enhance the quality of service, while bringing innovations at home. But what are the consequences in terms of employment in the home country? Does this imply that part of the workforce should be made redundant, or can the consequences of such massive staff transfers be amortized, smoothed through the non-replacement of retirement leaves? In the case of Aviva, in the aftermath of its move to India, the 3,500 staff in Edinburgh and Perth remained almost intact, but other sites including Norwich lost 2,500 jobs, according to ABI, though in reality the number of employees may have increased, with different jobs created.

And after call centers, back office operations, some administration jobs, what might be the next step? Due to global competitive pressure, thanks to IT progress, almost everything – except perhaps the Board and the top management – could be delocalized to India or other lower cost countries in Asia or elsewhere, to the appreciation of shareholders happy to see how such effective cost-cutting offshoring strategy can improve the bottom line… Overtime, a massive offshoring trend (e.g. in manufacturing and financial services) can't but bring increased unemployment problems in the insurance companies' home countries, and it seems that there would be some lack of realism to deny that simple reality. Besides, isn't it contradictory for a company to engage in community investment programs in order to gain a good corporate citizen image, and at the same time to make decisions that impact so negatively on the social fabric?

III.- Further improving the public image of Aviva through CSR: advances and recommendations

The Aviva Group, the world's sixth largest insurance group and number one in the UK, is one of the leading providers of life and pensions products in Europe. It employs 60,000 people worldwide and serves some 30 million customers. Over the past few years, it has gained a comprehensive understanding of CSR-related issues. It has devoted significant resources to define a clear policy in this regard and to implement a corporate social responsibility approach, and has committed itself to develop processes and practices that

change the way it carries on its operations across all its businesses. Aviva is now deepening the embedment of the responsibility dimension into all aspects of the group's management, and appears to be well advanced on the path to sustainability with respect to the best standards of conduct in the insurance sector. More generally, its achievements account for the fact that the company is ranked among the leading multinationals worldwide in sustainability rankings and indices.

However, it seems that Aviva – as all other financial services providers – is still experiencing some problems regarding its public image. This negative perception is not systematical; it ought to be qualified in many respects by other positive elements (e.g. customer surveys) that offset this impression. In addition, these image problems, wherever they remain, may be largely ascribed to the reasons that have been analyzed above, and that concern the industry as a whole. But these image problems are nevertheless a concern for the company, which therefore keeps searching new ideas to remedy this weakness and to improve its reputation. The Norwich Union Insurance investment to change its culture through the "Leadership and Care" effort is one of the visible examples. Although a lot has already been done in this direction through all the advances described in its CSR Report (Aviva, 2005), a number of ways could still be explored to make further progress.

The purpose of this section is thus to highlight some of the advances already made, as well as to make a few suggestions to enrich the range of potential responses to further improve Aviva's reputation through CSR. Three paths will be followed here:

- clarifying commercial practices and enhancing employees' competences and ethical awareness;
- further developing communication on behavioral, transparency and responsibility issues;
- acting as a lever for change in society.

III.1.- Reviewing commercial practices and enhancing employees' competences and ethics

III.1.1.- Clarifying selling and advertising policies and procedures

Legitimate concerns about mis-selling practices and problems linked to insurance agents' remuneration model, which cast an enduring slur on the industry's image, have led the British Treasury Select Committee to look into this pressing issue, and to recommend a clarification, a simplification and a standardization of the system, in order to reach a greater transparency and to restore customer confidence. It has expressed its position recently without ambiguity, recommending a change in the sales system of the long-term savings business, and a greater transparency on fees and commissions (House of Commons Treasury Committee, 2004/2, p.20 and p.26):

> *"In the Committee's view it seems likely that as long as most of the selling activity in the long-term savings industry is rewarded on a commission basis, many savers may remain suspicious that they are being sold a product for the wrong reasons. Shifting away from the current commission based sales system common in much of the industry is likely to be a key component of any strategy to rebuild consumer confidence in the industry after the long catalogue of mis-selling scandals in recent years. […] Full and open disclosure of fees and commissions in a manner that is readily comprehensible to savers and gives them a balanced view of the various options is a vital part of delivering an efficient market in financial advice and long-term savings products."*

A recent report for the Association of British Insurers also insists that initial and ongoing charges should be clearly distinguished and explained to subscribers, so as to ensure consumer-friendly selling practices (Charles River Associates, 2005, p.v-vi):

> *"<u>There needs to be an explicit ongoing charge for the ongoing relationship with the adviser that is transparent to consumers.</u> If the structure of commission or fees is meant to reward intermediaries for providing consumers with an ongoing relationship, this has a number of implications:*
> *- If a consumer wants ongoing provision of advice they should pay more than those who are only interested in a one-off advice;*
> *- The amount that consumers are paying for advice on an ongoing basis should be revealed to consumers, and advisers should be incentivized to explain the services they are providing for this on an ongoing basis; and*

- If the consumer is dissatisfied with the advice they are getting they should be able to transfer the payment elsewhere or even stop paying for this advice altogether.
Any model of remuneration should be explicit about the payments made for initial advice and also needs to allow the cost of initial advice to be spread over time. […] Collectively, providers should take responsibility for consumer friendly remuneration structures[13]*."*

These two reports provide very clear indications on how Aviva could work to improve its selling practices and remuneration system, especially – but not only – in the long-term savings business. The commission structure for any given product should provide advisers the incentive to give the right advice and to review product suitability and performance over time on behalf of the customer. The cost of initial advice should be – if legally possible - separated from the cost of on-going advice, and customers should not be forced to pay up-front for financial advice, or if they decide not to purchase a product. Hence, there is a need for insurers to incorporate behavioral control measures, such as incentives to encourage customer-oriented attitudes, into their agents' compensation system. It seems that a balance of outcome-based and behavioral-based control measures would be the best approach to adopt, following the idea of Anderson and Oliver (1987).

According to Anderson and Oliver (1987), sales force control systems can be classified into those that monitor the final outcomes of a process (i.e. outcome-based control), and those that monitor individual stages in the process (i.e. behavior-based control). In an outcome-based control system, salespeople are assessed and rewarded based on end results, such as their sales volume, number of new accounts gained, and whether they meet sales quotas or targets. On the other hand, in a behavior-based control system, salespeople are evaluated and compensated based on their behavioral performance (i.e. their activities, knowledge and skills), taking into account the methods they use to achieve sales results and whether they maintain good relationships with customers.

When a salesperson's performance is assessed based on end results, he bears performance risk because he will be penalized if he does not succeed in bringing in sales. Hence, he is

[13] Underlined by the authors.

more likely to behave unethically to achieve sales results, as shown by the study of Schwepker and Good (1999) mentioned earlier. An over-emphasis on end results may lead to a culture that focuses on short-term sales and neglects after-sales, long-term customer care. Hence, Aviva should not rely only on sales-based assessments in rewarding its agents. Instead, it should also incorporate further behavioral-based control measures into its reward system. This will reduce undue pressure on agents to meet short-term sales targets. At the same time, it will encourage them to act in an ethical way and establish long-term relationships with customers.

One way of assessing agents' behavioral performance is to look at the number of complaints and compliments that Aviva receives on each agent. The insurance industry's common practice is to hand out awards to agents based on their sales results. Perhaps, Aviva could consider rewarding those agents who perform well according to the complaints and compliments received, and who deliver long-term customer satisfaction. Such awards would act as strong incentives for agents to devote their efforts to building good, long-lasting relationships with policyholders. Conversely, Aviva could stop working with agents who generate a high level of complaints. Aviva should make such a policy highly visible to its agents, so that it will act as an effective deterrence to unethical behavior and unfriendly attitudes toward customers. In fact, there is already agent training within Aviva. Delta Lloyd for example has made a selection of agents it does and does not want to work with. The reason for not working with them varies, e.g integrity problems, solvability, etc.

Cultivation of the buyer's trust is particularly important in a relational sales context, where the customer needs to have a confident belief that the salesperson can be relied upon to behave in such a manner that his/her long-term interest will be served. Therefore, insurance companies and their agents must win customers' trust and build long-term relationships with them. Customers' trust in the insurance industry is not only dependent on the quality of the products' design, but very importantly, on the insurers' and their sales forces' level of integrity and professionalism when dealing with the public. All these factors affect a company's image. To gain public confidence, Aviva is in many ways making sure that all its commercial practices that are fair and customer-focused.

Besides, policyholders should be able to see that channels are readily available for them to voice their dissatisfaction or file complaints, if this becomes necessary. Aviva is committed

to dealing with customers' complaints fairly and swiftly. In their analysis of survey data on 569 adults' perceptions of their auto insurer's service quality in the US, Wells and Stafford (1995) found that consumers tended to rate their insurer's service quality higher if they were aware of their right to complain to the regulator. The study suggests that the awareness that a consumer advocate exists may reduce feelings of helplessness, dissatisfaction, or resentment that consumers may ordinarily have when dealing with a large insurance company. From the study's finding, we can perhaps make the following prediction: if insurance companies make customers aware that besides being able to seek recourse with the regulator, they also have a right to complain to their insurer and to the industry's associations, and that their complaints will be fairly dealt with, this is likely to also reduce consumers' feelings of helplessness, dissatisfaction, or resentment with their insurer.

When a customer does not complain, it does not necessarily mean that he is satisfied with his insurer's services. Aviva is bearing that in mind. Previous research on services has estimated that only 5% to 10% of dissatisfied customers choose to complain following a service failure. Five reasons have been identified for customers' reluctance to complain: customers believe that the organization will not be responsive to their complaint; they do not wish to confront the individual responsible for the service failure; they are uncertain about their rights and the firm's obligations; they are concerned about the high cost in time and effort of complaining; and they are afraid of negative consequences, such as receiving service of lower quality the next time they need service from the firm (Tax and Brown, 1998). Some of these non-complainants silently switch service providers if the costs of switching are not too high, while others remain with their service provider because of excessive switching costs. But, as Jones et al. (2000) have commented, when customer dissatisfaction is an ongoing phenomenon, customers may remain due to high switching barriers, while engaging in negative word-of-mouth, which hurts the reputation of the company. Hence, a good handling of complaints is an essential component of service quality.

Aviva encourages policyholders to provide their feedback in several ways (via websites, research, one-on-one interviews, etc). This serves as a good channel for the Group to hear customers' grievances and suggestions on how it could improve its products and service quality. The initiative shows that the Group truly and sincerely values customers' views. It enables Aviva to engage customers in assessing how well it is serving them, cultivate

customers' involvement as stakeholders of the firm, and help the Group build long-term relationships with customers.

III.1.2.- Upgrading professional skills of insurance agents and staff

Surveys conducted on insurance professionals have highlighted the existence of serious concerns regarding their competences. In a survey of professionals working in the property and casualty insurance sector (Cooper and Frank, 2001) and another survey of life insurance industry professionals (Cooper, Frank and Williams, 2003) conducted in 1999 and 2003 respectively in the US, the workers were asked to rate 32 ethics-related issues on the extent to which each issue represented a major problem to those working in the respective sector. The property and casualty insurance sector survey has revealed that the seven issues perceived as presenting the biggest ethical problems encountered in the sector, listed in descending order, are: (i) lack of knowledge or skills to competently perform one's duties; (ii) failure to identify the customer's needs and recommend products and services that meet those needs; (iii) office/agency closing and layoffs; (iv) failure to provide prompt, honest responses to customer inquiries and requests; (v) misrepresenting or concealing limitations in one's abilities to provide services; (vi) false or misleading representation of products or services in marketing, advertising or sales efforts; and (vii) conflicts between opportunities for personal financial gain (or other personal benefits) and proper performance of one's responsibilities.

Similar findings were obtained in the survey of life insurance professionals. Six of the seven issues mentioned above, except (iii), were among the top seven issues perceived by respondents in the life insurance business as presenting the greatest ethical problems for the sector. Item (ii) took the top position, with (vii), (i), (vi), (v) and (iv) occupying the next five positions, in descending order of extent as a major problem. These results clearly demonstrate that the lack of professional skills of insurance agents is a serious issue that the industry needs to address. Besides, the already mentioned study conducted by Charles River Associates has confirmed the need for improvement in the overall quality of advice given by insurance agents to customers.

Aviva sets high expectations in both the technical competence and ethical behavior of its agents. This involves adopting stringent requirements for the selection of affiliated sales agencies and individual agents. At the same time, there is a need to pay close attention to staff

training, so as to make sure that the sales force is technically competent to make the correct product recommendations to customers. This will minimize the incidence of mis-selling. The financial services industry has undergone rapid developments. Financial institutions like insurance companies and banks are offering more sophisticated products in their bid to uphold their market share in an increasingly competitive environment. Hence, insurers make sure that their sales force has the technical skills to handle the enhanced complexity of such products, by stepping up on staff training. Improving – on a continuous basis – the competence and professional standards of its agents helps Aviva win the public's trust and confidence.

III.1.3.- Including the CSR dimension into internal training programs

Training agents and staff has been in all business units – and for a very long time – a very important item. One of the strengths of Aviva is that they have had very active CSR programs in all their businesses around the world for some years. The performance and challenges and targets for each business can be found in the individual country reports. But because Aviva's head office is based in the UK, one of the countries where CSR has been a topic for a long time, Aviva must constantly keep an eye on maintaining the international mix of the program, and must focus on spreading its responsible practices across the countries where it operates. To deepen the incorporation of corporate social responsibility into the Group as a whole, Aviva continues also to mobilize its employees in this regard, by including this dimension into internal company training programs. The Board and senior management are clearly supporting and fully committed to the CSR program as well as conscious of the need to lead by example.

The generalization of internal training programs on responsibility issues is necessary to reach two fundamental objectives:

- appropriation of the CSR policy by all employees;
- internal consistency of the CSR approach at the Group level, across all management functions and lines of business (Lépineux, 2004).

The attainment of these two closely intertwined objectives is essential to enable Aviva to "walk the talk" of its CSR Report; it provides the keys for the Group to become a fully responsible insurance company in every country where it operates.

III.2.- Issues regarding the communication and reporting areas

After the official launch of its CSR policy at the beginning of 2002, Aviva has published its first CSR Report in 2003, drawing on previous efforts that had commenced in 1997 with the announcement of a formal environmental program at Commercial Union, continued in 1998 with the approval of the environmental policy by the Board of CGU, and in 2000 with the publication of the first Environment Report. The 2003 Report has been followed by the 2004 and 2005 Aviva CSR Reports, confirming the reality of the Group's commitment to continuous progress in this field. Although these reports are quite substantial and useful to bring Aviva's achievements to light, it seems that some additional materials could enhance the efficiency of the Group's communication.

III.2.1.- Increase the transparency of sales materials and produce additional brochures dealing with specific issues

Insurers need to improve the transparency of their business practices in order to win the trust of policyholders. There should be better disclosure of information about products in sales materials. Before consumers sign up for the products, they should be informed about all charges that would be incurred for the product, the projected returns that they would be getting, as well as the assumptions that the projections are based on. The projections should be credible, not unachievable. If the returns are not guaranteed, the company should be very clear about that. The terms and provisions of policies should be accurate, truthful, upfront, and written in a language that policyholders can easily understand as consumers frequently find insurance products complex and difficult to comprehend. Conditions and risks that are excluded from the insurance coverage should be clearly highlighted and explained to customers at the point when policies are sold. This will avoid unhappiness later on when customers file for claims. When it comes to selling insurance policies, the old saying "Honesty is the best policy" can't be more true.

Aviva publishes a printed summary of the Group CSR Report that aims to provide a global overview of its relevant issues, performance and key challenges. It also publishes CSR reports from all the business units on its website for both the local stakeholders and people that are interested in more detailed information. In addition, it seems that Aviva could also

develop a number of brochures or leaflets on some issues to customers, with a view to distributing them to various categories of stakeholders. This could prove a very efficient means to get key messages through for people interested in such areas. However, it should be taken into account that the Group operates in different countries, in which CSR priorities are different. Aviva's CSR program stimulates the business units to engage in those issues that are relevant for their stakeholders, and therefore this could lead to local brochures. Aviva has already issued a short document on its environmental policy. Other subjects seem no less important and deserve similar consideration. Therefore it could prove useful to produce and distribute brochures on the following issues to stakeholders and customers:

(i) The quintessence of Aviva's CSR approach

In spite of all its qualities, the CSR Report is a big document, and only stakeholders specialized in sustainability issues are likely to read the whole of it and to grasp all its details. Therefore, it could be useful to shorten the current summary of the CSR report that would still present the quintessence of the Group's CSR approach, stress some key values and principles, and provide the reader with an immediate understanding of Aviva's actions in this respect. If Aviva decided to elaborate such a brief presentation of its CSR policy and practices, it could distribute it to all its stakeholders, both societal and business stakeholders. For instance, the classification proposed by Lépineux (2005) could be relevant in this regard.

(ii) Complaining procedure

Aviva finds it important to make it as easy as possible for its policyholders to complain, and therefore, puts effort in explaining the channels through which it is possible for them to do so. The Group aims to reduce the number of dissatisfied customers who choose not to complain, but bad-mouth the company to others instead and damage the industry's image as a result. As mentioned above, when the customer is aware that it is easy for him to complain, and that he/she knows how to do it, this may reduce his/her feeling of helplessness or dissatisfaction toward the insurance company. Therefore, Aviva cannot stress enough to its policyholders that they have a right to complain internally and to seek recourse externally when necessary, and that their complaints will be efficiently and friendly dealt with. In fact, every complaint is considered as a business opportunity, since this form of consumer feedback can help the company avoid future errors.

(iii) Community involvement

The Aviva Group is very active in the arena of community involvement, as illustrated by the section of the CSR Report covering this theme. However, in the 2005 Report, this section appears on p.28-29, which means that only specialized or passionate readers who have enough time to reach this point will pay attention to it, and that unfortunately most customers of Aviva will remain ignorant of this important aspect of the Group's contribution to society. Hence, the realization of a brochure recapitulating these two pages, as well as including the section on partnerships with NGOs currently presented on p.12 of the CSR Report, could prove very useful to raise the awareness of policyholders in this respect, and help improve Aviva's image. It is important for the Group not only to be, but also to appear in the eyes of its customers and of the public, as a good corporate citizen, concerned with the problems of the communities that are living around its establishments: Aviva's efforts in this respect deserve to be better highlighted and communicated.

On the other hand, Aviva should be careful not to be viewed as using community involvement as a way to hard-sell its products. In 2004, Aviva attracted strong negative comments from the public in Singapore when it was reported in the media that the Group might be paying S$ 5 million ($ 3 million) to the National Kidney Foundation (NKF) Singapore[14] over the next five years for it to fund its activities, in exchange for using NKF's database to sell insurance products. The large database contains personal details of individuals who have made donations to NKF or used its health screening services over the years. Many consumers saw the proposed partnership as an invasion of their privacy, and were concerned that they would receive "marketing trash" promoting Aviva's products as a result. Although Aviva clarified a day later that it had no plans to buy NKF's database to sell its products and assured consumers that their privacy would not be compromised in its tie-up with NKF, the controversy dented the Group's image in Singapore. The incident shows that Aviva could be more cautious in managing its community involvement initiatives to avoid missteps. Besides, it suggests that if reasonable communication on this subject is certainly useful, over-communication about community involvement might prove counter-productive.

[14] The National Kidney Foundation Singapore is a charitable organization whose main role is to run a public-funded subsidized dialysis program. Over the years, it has emerged as the largest not-for-profit provider of kidney dialysis in Singapore, and has expanded to provide health screening services. It is funded by public donations and corporate sponsorships.

(iv) Socially responsible investment

Morley Fund Management, the Asset Management division of Aviva in the UK, markets itself well on SRI. It would seem important for Aviva to continue to communicate more specifically on its SRI policy and practices, since there is a growing expectation of various stakeholders on this issue. As pointed out previously, a number of investors, both individual and institutional – albeit not the majority, but a significant minority – are now increasingly looking for SRI-focused investment products; Aviva could provide them with a brochure clarifying its offer in this field. In particular, the efforts of Morley Fund Management to integrate the social, environmental and ethical dimensions into its investment process, including governance and human rights issues, and its voting policy regarding companies in which it owns shares, could be perhaps summarized in a leaflet and distributed to those customers who find an interest in it. Besides, financial analysts and extra-financial rating agencies are also interested in such documents, as the integration of socially responsible investment by financial institutions is becoming a matter of concern for these publics.

III.2.2.- Progress measurement, objectives and indicators: how to address the quantification problem?

A number of Aviva's competitors provide aggregate objectives for the future and action plans in their CSR Reports, like Storebrand with its Corporate Responsibility Action Plan 2005-2006 (Storebrand, 2005), or RBS and Lloyds TSB, which insert objectives for next year in each section of their respective Reports (Royal Bank of Scotland Group, 2005; Lloyds TSB, 2005). The publication of such aggregate objectives represents a very efficient means of progress measurement at the company level, supports the commitment of these insurance companies to continuous improvement over the years, and stimulates employees' efforts. Aviva does not publish aggregate objectives in its CSR Report, since all its separate businesses publish their own targets and performance in their own separate CSR reports; given the range of its activities and countries where it operates, the Group has not deemed appropriate to gross up all this information. It is true, though, that Storebrand's and Lloyds TSB's CSR Reports are virtually one-country reports, and that RBS does not have the same global coverage; so our purpose here is less to compare Aviva with these companies, than to address the progress measurement issue on an aggregate basis.

Besides, the Aviva CSR Report does not rely much on indicators, which are essential to performance measurement; even though much of the corporate responsibility approach is obviously of qualitative nature, some elements can nevertheless be the subject of a quantitative analysis. In this regard, during 2003 and 2004 the Global Reporting Initiative and the UNEP-FI have gone through a multi-stakeholder process to complete a pilot version of the GRI Financial Services Supplement dealing with environmental issues, which complements the existing GRI Financial Services Supplement relating to social issues released in 2002. Both documents are intended to be used in conjunction with the 2002 Sustainability Reporting Guidelines to help financial institutions report on the social and ecological impact of their products and services. The GRI Financial Services Supplement (Environment) consists of 13 environmental performance indicators. For the moment, the Aviva CSR Report lacks a number of environmental indicators, such as those concerning water usage or energy efficiency for instance – and this does not enable the reader to have a clear view of the "ecological footprint" of the Aviva Group as a whole.

To conclude, by improving its communication in all these respects, it is likely that Aviva will reap important benefits in the form of fewer dishonest claims submitted by customers. Industry players have long been troubled by the problem of customers filing fraudulent insurance claims. The total cost of insurance fraud in the US is estimated to be between $ 85 billion and $ 120 billion a year, with property and casualty insurance fraud alone estimated to cost insurers about $ 29 billion in 2003 (Insurance Information Institute, 2005). In Britain, the cost of fraudulent insurance claims on motor and household policies alone is estimated to exceed £ 1 billion annually, according to the Association of British Insurers. Moreover, studies conducted to examine consumer attitudes toward dishonest insurance claims in these two countries show relatively high public acceptance of insurance fraud. A survey commissioned by Accenture revealed that almost 25% of 1,030 American adults polled felt that it was acceptable to overstate the value of insurance claims (Accenture, 2003), while 33% of American adults interviewed in a similar survey commissioned by the Insurance Research Council, an insurance industry research organization, said that it was acceptable to inflate an insurance claim to make up for a deductible (Insurance Research Council, 2003). According to another study commissioned by the Association of British Insurers, 47% of 2,000 British adults surveyed would not rule out exaggerating an insurance claim in the future, while 40% of them considered it acceptable to do so. In fact, 7% of the respondents admitted that they

had already lodged a fraudulent insurance claim before (Association of British Insurers, 2003).

The findings of two empirical studies of American consumers, conducted by Tennyson (1997 and 2002), offer useful managerial implications to insurers looking for ways to alleviate the problem of fraud committed by customers. In Tennyson (1997), responses of 1,987 adults obtained in a survey developed by the Insurance Research Council were analyzed. It was found that individuals who had negative perceptions of insurance institutions were more tolerant toward filing exaggerated insurance claims. That is, a negative image of the insurance industry in the eyes of consumers affects consumer attitudes toward insurance fraud and contributes to the fraud problem. Hence, the study suggests that improving a company's image will have positive effects on its policyholders' attitudes toward insurance fraud, although it has highlighted that more general norms of honesty in society are also important and must be changed if the perceived acceptability of insurance fraud is to be greatly reduced. Moreover in Tennyson (2002), analysis of data collected from 602 heads of households in a survey sponsored by the Coalition Against Insurance Fraud also revealed that individuals with positive views of the insurance industry were significantly less likely to find insurance fraud acceptable, compared to consumers with neutral or negative views. This finding further reinforces our belief that Aviva could work on improving its customers' perceptions of the company, in view of the negative image that the industry is presently facing.

III.3.- Engage boldly in new avenues and act as a lever for change in society

III.3.1.- Devise and implement new methodologies of risk assessment that integrate sustainability-related issues and innovate in risk prevention

Methodologies that are currently used by the insurance industry are not adapted to the mounting global ecological threat that is looming ahead. The pricing of insurance products is traditionally driven by the risk profile of the policyholder, not by social or ecological factors. Besides, to maintain portfolios based on prudent risk management and meet their legal and regulatory obligations, insurance companies are led to reject certain risks, even though accepting them might benefit society. But innovative insurance mechanisms are urgently needed to tackle the environmental challenge, and insurers will have to devise new ways to

integrate social and environmental concerns into their risk management and product pricing methods. Since financial institutions play an essential part in shaping the future of this planet, they are called to play a key role in creating market solutions that keep it a livable place. In this regard, new instruments such as weather derivatives or carbon finance, for instance, represent promising strides. Insurance companies can also provide a significant impulse to promote the transition toward renewable energies. They can elaborate new product groups and new risk transfer markets to handle the renewable energy business. Internal incentive systems should be implemented to reward those employees who are willing to devote their talent to confront these challenges.

With respect to societal issues, new methods are also required to prevent social exclusion and the dislocation of society, as it happens in some Western developed countries where the social divide has become an increasingly visible reality. Special kinds of contracts could be made available for individuals with low or medium income, for the disabled, for people from ethnic minorities, so as to facilitate their integration in social life. This philosophy could also be applied to help them undertake small businesses, which means covering their risks at preferential rates, in order for them to earn their living decently. Additionally, insurers could also devote more efforts to foster risk prevention, moving beyond traditional areas such as home protection, fire safety or driving instruction to avoid road accidents, into new, still unexplored domains of prevention.

In particular, new public health concerns are mounting today, such as the obesity phenomenon for instance, which is now widespread in the US, and is progressively hitting other countries that have adopted the American way of life. Obesity is now viewed by the World Health Organization as a world-wide epidemic; for instance in the UK, one in five adults is obese, with one in four predicted to be obese by the year 2010. Obesity does not only generate personal health problems, but is also associated with costs to society as a whole. An interesting innovation in this regard has been launched by the Dutch company VGZ Group, one of the largest health insurers in the Netherlands with more that 2 million customers, which has decided to reimburse those of its policyholders who consume some cholesterol-reducing margarine, yoghurt and milk products, in an attempt to prevent heart disease. Subscribers will have the possibility to claim up to a maximum of 40 Euro a year to refund purchases of cholesterol lowering food products marketed by Unilever under the brand name “Becel pro-active”. According to VGZ, Unilever’s Becel products have proved to help reduce

the so-called bad cholesterol. This is the first time an insurance company subsidizes good eating practices rather than medicine, and VGZ is counting on its policy of promoting a healthier diet to cut drug and hospital expenses in the long run (Wojcik, 2005). This pioneering example suggests that the future of insurance will gain from the development of prevention programs. Insurers can play a decisive role for the education of the public regarding a number of important issues, and for the promotion of a safety culture.

III.3.2.- Maintain a proactive stance in the UN Global Compact's "Who Cares Wins" Initiative and in the UNEP Finance Initiative's working groups

The socially responsible investment trend is now furthered by two important initiatives harbored by the United Nations: the Global Compact launched by Secretary-General Kofi Annan at the turn of the millennium, and the United Nations Environment Program. The "Who Cares Wins" initiative, developed by the UN Global Compact in partnership with twenty of the world's largest investment companies representing 6 trillion dollars in assets worldwide – including major banking institutions such as Credit Suisse Group, Goldman Sachs, HSBC, Morgan Stanley, and major insurers such as AXA Group and Aviva –, seeks to make the consideration of social, environmental and governance issues part of mainstream investment analysis and decision-making. The institutions involved also agree on the importance of bringing other actors in the financial world to join the program, including stock exchanges and pension funds, to reflect on how these dimensions could become standard components in the analysis of corporate performance (Global Compact, 2004). The following statement made by the companies supporting the initiative is particularly clear:

> *"We are convinced that a better consideration of environmental, social and governance factors will ultimately contribute to stronger and more resilient investment markets, as well as contribute to the sustainable development of societies"*.

The "Who Cares Wins" Report, which states the signatories' willingness to better integrate extra-financial considerations in the practice of value analysis, asset management and securities brokerage, is currently endorsed by the following institutions: ABN Amro, AXA Group, Aviva, Banco do Brasil, Bank Sarasin, BNP Paribas, Calvert Group, CNP Assurances, Credit Suisse Group, Deutsche Bank, Goldman Sachs, Henderson Global

Investor, HSBC, Innovest, ISIS Asset Management, KLP Insurance, Morgan Stanley, RCM, UBS and Westpac. A handful of insurance companies appear in that list; others are likely to join shortly, not only for the sake of being in the list, but also and primarily to take part in the challenge of changing the rules on the financial marketplace. What is at stake here is the invention of new methods and practices that will eventually bring about sea changes in the financial industry as a whole. In short, it is the achievement of a methodological breakthrough. The industry is expecting that breakthrough, and the leading financial institutions worldwide are now ready to unite their efforts to realize it. Those companies that have joined the group at the beginning to initiate and develop its reflections will later appear as pioneers. Therefore Aviva's choice to participate in the "Who Cares Wins" Initiative, in addition to leading the UK group of the Global Compact and to its involvement in the Globally Responsible Leadership Initiative, is a very important and positive decision for the company.

Another international initiative that strives to fuel socially responsible investment worldwide takes place within the United Nations Environment Program. Since the early 1990s, the UNEP, established in the aftermath of the United Nations Conference on the Human Environment held at Stockholm in 1972, has launched joint initiatives with a number of industry sectors, in order to develop environmentally sound practices in accordance with the principles adopted at the Rio de Janeiro Earth Summit. At the same time, it has undertaken to work with forward-looking organizations in the financial services sector, based on the conviction that this sector had a valuable contribution to make in protecting the natural environment. These efforts have resulted in the elaboration of the "UNEP Statement by Banks on the Environment and Sustainable Development" in 1992, and in the simultaneous creation of the Banking Initiative, renamed the Financial Institutions Initiative (FII) in 1997 to broaden its scope. As regards the insurance sector, the "UNEP Statement of Environmental Commitment by the Insurance Industry" was launched in 1995, followed by the establishment of the Insurance Industry Initiative (III) in 1997. The signatories of the latter Statement, a group of leading insurance and reinsurance companies as well as pension funds, pledged themselves to achieve a balance between economic development, social welfare and a healthy environment; they declared their willingness to progressively integrate the environmental dimension into their internal and external business activities.

From 1999, both Initiatives started to collaborate on issues of mutual interest and to form working groups on climate change, asset management, and environmental management and reporting. Eventually in 2003 the Financial Institutions Initiative (FII) and the Insurance Industry Initiative (III) decided to merge into one single entity, labeled the UNEP Finance Initiative (UNEP FI). To date, more than 200 financial institutions from over 45 countries have signed the Statements, among which some 80 insurance companies from more than 20 countries (UNEP Finance Initiative, 2004/1). The purpose of the UNEP FI is to create a forum where insurance companies, as well as interested banks and asset management companies, can exchange experiences, stimulate each other in pursuing sustainable development, in applying the precautionary principle, and in striving to identify and assess environmental risks.

Working groups have been set up to discuss and produce reports on a variety of subjects, including the impact of climate change, the implications of international environmental agreements, the development of renewable energies (UNEP Finance Initiative, 2002), the challenges associated with water scarcity (UNEP Finance Initiative, 2004/3), the materiality of social, environmental and corporate governance issues to equity pricing (UNEP Finance Initiative, 2004/2), and the definition of best practices. Leading companies can thus blaze the trail for less advanced companies, which will learn more quickly how to deal with sustainability-related issues. Aviva, which has joined the Finance Initiative, among a host of other insurance companies, participates in the working groups on climate change, asset management, and general insurance (the latter group being at an early stage yet). Although it may seem costly and time-consuming to be present in all working groups, Aviva could nevertheless keep an eye open on the advances of other groups, such as the UNEP FI - GRI[15] working group on environmental performance indicators for the finance sector, which strives to elaborate clear reporting guidelines for financial institutions in supplement to the GRI Guidelines revised in 2002.

Besides, the UNEP FI plays an important role by fostering international dialogue on the regulation of global risk and environmental issues between the insurance industry, governmental bodies and financial regulators. Essential topics such as the effects of global

[15] What is meant here is the Global Reporting Initiative – not to be confused with the Globally Responsible Leadership Initiative, the program initiated by the UN Global Compact, administered by the EFMD and in which Aviva did play a major and highly appreciated role.

warming, the risks associated with the transport of hazardous goods, or environmental reporting methods for the insurance industry, are debated through the interface of the Finance Initiative. Another positive contribution of the network consists in the knowledge transfer from industrialized countries to emerging markets. In sum, the combination of creativity, the sense of environmental stewardship, and the will to collaborate with other actors which has been mustered by this Initiative, cannot but lead to the elaboration of pioneering solutions which will eventually be adopted by the whole industry, and help reverse the trend of nature devastation.

Eventually, the UNEP Finance Initiative and the Global Compact have decided to work together in order to develop a set of "Principles for Responsible Investment", with the participation of the world's largest pension funds. This collaborative project also aims to elaborate tools and strategies for the implementation of the Principles, and to provide policymakers with suggestions to align investment regulatory frameworks with these Principles. It is thus coherent for Aviva to get involved in both networks simultaneously; the Group should definitely take a proactive stance in each of them, if it wants to reinforce its position as a pioneer and keep pace with its most advanced competitors.

III.3.3.- Encourage the incorporation of CSR-related issues by all the industry's business stakeholders

Globally considered, insurance companies have repeated interactions with almost all economic sectors, with all kinds of organizations, and with all the citizens of the countries in which they operate, through the myriads of insurance contracts that are signed every year. Therefore, the insurance industry can bring an essential contribution to rise the awareness of its business stakeholders on societal and environmental concerns, and to promote sound practices on the part of its customers and suppliers. A pro-active attitude is essential to foster significant progress, which implies to create and market insurance products and services that encourage responsible organizational and individual behavior.

Insurance companies can make their policyholders more aware of the impact of their practices on climate change, for instance. Besides, not only can they include social and environmental considerations in their asset management policies, but they can also share relevant information regarding SRI with their customers, thereby encouraging the latter to

adopt socially responsible investment policies. In so doing, they will enable them to reduce environmental risks and to adopt a more sustainable way of development through their own operation modes. In sum, the insurance industry, through its central position in the economic system, has the power to influence the mindsets and behaviors of all its business stakeholders: suppliers, financial intermediaries, and customers – either individuals or organizations.

Conclusion

To conclude, for the financial services and insurance industry, it is only by demonstrating that it understands its responsibilities and operates with integrity that it will be able to rebuild the trust of all its stakeholders. Trust is vital to the insurance business; it represents its main asset. This is why transparent and ethical practices are needed to restore the reputation of the industry. It will demand skills in managing change - now very visible in some parts of the industry (e.g. Norwich Union Insurance). Enlightened leadership is essential to provide the impetus, to set the organization in motion, and to follow up the internalization process. Beyond implementing compliance programs, defining sets of values and elaborating codes of conduct, the challenge for insurance companies – as well as for other multinational firms – is to live the responsibility dimension in their daily operations, and to maintain a high ethical profile through all the aspects of their activities. Well written CSR reports, professionally managed PR exercises will, in that case, not be substitutes for a genuine incorporation of responsibility (at all levels) but its illustration.

Besides, the centricity of the insurance industry within the economic system places it in an ideal position to raise the awareness of all its stakeholders regarding the common good issue. In a previous paper, we have identified three major determinants that are likely to drive multinational corporations towards taking the common good into account: the environmental degradation, the rise of an anti-globalization sentiment, and the need to invent new forms of global governance (Bettignies and Lépineux, 2005). In particular, insurance companies can be a driving force for the necessary adaptations of our modern societies confronted with climate change, the forewarning signs of which can already be observed by everyone, and also with the "peak oil" point, two phenomena which will generate tremendous consequences for the way of life on our planet, much beyond Western countries.

The heart of the matter is that insurance companies, being financial institutions, have the power to shape our common future: they manage investment funds, which gives them the possibility to invest in responsible companies or to sustain sound projects; and they have set up contractual relationships with millions of individuals and organizations of all kinds – in fact, with all of us in a way or another –, and this provides them with a tremendous leverage. By the policies they define, the products they design, the methods used to promote and sell them, by the way they manage and reward their employees, or by the level of transparency they are able to reach, insurance companies influence significantly the way individuals and organizations behave. If they can introduce new methods of risk assessment and management that foster environmental protection and contribute to social equity, and make explicit that responsibility starts at the top and effectively percolates throughout the organization, then an enduring change in the image of the industry will take place. The “image” of the insurance industry will be restored because the “reality” will have changed. Then, future generations may have the possibility to cope better with the more risky world they will inherit from us.

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