Perspectives on ETHICAL LEADERSHIP

The James A. and Linda R. Mitchell/American College Forum on Ethical Leadership in Financial Services

THE AMERICAN COLLEGE

THE LEADER IN FINANCIAL SERVICES EDUCATION

Fourth Annual

FORUM ON ETHICAL LEADERSHIP

The fourth annual James A. and Linda R. Mitchell/ American College Forum on Ethical Leadership in Financial Services took place January 10, 2004, in Naples, Florida. The event featured discussion of some of the timely and timeless issues facing the financial services industry, by executives from the financial services industry and business ethicists from academe.

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THE PARTICIPANTS

James A. Mitchell, Chairman and Chief Executive Officer (retired), IDS Life Insurance Company, Longboat Key, Florida (host)

Ronald F. Duska, Charles Lamont Post Chair of Ethics and the Professions, The American College, Bryn Mawr, Pennsylvania (co-host)

Larry Barton, President and Chief Executive Officer, The American College, Bryn Mawr, Pennsylvania

Thomas W. Dunfee, Kolodny Professor of Social Responsibility, The University of Pennsylvania, The Wharton School, Legal Studies Department, Philadelphia, Pennsylvania

R. Edward Freeman, Elis and Signe Olsson Professor of Business Administration and Director of the Olsson Center for Applied Ethics, The Darden School, University of Virginia, Charlottesville, Virginia

Frank Keating, President and Chief Executive Officer, American Council of Life Insurers, Washington, DC

Daryl Koehn, Director, Center for Business Ethics, Cameron School of Business, University of St. Thomas, Houston, Texas

James M. Middleton, President and Chief Executive Officer, USAA Life Insurance Company, San Antonio, Texas

Robert C. Solomon, Quincy Lee Centennial Professor of Philosophy and Business, Department of Philosophy, The University of Texas-Austin, Austin, Texas

Casey J. Sylla, Chairman and President, Allstate Financial, Northbrook, Illinois

Daniel J. Toran, President and Chief Operating Officer, Penn Mutual Life Insurance Company, Horsham, Pennsylvania

Patricia H. Werhane, Ruffin Chair of Business Ethics, The Darden School, University of Virginia, Charlottesville, Virginia, and Wicklander Chair of Business Ethics and Director, The Institute for Business and Professional Ethics, DePaul University

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EXECUTIVE SUMMARY

A group of senior officers from some of the nation's top financial services companies–"the practitioners"–and noted business ethicists from leading colleges and universities–"the philosophers"–joined together at the Fourth Annual Mitchell Forum on Ethical Leadership in Financial Services for dialogue and reflection on the themes of communication, "transparency" of process, and values-driven oversight in the industry.

The participants started the day with high hopes to learn more about the industry's "best practices" in dealing with clients and other stakeholders–the practitioners to learn from each other and from the questions posed by the philosophers, in order to improve programs within their own companies, and the philosophers to incorporate the feedback into their research and, more importantly, to bring it back to the classroom to educate the nation's future business leaders.

Annuities

The group started by discussing ethical issues in the selling of annuities–a hot issue in financial services today. In particular, the executives shared the practices their companies used to monitor the suitability of annuity products for their clients' needs, and discussed with the academics the issue of whether commission structures lead to abuse. The group discussed whether or not the disclosures in the sale of annuities–often accompanied by extensive detail to ensure companies are protected from lawsuits–could be sufficiently "transparent" to unsophisticated buyers, particularly seniors, who are frequently the target of annuity sales efforts.

> The group recognized the importance of sensitivity, clear communication, and selecting a course of action that redresses grievances of outside parties and ensures the ongoing good name of the company….

The executives emphasized the importance of corporate oversight in selling any product with the company name on it. Monitoring suitability is good business not only for the customer, but also for the company, which otherwise could put itself at risk by approving an unsuitable sale.

In considering whether some compensation structures may entice an agent to put his or her interests before the client's, the participants dealt with the issue of front-end-loaded commissions and the extent to which such commission structures tend to discourage servicing the client for the life of the product.

Case studies

The second major segment of the day investigated a number of corporate ethics dilemmas–whether to terminate a star agent who had forged a client's signature; whether to end a lucrative relationship with a corporate partner that had run afoul of securities laws; how to retain a valuable product–company-owned life insurance–and at the same time ensure that its recent abuses would not recur; and how to handle justly the complex case of an employee who had committed vehicular homicide while abroad on a company assignment. In all the cases, depending on the situation, the group recognized the importance of sensitivity, clear communication, and selecting a course of action that redresses grievances of outside parties and ensures the ongoing good name of the company.

Best practices

The third component of the Forum involved questions the philosophers asked about how the practitioners institute best practices for dealing with clients, producers, underwriters, shareholders, and other stakeholders.

All saw a need for an effective system of tracking and handling client complaints, with leaders of the company setting the tone for customer service. Some academics raised a concern about whether outside regulation and compliance directives such as the recent Sarbanes-Oxley legislation could be effective if companies did not take proactive steps to ensure ethical behavior in their organizations. The executives asserted that direct communication and if needed, action–both within an organization, from the top down and bottom up, as well as with outside parties–are key.

A particularly effective way to take a proactive stance… is to encourage what the participants called "push back"…

A particularly effective way to take a proactive stance is to encourage what the participants called "push back"–that is, questioning of senior management by employees, board members, and others about operations and their ethical pitfalls, and challenging management to address them. Other suggestions included companies making special efforts to highlight "good" behavior within their organizations, and being bold in acknowledging the facts when they or others in the industry make ethical missteps. Weeding out problem employees–those who make ethical mistakes in their jobs–should be another proactive priority. Finally, boards should make use of their internal and external auditors to ensure they get a second opinion, beyond that of senior management, on company operations.

All of these efforts can help companies satisfy what one of the ethicists called "Wall Street"–the shareholders, at the same time they are meeting the needs of "Main Street"–customers, employees, and the community at large–that is, those other stakeholders who have an interest in the value created by companies.

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INTRODUCTIONS AND EXPECTATIONS FOR THE DAY

Host Jim Mitchell, retired chairman and chief executive officer of IDS Life Insurance Company, and co-host Ron Duska, holder of the Charles Lamont Post Chair of Ethics and the Professions at The American College, welcomed the financial services executives—"the practitioners"—and the business ethicists from academia—"the philosophers"—to the 2004 Mitchell Forum. Participants were asked to share their understanding of the role and meaning of ethics in their respective organizations as well as their personal objectives for the day.

Duska noted that one of the reasons The American College was established was to raise the level of professionalism of life insurance sales. His chair in ethics has been an extension of this commitment. "It's been a wonderful role," he said. "My job is to try to contribute to ethics in the financial services system." For this, the fourth version of the Forum, he hoped to contribute to an ongoing dialogue between the academics and corporate executives.

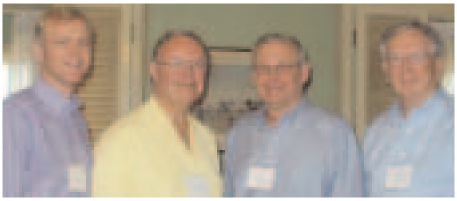
"As a philosopher and a practicing ethicist, I love to talk about ethical issues, especially with those who are at the top of their organizations, because I'm a firm believer that ethics in a corporation most often flows from the top down," he said.

Ethical leadership and credibility in business go hand in hand.
—Toran

Dan Toran, president and chief operating officer of Penn Mutual, noted that his career has taught him how ethical leadership and credibility in business go hand in hand. "This really enhances your business success. I'm not sure that leaders can really get the job done to the maximum if they are not able to connect integrity and credibility in people's minds."

Toran noted that the Forum can help "bridge the gap" between academic thinking on ethics and its practical reality in business. "Academics are the folks that are teaching our next generation of business leaders, and we've got to be sure that we keep each other current," he said. He hoped the Forum would help the executives in their own day-to-day practical responses to ethical challenges.

Casey Sylla, chairman and president of Allstate Financial, described how his company has evolved as an organization, resulting from a change in its business model a decade ago. "For years, Allstate was designed to sell products," he said. "We began changing that philosophy ten years ago to one of providing solutions to people's needs and helping to put their lives back together."



Pausing at the break during the Mitchell Forum were (from left) Larry Barton, president and CEO of The American College; host Jim Mitchell, retired chairman and CEO of IDS Life Insurance Company; Ron Duska, the Charles Lamont Post Chair of Ethics and the Professions at The American College; and Casey Sylla, chairman and president of Allstate Financial.

Initially, the company developed "the balanced scorecard"–a card on every employee's desk and in every conference room that reflected corporate commitments to the shareholder, the employee, the customer, and the community. "That was a cornerstone of how we wanted to conduct business," he said. Today Allstate is trying to move those commitments "…into the boardroom, which would not just serve as fiduciary for the shareholder. We're in a process of changing mindset, and I think we're making great progress."

Sylla said he hoped the day would help him gain a better understanding of what the academics view as "best practices," and what they see as the challenges of executing ethical practices in a large organization.

Ed Freeman, the Elis and Signe Olsson Professor of Business Administration and director of the Olsson Center for Applied Ethics at The Darden School of the University of Virginia, described his university and center's long commitment to teaching business ethics. The Olsson Center has been around since 1966, and it has a required, graded ethics course and many electives. "Because of the sense of community that the students and the faculty have, ethics is in the air, so I don't spend much time, as a lot of my colleagues do, fighting the legitimacy battle," he said.

However, he sees the challenge in this academic environment is to put business and ethics together, rather than considering them separately. He considered the Forum to be a way to continue what he and his university consider a requisite, ongoing dialogue with practitioners.

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Bob Solomon, the Quincy Lee Centennial Professor of Philosophy and Business at the University of Texas–Austin, said that, as one of three faculty (of about 2,500) who teach ethics to business students, he finds that placing ethics at the forefront in his environment has been "a constant fight." While he may not face the same kind of ethical pressures as the financial services practitioners do, he noted the importance of a "transparent and honest workplace" for anyone's well-being. Applying his academic view of the issues by drawing on "the wisdom of the ancients" would be his goal for the day.

Larry Barton, president and chief executive officer of The American College, noted that his first exposure to corporations was through covering events as a newspaper reporter at age 16. "I was dazzled by why terrible things happen to good companies and very good managers. I've always been captivated by that." Having taught public relations and management in a business school, he learned that already as young adults, his students had been "tilted towards the profit center rather than just doing the right thing." After editing a book on crisis management and ethics, he served as vice president of communications for a Fortune 20 company, where he had an opportunity to apply what he had taught to running an enterprise.

He believes that to implement ethics in an organization you need to be concerned with public perception. "You could defend something to your board, but could you defend it behind a microphone in front of the news media?"

"In our boundary-spanning role, we [ethicists] hear and synthesize critical commentary about business."
—Dunfee

Tom Dunfee, the Kolodny Professor of Social Responsibility at the Wharton School of the University of Pennsylvania, noted that at Wharton today there is no need to fight for "legitimacy" of the study of ethics in business. The ethics module required of all MBA students is one of the most popular in the curriculum. "Students are very interested in the social impact [of their decisions], and the contributions that they can make as individuals. The students even insist on meeting with the dean to determine how the ethics curriculum can be increased. Wharton encourages them in this."

He noted that, at times, some academics span the boundaries between businesses and their critics—that is, they defend the contributions of business in meetings with non-governmental organizations and other groups that sometimes take a critical perspective toward business. “In our boundary-spanning role, we hear and synthesize critical commentary about business. So we’re not necessarily reflecting our personal views when we say something critical, we’re reflecting what we have heard or what we know from other contexts.”

Dunfee hoped that participating in the Forum would allow him to come back with issues that he could discuss in the classroom. He also thought the Forum would provide him with more of an “insider story” of financial services, an orientation that Wharton emphasizes.

Pat Werhane, who holds the Ruffin Chair of Business Ethics at the Darden School of the University of Virginia and the Wicklander Chair of Business Ethics at DePaul University, said that while the University of Virginia has a well-known honor system and many great ethicists, it had not thought extensively about the role of integrity throughout its organization–not only for students but also for faculty, administrators, and staff. “Envisioning Integrity at the University of Virginia,” a project in which she and colleague Ed Freeman are involved, is designed to address this issue. At DePaul University she also is lobbying for a required ethics course in its MBA program.

She went on to express her objectives for the day. “We hear all the time about what we call technically and philosophically ‘scumbag stuff,’ but we don’t get to hear about what good companies are doing. Most companies have to be good or else we wouldn’t be here, we would all be out sweeping the streets because there wouldn’t be any money. So we really need many more models of best practices. To talk about this really helps us to think about that.”

“We hear all the time about what we call technically and philosophically ‘scumbag stuff,’ but we don’t get to hear about what good companies are doing.”
–Werhane

Jim Middleton, president and CEO of USAA Life Insurance Company, whose clients are members of the U.S. Air Force and other armed services, noted that the Air Force and the other services “really have as their basis honesty, integrity, loyalty, and trust. That’s the core of what you grow up with. The core values of USAA are exactly the same four that I named, with service added. We live that. We have to live it because that’s the niche we serve…who we operate with.”

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Middleton pointed out that the uniqueness of his organization calls for a different leadership model. Unless you've experienced it, "…you don't know what it means to move every year or two and to have the connection with our membership that our reps have had for so long. I try to grab senior people and try to make them listen to phone calls, because when you listen to phone calls you know that's where our business is." He hoped the Forum would enable him, his colleagues, and the academics to discuss these matters.

Frank Keating, president and chief executive officer of the American Council of Life Insurers (ACLI), noted that it is very important for teachers, family members, and friends to inculcate in young people a value system that appreciates there are acts that are *malum in se*–acts that are bad in and of themselves. You don't steal, you don't lie, you don't cheat, you don't kill. It is important to distinguish those from acts that are *malum prohibitum*–acts that are bad because they are prohibited. Depending on the culture, what is or is not ethical will vary, but not everyone understands this, he continued.

Linda Mitchell (center), who with her husband, Jim, co-sponsors the Mitchell Ethics Forum, welcomes guests to the reception that preceded the event. From left also are Kathy Higgins, wife of Forum participant Bob Solomon of the University of Texas-Austin; Dottie Dunfee, wife of participant Tom Dunfee of the University of Pennsylvania; and Amy Toran and her husband, Dan Toran, president and COO of Penn Mutual Life Insurance Company, who also participated in the Forum.

"These are all such extraordinarily important issues in which to give people a solid foundation–don't do this because it's bad, also don't do this because it's prohibited in our culture, you'll goof up the business, you'll destroy your credibility," he said. "We need a lot more chatter, a lot more discussion of that so that people won't make dumb mistakes." Echoing Solomon's comments, Keating noted the importance of "transparency" in an organization's workings when it comes to matters of ethics. "I think success in business is the result of transparency and trust."

Unethical practices should provoke "knots in the stomach," he continued. "We need more knots….We need more challenges for the sake of America to retain 3 percent of the world's population and 25 percent of the world's wealth. We can't do it if we have a bunch of people with jellyfish morals and ethics. We just simply are not going to be able to succeed, selfishly. We want to do the right thing because it's the right thing to do. To the extent that the academics around the room can help those of us who are either in politics or business to get there, we are very grateful for that."

Daryl Koehn, director of the Center for Business Ethics at the University of St. Thomas, noted that one of the problems she has with her students is not that they don't have a sense of right or wrong, or that they are relativists. "The real problem is that they think that ethics applies to somebody else rather than themselves," she said, noting how they can readily analyze corporate ethical missteps, but are "absolutely clueless" about how to apply any of that analysis to their own behavior. Koehn said that teachers have "one very big lever" to reach into their students' souls and transform this thinking–the students' dissatisfaction with their own lives.

"The real problem is that [students] think that ethics applies to somebody else rather than themselves.…"
–Koehn

As for what she expects from the Forum, Koehn said she would like the Forum to provide a "reality check" on what constitutes best practices in the financial services industry. She doesn't often get the opportunities to hear executives and academic colleagues share the reasons why they are not going to follow a particular unethical practice. "I would like to hear more about those kinds of practices and the best practices inside this industry."

Jim Mitchell said that the day would include such discussion. He noted a recent survey by the Gallup organization that asked which groups were "trusted to act in the best interests of society." Business people placed next to last (above only legislators). "There's clearly an opportunity here to improve the standing of business people. We know that business is the economic lever that creates wealth in society. If society does not trust business people, over time we'll have less wealth and everyone will be less well off."

Mitchell also emphasized the importance of reflection, particularly for busy executives who sometimes may need to step back and determine the right course of action. "I'm delighted you decided it was worth a day of your life to engage in this sort of organized reflection."

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ANNUITIES

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ANNUITIES: ETHICAL ISSUES FOR REFLECTION

After the introductory remarks, the participants turned their attention to examining ethical issues associated with the sale of annuities. These include:

The potential unsuitability of some annuity products for seniors, and related questionable marketing practices. When are annuities good for seniors? What should be the response to practices that induce fear and confusion in senior clients?

Commission structures that provide incentives to agents that may not be in the client's best interest. What is the company's responsibility in setting up systems of rewards that may compromise the agent's willingness to serve the client's best interest? How much of the payment structure should the agent disclose to the client?

Bonus credits. The Forum considered highlights of an address by Paul Roye, director of the Division of Investment Management of the U.S. Securities and Exchange Commission, titled, "Understanding the Securities Products of Insurance Companies" (January 9, 2001, Practicing Law Institute [PLI]), in which Roye described how bonus credits offer investors an immediate credit equal to a percentage of purchase payments, usually 1 to 5 percent. While the credits allow the investor to put an entire investment to work right away, investors generally pay for them, through higher surrender charges, longer surrender-charge periods, or higher asset-based charges. Roye noted that the SEC is concerned that these perhaps less-visible charges may more than exceed the bonus. Concerns increase when a bonus is paid to an investor transferring funds from one variable annuity to another in an exchange–often taking on a new surrender-charge schedule.

Substitutions of underlying funds. Roye also noted in his address that another questionable area of company behavior is the increasing number of applications requesting Section 26(b) approval for substitution of underlying funds supporting variable annuity and variable life contracts. He noted that a fund unaffiliated with the insurance company may be replaced with a fund managed by an affiliate of the insurance company. Even when the substitution is to an unaffiliated fund, he said, often the SEC finds significant revenue-sharing arrangements between the insurance company seeking the substitution and the management of the proposed new fund. Does the proposed substitution benefit contract owners in a tangible way? Questions arise when a new substitute fund has higher advisory fees or 12b-1 fees that otherwise could not be imposed without shareholder approval, Roye told PLI.

Inappropriate practices used in managing the mutual funds that underlie annuity contracts. Late trading, market timing, misleading information about past performance, lack of disclosure about fee levels and their impact on returns, lack of effective oversight by fund directors, and special pricing and trading prerogatives are among the problems. Other issues may arise as time goes on, as companies have to find ways to guarantee rates on fixed annuities, particularly as insurance company portfolio yields decrease.

Most of the discussion centered on inappropriate sales practices, the suitability of certain annuities for some clientele, and the problem of multiple pricing and compensation structures for identical products, which incentivize selling inappropriate annuity products.

There was a discussion of a *Wall Street Journal* report[1] of a company that offers training sessions on selling annuities to senior citizens. One trainer's advice to his students is to treat seniors like children, and minimize technical details, instead implying to customers that annuities are simply safe, guaranteed investments. The trainer's manual suggests that seniors make decisions based on emotions such as fear. He tells his students to take this into consideration, suggesting to senior customers that their financial planning has been deficient, or that their assets may be at risk if they do not buy an annuity.

As an example of inappropriate annuity sales, a June 27, 2002, Securities and Exchange Commission filing of civil fraud charges against a California broker was discussed. The SEC alleged that the broker defrauded scores of retired customers by recommending they replace existing investments in variable annuities with new investments in similar variable annuities.

[1] Ellen E. Schultz and Jeff D. Opdyke. "At Annuity University, Agents Learn How to Pitch to Seniors," *Wall Street Journal*, July 2, 2002.

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The switches enabled him to receive $275,000 in commissions for approximately 60 such unsuitable switches in less than four years. The broker told the clients they needed to switch in order to stem investment losses caused by declines in the stock market. They could have achieved that objective by simply electing another investment option within the original variable annuity. Instead the customers either received no economic benefit or lost money in the switch transactions and together incurred more than $200,000 in needless transactions costs. The Commission also proceeded against the broker's supervisor for failing to reasonably supervise the broker and not investigating red flags raised by certain switches when she reviewed the transactions.

Ron Duska asked if those representing companies in the Forum had faced problems such as these. Further, he asked, even if they are not in the business of selling annuities, do they have a responsibility to police the companies that are?

Pat Werhane posed a question to the practitioners, asking whether, in the sale of variable annuities, transparency shouldn't be the ethical best practice. Werhane said she's never seen this "transparency of comparison" among products. "I can go do that myself but I know that a lot of other people cannot. Is this always this transparent and can you do it and still sell annuities?"

Casey Sylla responded that while there may be a lack of transparency in parts of the insurance industry, at the same time a single company would not provide various compensation structures for selling an annuity for agents representing that company.

Bob Solomon wondered whether one can effectively educate the consumer–typically a senior–about the complicated concepts behind annuities, since even sophisticated practitioners in the industry sometimes find them difficult to fully understand. While Freeman suggested that the agent is responsible for simply and honestly explaining how the product works, Sylla noted that increasing class-action litigation causes companies to grow more and more cautious and feel pressured to provide much more detail than the client can understand.

Frank Keating raised an example of unethical behavior. An independent agent sold a 93-year-old woman an annuity on her savings of $100,000. "There is no way that she'll ever get back her $100,000 for the money she put in this annuity," Keating said. The independent agent "didn't really have much in the way of direction, I suspect, from the company about suitability and ethical sales practices." The main concern was to get a big commission.

At the pre-Forum reception, Linda Mitchell (far right), co-sponsor of the Forum, joins Brenda Shay Duska (left), wife of Forum co-host Ron Duska of The American College, and Kathy Higgins, wife of Bob Solomon of the University of Texas-Austin.

But Ed Freeman wanted to know if the company whose product was being sold was in any way responsible for this sale.

Sylla answered, "The independent agent would not be the company's direct responsibility but it would be implied," adding that, "I can't come up with a good reason for anybody 93 years old to purchase an annuity to start with. I mean, that is just off the charts."

Keating noted that the situation could be avoided by a better discipline and oversight system in the company that is dealing with this independent agent.

But aren't there more aggressive ways to ensure product suitability? Tom Dunfee asked.

Dan Toran noted there are. "The broker-dealer, for starters, has the responsibility for oversight and supervision of that independent producer. Written supervisory procedures for field managers are critical as well as processes in place such as a manual or technology-driven rules engine."

Toran noted that at Penn Mutual, since his staff reviews the suitability of the sale, they will see a 93-year-old woman buying an annuity and that producer is going to have to be able to convince his company's suitability staff that the sale is legitimate. "The bigger the amount, the more the age comes down. But if it's off our grid, we're still going to call the manager for an explanation. If the manager doesn't explain it right, the manager goes back to the agent or we do. Ultimately we could be turning this down. In other words, we accept the responsibility. The broker-dealer is regulated by the NASD and the SEC. We can't risk our whole business by approving one that never should have been sold."

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Jim Mitchell had similar thoughts. "At IDS I felt accountable for seeing that our products were sold properly, regardless of what channel they were in, because they had our name on them. So while we couldn't supervise every sale, literally couldn't, we did look at their practices before we would sign an agreement with a bank or a broker-dealer. In some cases we walked away from the opportunity to do business. We figured we were accountable, at the end of the day."

Keating noted that unless companies and individuals are incented–sometimes through the risk of potential litigation–to stick to ethical practices, they will not necessarily do so. "Money drives everything, and to the extent that someone is compensated to do certain things, they do it. Even though it's not ethical, they'll just do it. If they are not compensated to do other things that are perfectly sound, they won't do it."

> "To the extent that someone is compensated to do certain things, they do it. Even though it's not ethical, they'll just do it. If they are not compensated to do other things that are perfectly sound, they won't do it."
> **–Keating**

Keating brought up the case of an 80-year-old woman with $300,000 in an annuity, whom he encouraged to get the money out of that product so she could have more money for her grandchildren and great-grandchildren. "So I called the agent and said, 'How come you haven't called her to talk to her about the possibility of getting an income stream?' And he said, 'I'm not compensated to do that. I sold that policy to her 30 years ago, and I'm not compensated to give her any other advice.'" The net result for the company is that the client now feels disadvantaged by the insurance company, and will complain to her friends and relatives–who will be less likely to buy an annuity from that company in the future.

In response, Toran noted that the practice of front-end compensation discourages a service-oriented attitude. "We would rather have compensation less in the front end and more paid out over time, so that the agent will want to service the client and feel like he or she is getting fairly compensated to service that older person, or any person for that matter, and continue to give them advice on their annuity."

But Freeman asked whether compensation structures are as critical a factor in delivering value as are the underlying products themselves. "'How do we do something that's different, that shows that we are doing what's in the consumer's interest? Compensation systems get people dissatisfied, but they don't really motivate people to do things. And so I think the compensation issue is a red herring."

Toran said he believes that at some point some form of levelized commissions will become the norm, as products developed by one company are recreated more and more quickly by others. The result will be differentiation through a trusted personal relationship. "You're back to the question, how are you going to differentiate yourself? Some companies are trying to do it on a full-value basis, which comes back to trust and the integrity of the sales rep. Most of the good professional agents absolutely accept responsibility for their clients' lifelong best interests. Life insurance lasts until they die. The whole purpose of a life insurance agent is to be there to be sure that the policy pays out properly to the heirs."

"Compensation systems get people dissatisfied, but they don't really motivate people to do things.…"
–Freeman

Mitchell noted that the retention rate for new producers in the insurance industry is, at best, 15 percent after four years of selling. "So there's about an 85 percent chance that whoever sold that annuity to that 93-year-old will not be in the business four years later. One important reason that companies pay a lot of compensation up front is that they're trying to help producers be productive early in their careers. As it is, companies invest a fair amount of additional money subsidizing the early career anyway. And still 85 percent of new producers fail in the business."

Mitchell said that his experience with the most successful producers is that they are happy to take levelized compensation. However, producers just starting in the business can't afford to do that, and the companies won't subsidize them enough so that they could afford to do that. "That's why levelized compensation is good in theory but doesn't help the retention issue for producers in the industry. And poor retention of producers is likely to lead to poor service for the customers to whom they sold products before they left the industry."

Werhane raised the service issue again. "How do you help agents think about the right thing to do, to call your relative, to look over things and see $300,000? She's never gotten anything out. She's 80 years old. And how do you get people to think, 'This is the right thing to do, I've got to deal with this?'"

Toran emphasized that direction must come from the top. "Everybody knows, from our company viewpoint, that the client comes first. Did you put them first this year?"

"Most of the good professional agents absolutely accept responsibility for their clients' lifelong best interests.…"
–Toran

Freeman went further, tying the issues of compensation and values together. "Back in the day when IBM was a great company, one of the most impressive things about them was the connection that they made between their compensation system and their values. And that seems to me to be the issue here, the linkage between the values and what the system is."

Freeman reiterated the notion that service and innovation will differentiate in what otherwise is an increasingly commodity-based business. "There's really no way to make money in a commodity business or sustain it for long. The only way to do that is to get it there quicker, faster, or cheaper or with more value. You have to have some service components or you have to innovate fast."

Toran noted the field of estate planning in particular is not a commodity anymore because the client pays for professional advice.

DILEMMAS

THE DILEMMAS: MAKING ETHICAL CHOICES

At this stage, the discussions turned to examining a number of ethical dilemmas the practitioners had encountered in their years of experience.

Dilemma 1: The forger

A 25-year company veteran and star salesman was in the pension business, which typically requires the client to sign numerous forms. Ten to twelve or even fourteen forms would not be unusual in the course of administering a pension plan each year. The agent made the call, and went with eleven forms, but without the twelfth required form. Upon returning to the office, he signed the client's name to the twelfth form. It had nothing to do with the life insurance aspect of the case–the life insurance application and related forms were all signed, and all of the forms that required decisions on them were signed. However, for the twelfth form–involving notification of disclosure–the agent forged the client's signature. This was not the first time this had happened–on two prior occasions, under prior management, the agent had done the same thing, and was reprimanded at the time. Now, on the third occasion, what should the company do?

Participants took different positions on the case. Ron Duska took what he said some people in the industry might consider an "outrageous" stance–noting that while the behavior might be improper or inappropriate, it wasn't a "true" forgery, because a true forgery involves taking unfair advantage of the client, and that was not the case in this scenario. However, Ed Freeman, Tom Dunfee, and Frank Keating took a harder line, recommending that the company fire the agent, particularly in light of repeated warnings.

Keating likened it to a law enforcement agent informing a client of his or her Miranda rights, but not getting the requisite legitimate signoff. "Remember, you're dealing not only with an ethics challenge within your company–a public relations disaster, potentially, within your company–but also you're toying with forgiving an ostensible violation of the criminal law of the state, which you cannot do. So when you are facing a situation like that, it is absolutely imperative to find out from your general counsel, is this a crime here in this state? Because if you forgive and the state doesn't, or it comes out that you forgave it and they never heard of it, you have a big problem."

The practitioner who raised the case reported that the company did, indeed, fire the agent, although initially others in the company were shocked that it was willing to terminate a star player. "I said, 'It really doesn't matter,'" the practitioner continued. "'This really isn't up for discussion, folks. And, if this is so shocking to everybody as to where the bar is set, I guess it says we ought to do it because we have to be sure everybody knows where the bar is set.'"

While the debate could have focused on how the company had handled prior transgressions–and how well they'd warned the agent and established a policy against these actions, handling the incident more directly was better in the long run. As the practitioner pointed out, "They [company staff] started to interpret situations so strictly that transgressions of any type would not be tolerated. I said, 'Boy, we might be cleaning up a bunch of stuff I don't even know about,' which is how we left it."

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DILEMMAS

The group briefly raised the issue of whether to provide job references for the terminated employee. The practitioner noted that his company notifies insurance commissioners' offices in states in which the agent is licensed, so it is on the record, and tells prospective employers that the person would not be rehireable by the company, without providing a reason.

Dilemma 2: The partner with a (recent) past

A company, XYZ, is in partnership with several investment management firms handling its variable annuity business. One of them, Magnum Securities, which handles about 40 percent of the company's variable annuities business, had a very public ethical failure involving questions of insider trading, market timing, and late trading. Federal and state officials for securities violations charged several of Magnum's senior employees. Magnum's board took action, fired them immediately, brought in outside oversight, and paid a fine to settle civil charges without admitting or denying any guilt. The public relations fallout led to a loss of some assets. What should the company XYZ do with respect to its relationship with Magnum?

The company has three choices: (1) Terminate the relationship immediately, which might result in litigation by Magnum against the company; (2) Leverage the situation by reconstructing a business relationship with them in a different format where the company has a greater say in Magnum's operations; or (3) Continue to monitor and investigate the situation but give the company another chance on the theory that the fired senior personnel were the "bad apples" and are now gone. Some of the company's customers recommended termination. For example, some banks said they would not recommend the company's variable annuity products if Magnum was still a partner. The company also needed to protect its stellar brand image and ask what it would mean to be associated with a partner who doesn't meet the company's standards of excellence. Even more important than making a good financial decision, the company felt that it was critical to ensure transparency of the process. For now, the decision has been to continue to monitor and investigate, but put the partner "on alert" that if the situation occurs again, the relationship is over.

A question was raised about whether the size of the partner's contribution to the business made a difference in how the situation has been handled. "What would you have done if this was one-tenth of 1 percent of your revenue stream?" Keating asked. "Would you have done anything differently?"

Casey Sylla (left) of Allstate Financial and Ed Freeman of the University of Virginia listen to a point during the day of dialogue.

The practitioner replied, "We would have done due diligence. I will tell you that I have a kind of litmus test for ethical behavior. Ask two questions: First, would you be comfortable telling your mother about this? Second, would you be comfortable if this showed up in the press tomorrow morning on the front page?" While ethical control is important, at the same time, he said, the company probably would not have invested the money and effort in continuing the relationship if the partner only brought one tenth of 1 percent to the table.

Dilemma 3: The patent prize

The practitioner, a senior executive in his company, got a call from his IT department head who handles the company's patents. Typically, when a new patent is awarded or some other major accomplishment has been achieved, the employee responsible receives an award. Management is exempt. So, the practitioner was justifiably surprised when the IT department head said, "You've just been awarded $2,000 by the company. Your patent on the ABC process got approved. And it's going to be in your next paycheck." The practitioner replied, "Huh? That's my job. I mean, I'm not taking $2,000 for this. Tell the committee that I did not accept this and no officer in this company would accept any money for any patent ever. And make sure everybody knows it, and make sure that you go to payroll today so it does not even show up in my check–because I don't even want to give it back to you." The practitioner related how it would have been really easy to say, "Uh, just let it go in my paycheck." But he wanted the committee to know that this was a bad decision, a wrong thing to do.

The case raised the question of whether there should be a difference between situations like this in a large company and similar situations in academia. Keating noted that academia is a "totally different culture." He observed that at one time Oklahoma had a constitutional amendment that stated that no one on the state payroll–including professors at state-run universities involved in research, including patent or trademark work or even textbook writing–could profit from his or her position. The amendment discouraged anyone from wanting to work in state-run institutions. A second amendment subsequently permitted universities to negotiate as part of their employment contracts with professors, the arrangements that apply to book publication, patents, and the like.

Several of the participants agreed with the practitioner's handling of the case in his company, but recognized the distinctiveness of academia. Freeman noted that, as an employee of his university, he is paid a salary, but he also writes books and is permitted to keep the royalties. The university's "funding" of a book, however, is not as costly as funding of scientific research, Pat Werhane said, and so scientific disciplines are sometimes treated differently. "Many universities have careful agreements regarding patents and discoveries in the sciences because of the expense of funding the ability to do it. Frankly, it doesn't cost much to fund us to write a book."

Dilemma 4: Company-owned life insurance

Keating next raised the issue of company-owned life insurance (COLI) and related how, as president of the American Council of Life Insurers, he has found that good ethics is always good politics.

Recently COLI ("janitor's insurance," or "peasant's life insurance," as it has been described in the Wall Street Journal*) has been seriously criticized in the news. Companies have taken out life insurance policies on their workers with no notice or consent, and the payments have been used for general corporate service. The Senate Finance Committee voted to basically abolish company-owned life insurance, which would have a significant impact on the bottom line of a lot of insurance companies. The ACLI decided to bring together agents and company CEOs, and marshal as much political muscle and as persuasive an appeal as it could, and started the discussion of its strategy. There were those from the industry* *who said, "We can't give an inch on this one. This is death for the industry. We've just got to try to muscle it through." Keating's strategy was that you can never win if you're doing something wrong, ever. So what the life insurance industry ought to do is decide if, in fact (1) these policies are issued without notice and consent; (2) these policies don't go to benefits, including medical and health care; and (3) they're not in a lockbox. If these circumstances hold true for a COLI policy, then the industry won't sell it. As Keating said, "That's the way you put this thing behind us….We went before the Senate Finance Committee…. and I said, 'Here are the abuses that we've seen in this product. It's an extremely important product to fund medical and health care benefits. We want to see notice and consent of all these funds solely for the purpose of employee benefits, and a lockbox for the purpose of employee benefits.'"*

Tom Dunfee of the University of Pennsylvania and Pat Werhane of the University of Virginia were among the "philosophers," or business ethicists, at the Forum.

He related how one of the members of the Senate looked to a witness, an ex-university football player, and asked, "Are you satisfied?" He said, "Absolutely. Would they do that? That sounds fine with me."

Thus, what started off as a debacle and impasse turned out to be a very positive thing for the industry. "Today that issue is a nonissue," Keating told the Forum participants. "That doesn't mean it won't, perhaps, raise its ugly head again. But I think ethically if you have a problem, the best thing to do is to fix it. Insurance companies need to be good citizens. And I think, with COLI, the way the ACLI handled it was exactly how it ought to have been handled."

Werhane asked whether the discussion could lead to industry self-policing. "It seems to me that this still is an opportunity for the industry as an industry to get together and put pressure on each of you not to have these noninformative-consent COLIs, right?"

Keating concurred, "I think what you're going to do is you avoid individual lawsuits, you avoid public embarrassment. It's pretty hard to explain to somebody [an insured employee who has not given his consent to the insurance] that something's been done to him without his knowledge."

Dilemma 5: Vehicular homicide on company time–in China

A 17-year American employee of company ABC had been in China for about six months on a project, and three to four days before he was due to return to the United States from the assignment, he was involved in a vehicular homicide–a case of drunk driving. The rules at that point in China were very strict in requiring incarceration in cases of liability. Whether you're an "expat" or not had absolutely no applicability in terms of how the case was viewed by the Chinese justice system. When the employee came before the magistrate, representatives of the company, including a local attorney who understood the culture, said to the judge that they would like this person released on personal recognizance and that the company would take responsibility for this person. The company put its corporate good name before the judge as its sacrifice. The employee was released.

The company's senior executive in China heard there was a high probability this was going to make the newspapers within a matter of hours, and so proposed that the company offer the family a substantial sum so that the family would drop the case. It was hoped that, through that effort and the good graces of the State Department and possibly others, the judge would understand that typical action should not apply in this case for a variety of reasons, including the fact that the employee was working on a project that might benefit the government of China. The case was messy and ugly–and human, since the employee charged with homicide feared being in a Chinese prison for the rest of his life, and yet by his own admission, caused this person to die. He did something stupid, but he was on company time, on a company project.

What was the responsibility of the company when its employee gets into trouble abroad? The trouble was not malicious. It was not extortion. It was not embezzlement. It was an accident caused by stupidity. At what point does the company take responsibility for its employees?

Keating said the company cannot ignore responsibility, but at the same time, before proceeding with a substantial payment, it is important to investigate the legal system of the culture and whether and when negotiations to "make the family whole" are appropriate. "Clearly the company cannot ignore responsibility–certainly, indirect responsibility–

because it will be the person, in a corporate sense, in the newspaper who is responsible, not this guy who actually killed somebody. The good will of the company long term in China is at stake. The Chinese are very sensitive to those things."

Bob Solomon of the University of Texas–Austin strikes a pensive pose during the Forum.

If you don't know how these decisions are handled in that culture, you could act prematurely and the end result could be "terribly inept," Keating continued. He added that if a similar offer was made to an injured family in the United States in exchange for dropping criminal charges, the company would be guilty of obstruction of justice.

Daryl Koehn said that the issue of "expat" status changes the situation. "In China, you're not allowed to have public counsel," she noted, adding that the last time she was in Hong Kong, there was complaining because the lawyers do not even have to be told where their client is being held in prison by the Chinese government. So she thought that the company is responsible to do some things because they've put this person in a much more vulnerable position than they would have been in the United States.

Koehn also noted that drinking games are a popular way of entertaining business people in China. "It may very well be that the company, in the past, encouraged this guy when he was doing business to abide by local customs, which include drinking games. Those facts would all be relevant in the case."

Freeman said that while you are bound by the laws of the country that you're in, "A reason a company might go to bat for the employee is, they don't want an employee of theirs to end up in a Chinese jail. It's that simple. The company's obligation to its employee might outweigh the obligation it has to obey the laws of China."

The practitioner who raised the case said one concern was that, if the news of the settlement made it into the *Wall Street Journal*, it might send the wrong message. It was also important to consider how members of Congress would react when they read that article.

As these issues were being debated within the company, it learned that the employee had bought a fake passport and already exited China. He had been desperate to get out of the country and desperate to get home to his family.

The practitioner continued, "Our feeling was that at that point he had broken not only their trust, but our trust," he said. "He had been given every benefit of the doubt, but at that point, no more. He was aware of the fact that we were making every effort to get him out. It might take a little longer than he wanted, but the reality was, we were going to defend him even against our own best judgment. But when he exited China, his behavior was not acceptable. So the company assisted with his extradition back there. He was given a reduced sentence as opposed to life in prison, and probably has another two years to serve."

BEST PRACTICES IN CORPORATE ETHICS

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The Forum discussions then moved from examining cases to investigating issues raised by the academics about best practices. Tom Dunfee began by asking the executives how financial services companies mount proactive responses to problems and potential problems. He cited several examples in other industries. "These are people who are very proactive. They aren't waiting for the problem to surface. They are trying to anticipate it. In what areas are you being proactive or should you be proactive? How many complaints have each of you seen in the last year in terms of marketing practices or anything within your company? And if the answer is a low number, are you comfortable with that? Do you, in fact, have a system that is actually revealing to you where some of the problem areas are?"

Addressing complaints

Dan Toran noted that Penn Mutual's controls on monitoring complaints are aggressive and actively overseen by a combination of departments–an audit department as well as a quality team in every department, which is actively looking for complaints. "Any business that doesn't have a very effective mechanism [of logging and tracking complaints] in this day and age is just looking for trouble–sometimes legal trouble. We also have a philosophy that, if you haven't responded appropriately, the complaints only get worse. The longer they're around, the worse they get. Respond to them as soon as possible and deal with them straight."

Toran said that Penn Mutual works with the Life Insurance Market Research Association (LIMRA) to survey clients after a sale to be sure the clients know what they bought and if they had any complaints. The company forwards these responses to the agent so he or she can follow up with the client if need be. "I do not believe that we are unique in the industry in our fairly aggressive posture on this," Toran continued. "I've heard from peers and counterparts I've talked with over time that they're usually using the LIMRA program or some other program in searching out best practices. It's sound leadership style to stay aware of the hot items."

Casey Sylla said that his company focuses heavily on producers and underwriters. "If you want to find people who have pressure day to day, look at an underwriter. The producer is trying to do one thing, he's trying to get that policy through, he's trying to get it through at the best rate he can get for his customer. So underwriters get a lot of pressure and a lot of calls coming in. I guess you could call them complaints."

In investigating these calls, the company finds that often what happens is that information is incomplete or inaccurate, or there's a dispute over the underwriting. "And so we go back and we take a look. We grade our underwriters. We constantly review–we have a substantial effort focused on quality execution. We have many people in our organization doing nothing but reviewing processes, and we have teams doing audits."

Jim Middleton said that his organization does not have the same issue with having to deal with producers. "Our only customer is our customer. We don't deal with producers because they're not the ones that we're trying to satisfy. We're trying to satisfy our members both in service and from a competitive standpoint." He noted that the organization doesn't have "any big pressure points with underwriting," except that, given the volume of business it does, "I always watch issues because I don't want any undue pressure on underwriting with stuff that shouldn't be an issue. That's really why we've got great mortality." In terms of handling complaints, he noted that he is apprised of all of them, and will talk to members who insist on talking to the chief executive.

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Toran said that it is important that the top leaders in an organization set the tone for customer service. "If you want your people to be responsive to the customer and complaints, the leader must be responsive. As soon as they see you doing it, they in fact will, too."

Toran mentioned that his company also provides instructions for call-center staff when they get unreasonable complaints from producers. "We have guidelines where we tell them that we do not want them to take that abuse." He described how several years ago the company terminated a producer for speaking inappropriately to a call-center staff person. "If you don't think every call-center associate throughout the company wasn't watching for that, you are just not aware. When the producer was terminated for inappropriate conduct, there was applause across the company. It all comes back to respect for the individual. We expect that in our company."

Is more "compliance" the answer?

Pat Werhane raised the issue of the long-run effectiveness of compliance efforts such as the Sarbanes-Oxley Act or securities industry investigations by New York Attorney General Elliott Spitzer. "I don't know if that's going to solve our ethics problems, or if people aren't going to shave the law again, just right on the edge. What is the responsibility of the company or agent to take proactive stances–to think about self-monitoring–rather than waiting for Elliott Spitzer and Sarbanes-Oxley, and various other regulations?" Further, how can the industry start thinking about the moral reasons behind its actions rather than just complying with the law?

> "As leaders, you keep digging, you keep looking."
> **–Sylla**

Jim Mitchell pointed out that one such effort was the founding of the Insurance Marketplace Standards Association (IMSA) as a way for the industry to police itself. IMSA encourages voluntary assessments by insurance companies of how they operate in the marketplace–a "Good Housekeeping Seal of Approval," so to speak, for companies that meet IMSA's standards, he said.

Sylla noted that corporate boards of directors are emphasizing responsibilities beyond serving as fiduciaries or shareholder representation. His company also emphasizes employee input. "We have employee hotlines, where employees can report on any activities or things that they see [that are unethical]. They can come in confidentially, and it all gets logged into a system. All input is reviewed. The input could be anything ranging from recognizing certain behaviors at work that might be inappropriate, to activities where people are shortcutting. As leaders, you keep digging, you keep looking."

Jim Middleton of USAA Life Insurance Company (left) and Frank Keating of the American Council of Life Insurers were among several practitioners from the financial services industry who participated in the event.

According to Sylla, regulatory efforts like the Sarbanes-Oxley Act cost the industry millions. "These are costs to society. There's a huge cost of trying to do the right things right."

Concurring with Werhane that regulation alone will not achieve the desired results, Daryl Koehn cited the example of the Japanese dairy company Snow Brand Milk. Snow Brand took dramatic steps in response to the deaths of 3,000 people and related hospitalization of some 15,000, arising from poisoning from the company's milk product. "What the people at Snow Brand had done in response to their problem of trust is really just awesome. They've reconstituted their board to put an independent consumer advocate on it. The current CEO wrote personal letters to all 13,000 families of the people who were poisoned, apologizing and taking responsibility in the name of the company for what had happened. The company now has a memory day this year. It's a day in memory of the scandal so that people will never forget the hole that they made in Japanese society."

Koehn asked whether an American company would respond that way, particularly in response to recent ethical violations, or if "we are just going to be tinkering around with Sarbanes-Oxley regulations." Given the increasing cynicism of people about American business in general, she thinks merely succumbing to compliance will be a real problem.

Larry Barton said the crisis literature is filled with cases where executives have humbled themselves and distinguished their companies, but the circumstances behind a crisis heavily influence how ethical and candid the response may be. "There's a big difference

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between apologizing when you have an incident in your facility, such as an industrial accident that's unavoidable, versus complicity–when you have a company that intentionally knew of misdeeds by the CFO, the senior executives–that's when the public loses patience."

However, Koehn reiterated her opinion about the Japanese company's response. "This goes beyond saying, 'I'm sorry.' I guess the company did admit they had been negligent and they had been indifferent to the status of things. It's really kind of amazing that a year and a half later, the company has done so many things in a kind of proactive way to develop trust and to get regular feedback. That, I think, goes way beyond just saying, 'I'm sorry.'"

"…when you have a company that intentionally knew of misdeeds by the CFO, the senior executives–that's when the public loses patience."
–Barton

Bob Solomon said that the typical American corporate response is often framed by the difference in liability laws in this country. "I'm appalled when I read the first instruction in an insurance policy booklet, that if you're in an accident, don't admit it. So even if you're the one that hit the other person, you can't get out of the car and say, 'Gee, I'm really sorry.' It seems to me that has permeated the entire society. It's not surprising, then, that it's permeated the corporate thinking. So, of course, a CEO can't get up and say, 'I'm sorry.'"

Mitchell agreed. "Corporations are just like people. They're going to screw up sometimes, and they have to acknowledge it or they're not going to be credible. I think there are times as a CEO that you've just got to ignore your general counsel–who will always advise you to say nothing–and say, 'Yeah, we messed up and we're going to try to make it come out right as best as we possibly can.'"

Toran said that some companies are responding in appropriate ways, but the public may not always hear about it. "We had a $5-million problem in one state–a sales rep that misled some people–and we notified the state authorities. We set out immediately to contact those people and make them whole. It cost us $5 million up front to say that it was our rep–what he sold…and we knew nothing about it. Could we have gone to court and proven that we were not at fault? Possibly. But that wasn't the issue. Older people who were our clients were out $5 million, so we went and made them whole."

"Most business people are really quite ethical creatures," Mitchell replied. "We asked the executives at our Forum last year, why they weren't willing to publicize their commitment to being ethical. Basically the answer was, 'If I speak out, I might as well paint a bull's eye on my back. I will become a target; I will become a target for plaintiffs' attorneys, regulators, and the press. So I can't speak out, or at least I won't.'"

How to rebuild the public trust… and encourage "push back"

Ed Freeman raised the question: How can companies encourage employees to "push back"–that is, encourage dissent and discussion about company operations and related ethical issues, and challenge management to address them? He related a story about how his young son asked him about why, if he was committed to spending time with his family, he had to go on a business trip abroad, requiring him to fall short on this commitment.

"He looked at me and said, 'What's more important, Dad, your job or your family?' And I said, 'My family, Ben, of course.' He said, 'You're not acting like it.' I had clearly given him permission to push back. It was very painful. I told him, 'Look, I've got to go on the trip…I've got to do it. I'll stay home next summer. I won't go anywhere. I'll coach your baseball team.'"

The point is, Freeman continued, he had given his son permission to push back, a practice that company leaders need to encourage as well with their employees. "My sense is that in a lot of companies a lot of folks think they're good guys. They think they have an open door, and that people will push back. I just don't see how some of the scandals could have occurred if there's a culture of people pushing back and asking questions, saying, 'Why are we doing this?'"

Barton recalled how, since becoming president of The American College in July 2003, he had surveyed employees twice, and found them willing to share what they felt he needed to know in taking on the organization. "The yield, for me as a leader, has been tremendous. The insights, the suggestions, including how I can help the performance of the team, have been wonderful."

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Employees who raise questions expect a response back, he said. "They simply want to know that you're listening, and you can do small things to show that you can be heard about that complaint or that concern. I think it moves the needle in the right direction. It's not very scientific, it's not very fancy, but for me, personally, it worked throughout my whole career in saying, 'Folks, I care. Tell me what you think.'"

Sylla said that, in pursuit of this improved communication, "You never really know if you're successful or not….The larger the organization, sometimes the harder it is. The communication is not just a big deal. It is a huge deal."

Sharing conversation over the dinner that preceded the Forum were (from left) Daryl Koehn of the University of St. Thomas; her husband, Julian Brown; and Amy Toran, wife of Forum participant Dan Toran of Penn Mutual Life Insurance Company.

All of Sylla's Allstate staff participate in a periodic leadership questionnaire, where they focus on questions like: Are you getting the straight story? Do you witness bad behavior in the workplace? The end result is valuable feedback that enables the company to evaluate its operations. "When you get tired of communicating, all you can really do is just communicate more. It really was hard for me for a long time to understand you've got to tell people the same thing many times, and you've got to be willing to listen."

However, Sylla noted, not all leaders in all companies want to be talked to. "If you don't have a receptive ear at the top of the organization, people know when to clam up. They figure it's not worth their time. But if they respond and you fix it–it could be something small–the word spreads. All of a sudden, something like that will lead to a whole lot of stuff being communicated."

Reiterating Sylla's emphasis on the importance of communication, Toran noted that Penn Mutual uses what it calls its "360 Degree Program," which involves surveying employees about company issues that are important to them.

"It's about finding ways to keep on communicating. And finding the means to facilitate that feedback. Different leaders have different styles, but they all have to be working at getting feedback constantly."

Mitchell also emphasized the importance of the employee survey. "The hardest thing for any CEO is to know whether they're getting straight feedback. Because the message gets a little more sugarcoated at each level of the organization. I hear a lot of CEOs, even post-Enron, say, 'We're a very ethical company.' And my response is, 'How do you know? Unless you've taken an anonymous survey recently of all your employees, how would you know?'"

"When you get tired of communicating, all you can really do is communicate more."
–Sylla

Freeman said his favorite case of this openness to feedback was Jack Welch at General Electric. "Candor was a part of it…. Welch, again and again and again, tried to get people to bring up what was wrong, tried to get people to push back. It's got to be surveys, it's got to be touching the people, it's got to be all this stuff. And you've got to be skeptical about whether you're getting the truth."

Sylla said that employees also are skeptical. "They want very much for the companies that they work for to be respected. They want to go home and tell their families that they work for good companies who are doing good things." With recent corporate failures affecting employee pension plans, employees had questions about their own plans at Allstate, and the company responded, he said. Communicating with employees is key to helping them understand their importance in the organization. "You can make them feel it, you can take on the world with people. That's how we try to get at it–just work our tail off talking to people, and we don't get them all."

Mitchell noted that the Enron culture was the opposite of getting people to ask questions, to push back. And for board members receiving $250,000 to $275,000 in compensation, there was not a great incentive to question management decisions, Sylla added.

Using the auditors

Based on his experience serving on corporate boards, Frank Keating suggested that they could make better use of internal and external auditors in evaluating company operations. "There should be a hotline to the audit committee–it's amazing the stuff we get, as opposed to the CEO or somebody else."

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Sylla concurred. "And the other step is, to take it even beyond that…the board reconvenes without any management present. There may be one or two people from the management team on the board who would excuse themselves from that portion of the meeting. The lead director takes over and presides over the outside directors who meet without management present."

How to institute virtue and integrity throughout the industry

Solomon noted how business ethics, when he started in the field 25 years ago, focused on large policy questions–contractual relations between companies and about companies. "My idea was that this was incomplete, that the way to look at business ethics is on the individual level–every employee in the corporation, because it's not just something that happens in the executive suite."

Drawing on Aristotle, Solomon said, he honed a philosophy that business ethics should focus on character, virtue, and integrity. "At the same time I became keenly aware of a point that Dan [Toran] has been making all day, and that is that virtue and integrity have to start at the top and it filters its way down the organization."

Larry Barton (left), president and CEO of The American College, chats with Casey Sylla, chairman and president of Allstate Financial, at dinner the night before the Forum.

He said that while people may be autonomous and capable of making their own decisions, they are also heavily influenced by what goes on around them–and on top of them. So he asked the group, "How do you manage to institute and encourage virtue and integrity throughout the corporate industry? How do you encourage people not just to comply with the law? How do you get people to act with a sense of virtue, honesty, trustworthiness, and so on? What kind of practical mechanisms can you implement to do this?" Solomon suggested that the possibility of shame and embarrassment–people and companies don't like to be humiliated–tends to discourage people in the business community from saying what they think about each other.

"If people in the business community were to vocally and publicly turn on their malfeasing colleagues and shame them, it seems to me it would be a very powerful influence," he said. "So, too, in the corporation itself." Citing the honor code at Princeton and other universities–where personal behavior reflects on the integrity of the group–Solomon thought that a similar code should be instituted in corporations as well.

"How do you manage to institute and encourage virtue and integrity throughout the corporate industry?" **–Solomon**

"We need something more like that in more corporations where people don't just think in terms of doing their job and doing it well, but think that this organization and its status are their responsibility." He added that companies rarely cite employees for routinely doing virtuous things or routinely acting with integrity, but instead focus on oftentimes "unassailable" criteria, typically focusing on money or sales. "We don't have anything comparable for rewarding people who just act well, who just do what they're supposed to do but without the dramatic financial results."

He went on to ask how the companies represented at the Forum "work" their promotion and reward system so that issues of integrity and ethics are highlighted.

Mitchell answered that in his tenure at American Express, the company focused on four values, and on a quarterly basis gave "Values in Practice" awards. "We made heroes out of all of these people as best we could, and our employees understood that we were serious about these values, and that we were actually looking for good examples of behavior to single out for an award. It let us say, 'See, that's what *Clients Come First* looks like, that's what *Excellence is a Journey* looks like.'"

Mitchell noted that American Express also had made extensive use of an annual 70-question, all-employee survey. A significant part of his compensation was determined by how his company's survey results compared to those for the rest of the corporation. "I am a big believer in employee surveys. You can spot unhealthy departments in otherwise healthy organizations. The trouble spots will show up right away."

BEST PRACTICES

Removing problem employees

Sylla noted that removing employees who present ethical problems within organizations can be a challenge. “Good organizations sort out the chaff from the wheat, so to speak. The issue is, will leadership–and I’m not just saying the CEO–look the other direction? All too often they’re tolerated.” Moving people out of organizations is often difficult for legal reasons especially if their actions have not been documented satisfactorily.

Mitchell replied that in some instances it is easier than others. “You get an opportunity once in a while when somebody manifestly brings shame upon themselves. Every organization has people that screw up, that violate the law. When you fire them, it gives you an opportunity to say, ‘That’s not who we are. What that person did is absolutely unacceptable.’”

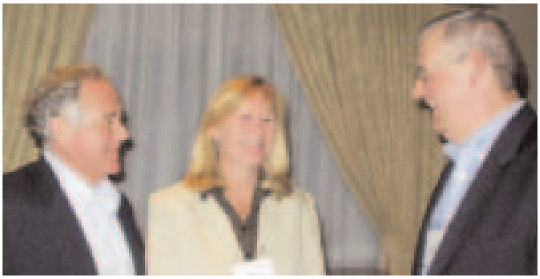
> “A corporation isn’t a free-for-all. Freedom can only exist in a corporation within the boundaries.”
> **–Mitchell**

Unfortunately, Freeman noted, in some cases–such as with the board of Enron–there are not always “loud calls for shame.” Instead, as Ron Duska noted, in some business cultures described in books like *Power Failure, Liar’s Poker, Moral Mazes,* and *Serpent on the Rock,* the shame is that you haven’t taken advantage of someone to make the numbers. “It’s the exact opposite kind of shame,” Duska said. “In such cultures the expectations are making the numbers and playing the game and not worrying about the customer, not worrying about the product, just making the numbers and playing the game.”

For this reason, shame has to be tied to virtue, Solomon replied. “A new employee makes a casual comment about having padded an expense account, and everyone listens for what the immediate response from the colleagues is. Forget about the boss, forget about the accounting department, I mean, if the colleagues say, ‘Yeah, I do that, too,’ you are in trouble.”

How to achieve freedom within boundaries

Koehn provided an alternative perspective of the Enron case, since some of her students worked for it or related companies. One of them, who had worked at Enron, extolled the company for its “creative environment” where she could, in fact, make a contribution. “You can begin to see how seductive a culture it was. And people's other options are Starbucks or working at some kind of job like that. To be given this wonderful opportunity to be in a dynamic industry rather than an 'old fogies' kind of industry, I could see what that appeal would be like to very bright capable students coming out of top universities."



Forum co-host Ron Duska (right), the Charles Lamont Post Chair of Ethics and the Professions at The American College, welcomes Jim and Linda Middleton to the reception that preceded the Forum. Mr. Middleton is president and CEO of USAA Life Insurance Company.

Mitchell countered by suggesting that the lack of boundaries at Enron posed problems. "A corporation isn't a free-for-all. Freedom can only exist in a corporation within the boundaries. You have to be clear what the boundaries are." Sylla added that the key is in balancing the constraints–the bureaucracy–with the need for a creative environment.

Koehn replied, "I think you're absolutely right about what freedom ultimately is. I don't think 20-year-olds necessarily see it that way." And if the business leaders do not make that case in some kind of engaging way to students, they may experience the bureaucracy as a constraint or an impediment.

"Wall Street" versus "Main Street"–shareholder value versus stakeholder value

Duska said that, in examining the Enron and Arthur Andersen cases, he finds that companies are losing their focus. "If you don't have focus and you don't know what you're about, as Aristotle says, you have no limits, you do what you have to do to make a profit."

Sometimes focus is lost when a company specializing in one type of product, such as insurance, brings in as CEO someone with expertise in a very different financial services area, like securities. "Here's a securities guy trying to turn a life insurance company into a securities company, and you get this real tug," he continued. "So I think it's really, really important to look at the product you're selling. And to let your employees know they're helping the company make and sell and distribute this worthwhile product. We're not just making money. We're helping all the stakeholders."

BEST PRACTICES

Freeman suggested that good management has been hijacked by a focus on shareholder value only, focusing only on "Wall Street," versus the value provided by the business to customers, suppliers, employees, and the community–"Main Street."

"In a world in which there isn't much growth, the only way to focus on Main Street is to figure out how to innovate, how to do new stuff," he continued. "That was the good part of the Enron culture. They got the innovation, but what they missed was the purpose. They falsely thought that purpose could be just the shareholder value. Peter Drucker said a long time ago–you've got to make money, but profits and shareholder value don't work as a purpose. We have a chance, a moment, to get that right. But I'm not terribly optimistic, because the shareholder value thing has such a stronghold."

Mitchell said, "We've got to get back to thinking about shareholder value over time as a consequence of doing the rest of the things that you say. Part of what got screwed up in the '90s was so much emphasis on short-term stock prices."

Freeman responded, "I think we need to create value for all the stakeholders in the short-term. I think we need to do this now, not just over time, but how do you do it now? You put these interests together in a way that creates value, and then you keep it up, but you have to be innovative."

Mitchell noted that a recent book, *Authentic Leadership*, by Bill George, retired CEO of Medtronic, addresses this point. "He does emphasize creating value over time. He is, of course, demanding results in the near term, but he makes the point that you can't manage your company for Wall Street. Their point of view–their interest–is different from your interest in creating value. You have to pay attention to Wall Street, but you cannot be a slave to it."

There is a problem with focusing only on long-term results in the area of ethics. "The way you start to make progress is by putting ethics right in front," Mitchell said.

CONCLUSIONS

To wrap up the session, Jim Mitchell asked the participants to summarize what they got from the day and what they would reflect on tomorrow.

Daryl Koehn was struck by the diversity in the industry. "We get into sweeping claims about ethical problems and they may not, in fact, be equally true of all kinds of companies. It was a little bit eye-opening for me to realize just how diversified the insurance industry is in itself." For the future, she planned to think about the importance of the push-back factor in dealing with CEOs. "If we can't depend upon regulation to make us better companies, then it seems to me we're going to have to rely upon the CEOs of the company. So you do have to have this kind of push-back. I think how you institutionalize push-back at the level of the rank and file and of the board is a very big question."

Frank Keating noted that his take from the day was an even stronger sense of the need for laying out best practices in the industry. "It's a cross-collateralization system, which means every company ought to have a real interest in the business and ethical practices of its fellow companies. Further, every company needs to be much more involved in the industry as a whole, how it's doing, and certainly how its ethics is."

Keating also said he came away with a greater commitment to compliance within ACLI and its use in providing further discussion of the issues of integrity, honor, legality, and moral uprightness.

Jim Middleton especially thanked Casey Sylla and Dan Toran for their ideas about best practices, some of which he planned to implement in his organization. He also noted that the academics brought some practical understanding of business to the table. "What I really walked away with is an appreciation that you academics do understand the practical aspect of it–that it's not just a theoretical deal. You're able to go back to the classroom and say, 'I sat down with some industry guys that deal with this stuff, and here's the theory and here's how it works.'"

Pat Werhane said she hoped that all the participants could go on to develop best practices projects where they say, "If we don't act this way,

"You're able to go back to the classroom and say, 'I sat down with some industry guys that deal with this stuff, and here's the theory and here's how it works.'"
–Middleton

CONCLUSIONS

we're doing the wrong thing." She was also very encouraged by the fact that IMSA was driving the industry to be more self-regulatory. But she noted that it was important for the industry to do some push-back of its own against regulations that might not be appropriate. "I know that's a risky thing to do, but I think of it as an industry-wide project."

Tom Dunfee said he planned to take away from the day two "puzzles"–one, what ethical issues arise from viewing life insurance as a "commodity," particularly in the area of price, and two, how ethical divisions can occur between the "upstream" (supply side) and the "downstream" (customer) channels in business.

Larry Barton said that, as an educator, he was concluding the day with considerable optimism. "We can focus too much on problems. I think the good news is that this group includes senior executives who are very much in touch with their organizations. Public perception may be that you're out there doing martini lunches, that you're 'working' Wall Street analysts, or you're addressing internal issues, but you are not necessarily cognizant of endemic, ethical challenges. This program helps dispel such notions if we apply the standards we discussed on a daily basis."

Bob Solomon noted that the day made him think about how trust lies behind everything the practitioners in financial services do. In the future, he said, he would like to hear more about customers, and he questioned the assumption of some of the practitioners that people who buy financial services products, particularly seniors, are thinking rationally. "It seems to me that the real problem, when you're selling the kinds of things you're selling, as opposed to, say, mutual funds, is that there are very deep emotional attachments, denial, and so on that are going on in the customer's head. I would like to hear more about how you would respond to that."

He also said he would like to hear more, in the future, about what companies do about the "bad apples" in their organizations. "Do you just keep doing what you're doing, do you report them?" he asked. "It seems to me that there is a kind of responsibility that each company as well as individuals have to monitor and check what's going on in our immediate work area and in the whole industry."

Ed Freeman said that the Forum furthers his quest, as a teacher and a researcher, to understand general principles of business he can take back to the university. "One of the things that's been reinforced here today is that every business is different," he said. "I'm searching for principles, I'm searching for ideas that work. I understand that USAA is different from Allstate, is different from Penn Mutual, and am trying to find the healthy 'intertwine' between the differences of cases and the differences in your executive jobs, to find what might be general to teach students."

He also said he thought the extensive discussion of "pushing back" had given him lots of ideas to discuss with students and other executives.

Casey Sylla remarked that the Forum made him think about how the academic world has extensive resources and "great minds" thinking about issues that could help the industry do a better job. "This is where the leading edge is, in my view, of what will hit the corporate world down the road. I think it's going to be exciting." He also said that the day "re-energized" him to return to his company to further the ideas discussed at the Forum.

"There is a kind of responsibility that each company as well as individuals have to monitor and check what's going on in our immediate work area and in the whole industry."
–Solomon

Dan Toran expressed his thanks for being invited to the Forum. "It's reinforced some good things for me and I encountered some new ideas on how to reach out to my folks even better than we do." He said that he was "pleasantly surprised" at how "well-grounded" the philosophers were in reality and that there was not a large gap between the "ivory tower" and the real business world.

Ron Duska said he gained renewed optimism from the Forum. "I did a review for Daryl of three books about companies with unethical practices–one about Enron, one about Andersen, and one about the Equitable Life Insurance Society before the Armstrong Commission, and was pretty pessimistic [about the industry]," he said. "Coming to The American College and participating in forums like this gives me many opportunities to talk to and interact with decision makers in a really fascinating, interesting industry. They turn out to be some of the best people I meet. I find they are deeply committed to running an ethical company. Dialogues such as this one today renew my optimism toward the possibility and reality of ethics in business."

CONCLUSIONS

Mitchell concurred with the others that he came away from the conversations with a sense of energy. "Part of why I get that energy is because I like to learn, to rub minds with smart people. And the topic of ethical leadership is just very near and dear to my heart."

He emphasized the importance of creating the right culture in companies today. "I believe that every employee deserves the opportunity to do meaningful work, that is fulfilling and challenging. Creating the kind of culture where every employee can contribute to the mission has a huge payoff in terms of productivity and all the stakeholders win."

> "Coming to The American College and participating in forums like this gives me many opportunities to talk to and interact with decision makers in a really fascinating, interesting industry. They turn out to be some of the best people I meet… they are deeply committed to running an ethical company. Dialogues such as this one today renew my optimism toward the possibility and reality of ethics in business."
>
> **–Duska**

Creating those kinds of cultures is "noble work," he concluded. "I appreciate all of the contributions that each of you is making to help create ethical business cultures." He said he looks forward to increasing The American College's influence in the area of business ethics, and including the participation of the executives and academics in this effort.

The James A. and Linda R. Mitchell Center for Ethical Leadership in Financial Services

Nearly a century ago, ethics became the cornerstone of Dr. Solomon S. Huebner's pioneering work in establishing life insurance as a professional calling–in particular through the institution he cofounded as The American College of Life Underwriters in 1927. It has continued to remain a critical part of the mission of The American College, even more so with revolutionary changes in the financial services industry.

The impact of Dr. Huebner's vision continues today through The College's **James A. and Linda R. Mitchell Center for Ethical Leadership in Financial Services,** the sponsor of the Forum. The Center was founded by Mr. Mitchell, the retired chairman and CEO of IDS Life Insurance Company, and Mrs. Mitchell to foster discussion about, and promote practical applications of, ethical leadership in financial services. Through the Mitchell Center, The College stimulates thinking by both practitioners in business and ethicists in academe–encouraging ethical behavior in the industry and, through the academics at their own institutions, influencing the next generation of business leaders.

For more about the Mitchell Center visit The American College's Web site at www.amercoll.edu (Ethics), or contact Ronald F. Duska, PhD, The American College, 270 South Bryn Mawr Avenue, Bryn Mawr, Pennsylvania 19010, (610) 526-1387, ronaldd@amercoll.edu.

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