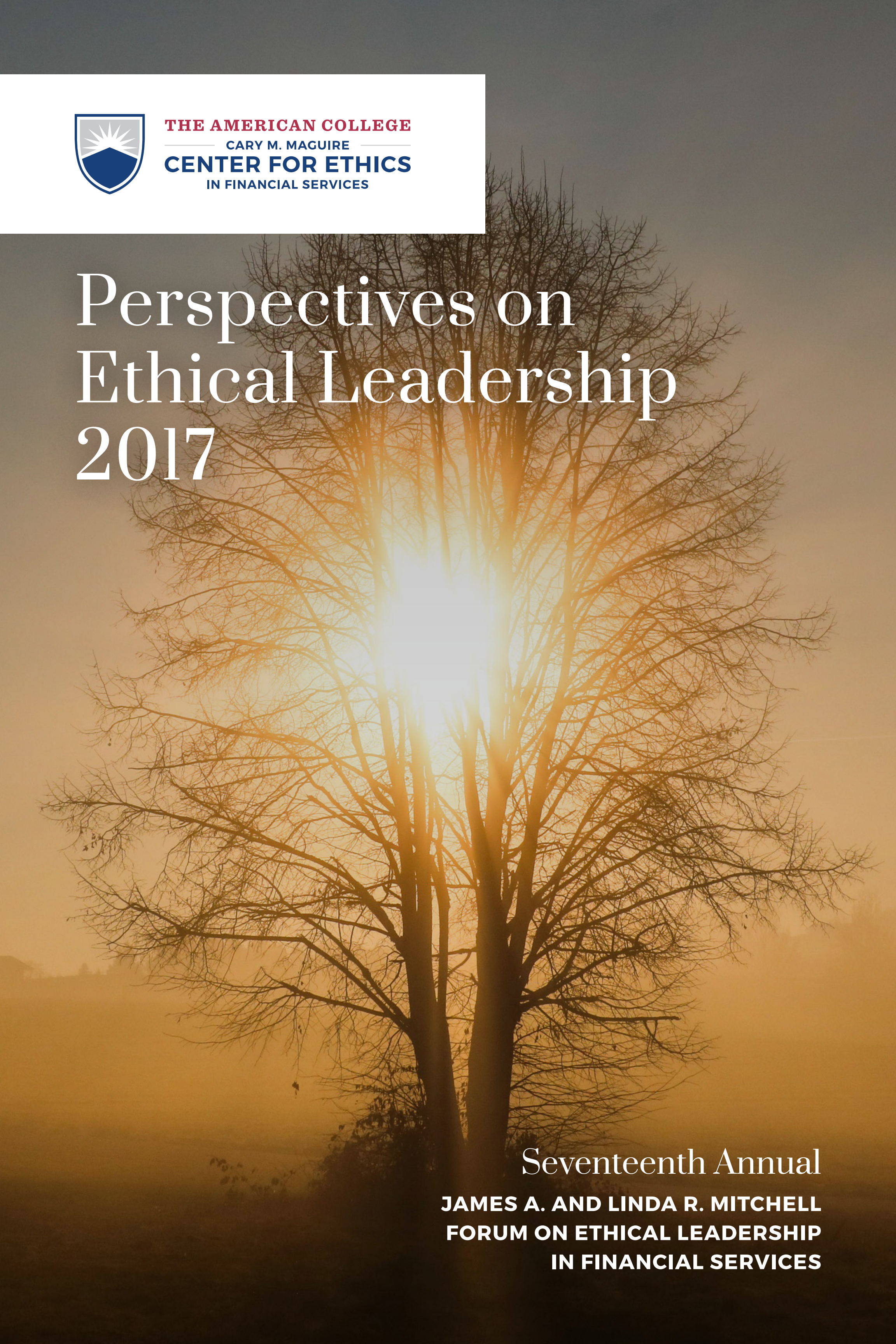


THE AMERICAN COLLEGE
CARY M. MAGUIRE
CENTER FOR ETHICS
IN FINANCIAL SERVICES

Perspectives on Ethical Leadership 2017

Seventeenth Annual

JAMES A. AND LINDA R. MITCHELL FORUM ON ETHICAL LEADERSHIP IN FINANCIAL SERVICES

Forum on Ethical Leadership

THE SEVENTEENTH ANNUAL JAMES A. AND LINDA R. MITCHELL/THE AMERICAN COLLEGE FORUM ON ETHICAL LEADERSHIP IN FINANCIAL SERVICES TOOK PLACE ON JANUARY 14, 2017 IN PALM BEACH, FLORIDA. THE EVENT FEATURED A DISCUSSION OF SEVERAL KEY ISSUES CONFRONTING THE FINANCIAL SERVICES INDUSTRY, ALONG WITH AN EXAMINATION OF PRACTICAL ETHICAL DILEMMAS ENCOUNTERED BY EXECUTIVES DURING THEIR CAREERS AND QUESTIONS RAISED BY BUSINESS ETHICISTS FROM MAJOR COLLEGES AND UNIVERSITIES AROUND THE COUNTRY.

Participants

ACADEMICS

AINE DONOVAN, Director, Ethics Institute, Dartmouth College

KEVIN GIBSON, Professor of Philosophy, Marquette University, Maguire Fellow, The American College

ROBERT JOHNSON, President and CEO, The American College of Financial Services

KIRSTEN MARTIN, Assistant Professor of Strategic Management & Public Policy, The George Washington University

CHRISTOPHER MICHAELSON, Professor of Business Ethics and Social Responsibility, University of St. Thomas

ROBERT PHILLIPS, Professor of Management, University of Richmond

EXECUTIVES

CAROLINE FEENEY, President, Prudential Advisors, Prudential Financial

ROGER FERGUSON, President and CEO, TIAA

ANNETTE NAZARETH, Partner, Davis Polk & Wardwell LLP

JOHN HOWARD, Chairman and CEO, BB&T Insurance Holdings, Inc.

JAMES MITCHELL, Chairman of the Advisory Board, Cary M. Maguire Center for Ethics in Financial Services, The American College, Chairman and CEO (Retired), IDS Life Insurance Company

GREG OBERLAND, President, Northwestern Mutual

KURT OLESON, Chief Compliance Officer, State Farm

ROBERT PLYBON, CEO, Plybon & Associates, Inc.

Executive Summary

EXECUTIVE SUMMARY

On January 14, 2017, a group of eight executives and six academic ethicists gathered in Palm Beach, Florida to participate in the Seventeenth Annual James A. and Linda R. Mitchell/The American College Forum on Ethical Leadership in Financial Services.

The purpose of this annual event, established in 2001 by Jim and Linda Mitchell, is twofold:

- To provide executives with an opportunity to reflect on ethical issues they confront on a regular basis with questions posed to them by academics engaged in business ethics education.
- To afford academics the opportunity to engage in discussion about these issues with top-level executives so they can bring that experience back to their classrooms.

The participants pay attention to Aine Donovan's remark.

THE ETHICAL IMPLICATIONS OF A DECISION TO INCREASE INSURANCE PREMIUMS

After the participants introduced themselves and shared their goals for the day's discussion, the conversation turned to the case study. The case study centered on the issues raised by a company's decision to raise the premium rates of existing life insurance customers in response to a persistently low interest rate environment. As the fictitious situation described in the case indicates, these increases, while legally permissible according to the original insurance contract, often take consumers by surprise, and the new terms may make it impossible for them to maintain the same amount of coverage.

The participants observed that the case contained a multitude of stakeholders whose interests needed to be taken into account by decision-makers at the insurance company. While perhaps the most obvious stakeholders were the client in the case and his beneficiaries, it is also important to consider the organization's other policyholders. These individuals could potentially be adversely affected by a decision to keep the client and others in his situations in policies that are underfunded given the persistent low interest rate environment. The participants agreed that this interpretation made the ethical case more difficult since it was not simply a matter of balancing the interests of the company versus those of a group of clients, but rather the need to balance the interests of groups of clients, some of which have different interests.

The participants also discussed two other stakeholder groups that are often unmentioned. The first are the regulators who oversee the industry. Participants observed that, since the State Department of Insurance approves the language of every insurance contract issued within its jurisdiction, they play an important role in looking out for consumer interests. Participants also noted that the insurance company's competitors are a stakeholder in this situation. Participants expressed concern over the seemingly constant 'drip-drip' of bad news about the financial services industry. Consumers are often unable to distinguish between companies (or even between sectors) within the financial services industry. Participants worried that this meant that the ethical problems that plagued one organization could be imputed to other companies as well. This 'tarring with the same brush' decreased the level of public confidence in the industry and made the task of earning the confidence of individual consumers even more difficult.

Participants also discussed the distinction between law and ethics, noting that simply because a legal contract gave the company the right to perform a certain action, this did not mean that it was the right thing to do. Such reliance on increasingly opaque and lengthy contracts to govern obligations to various stakeholders is especially problematic when consumer financial literacy is understood to be quite low. The participants agreed that individual financial advisors had a responsibility not only to make sure that their clients understood the terms of the product at the point of sale, but also that clients were regularly updated regarding changes in the product and how those changes would impact their overall financial security.

EXECUTIVES' ETHICAL DILEMMAS

In this segment of the Forum, the executives each presented an ethical situation or problem that they had encountered in their careers.

The first executive shared that while he was the head of a prominent industry organization, he was asked to lend his support to a strategy designed to supplement the funding of a large public sector pension fund. The strategy involved a product called 'investor-owned' life insurance. Investor-owned life insurance policies are funded by investors, rather than by insureds, and it is these investors who pay the premiums required to keep the policy in force. These investors are listed as the beneficiaries of the policy and receive the death benefit payment when the insured dies. In the case of the proposed strategy, part of the death benefit would be directed to the public sector pension fund, with the remainder directed to the investors as part of their return. The executive could not support the expansion of these products, which he believed

Bob Plybon, Kurt Oleson and Christopher Michaelson listen to Greg Oberland.

undermined the ‘why’ of life insurance, which is to provide financial security to the loved ones and dependents of the insured in the event of their death.

A second executive discussed the challenge of how to respond to various interest groups who are seeking to influence the decisions of companies. While the executive believed that it was important for the company to be responsive to the concerns of the communities it serves and to conduct business in accordance with accepted moral norms, the demands made by these issue-based organizations are often contradictory and outside of the scope of the company’s core business. The executive wondered how his company and others should respond to these requests.

A third executive recalled the challenges they had faced in developing and pricing a new disability insurance product. In the 1980s and early 1990s, the market was enthusiastic about disability insurance, which was often sold in combination with life insurance. Companies competed to offer an attractive benefit package at competitive rates. During the process of creating the product, the executive wondered if the company was creating a ‘moral hazard’ by developing an attractive product at such a low price. Wouldn’t this create the potential of an individual finding it more beneficial to claim a disability than to continue working? Unfortunately, this is precisely what happened in the 1990s and it placed the executive's company (along with several others) in a difficult position. The executive, who was now in charge of resolving the issues created by the unanticipated level of claims, had three objectives: honor the claims of those clients who were truly disabled, identify those clients who were filing false or misleading claims, and protect the soundness of the organization so it could continue to serve future clients.

A fourth executive raised an ethical issue that issuing companies can create for the people who distribute and sell their products. Most consumers are unaware that the person who is selling them a product (usually referred to as an 'agent') has an obligation to look out for the best interests of the issuing company once the client has decided to purchase a particular product. Moreover, it is common for issuing companies to offer a variety of incentives to encourage agents to sell particular products. These incentives coupled with the legal obligations that agents have to the company can make it difficult for agents to look out for the best interests of their clients. One of things that makes this case challenging is that this is a structural ethical dilemma, that is, it is a dilemma that all agents face because of the policies and practices of an industry, and not the result of their choices.

Rob Phillips and Jim Mitchell pay attention to Kevin Gibson's remarks.

A fifth executive took a different approach and discussed how it was possible, and desirable, to place yourself in a situation where you could avoid ethical dilemmas. The executive recounted that they were approached to advocate as a credible expert on the use of a particular product in retirement income planning. While there was nothing illegal in what the executive was being asked, and there was even some persuasive research that the incorporation of this product in a retirement income plan could be helpful for a small group of consumers, the executive felt uncomfortable with the wider incorporation of this particular product into retirement plans, as the product was understood to be complex and risky. The executive emphasized that it was important to have the flexibility and courage to decline business that might lead you to go astray.

The sixth executive also had a human resources issue to share with the group. The executive, during the course of her career, had encountered people who were outstanding performers but failed in terms of being a good cultural match. The executive understood that people who were 'cultural derailers' needed to be separated from the organization, even if they added values in terms of their production. However, the executive was conflicted as to how to respond when representatives of other organizations, some of whom they were personally close to, asked for the 'real story' as to why the employee was terminated. The executive felt an obligation to the person requesting advice, as well as to the industry, to be transparent about the reasons, but at the same time, the executive was cognizant of the fact that other organizations simply were not as interested in cultural fit.

ACADEMICS' QUESTIONS

The first questioner observed that the often-heard statement that 'shareholders own the corporation' was simply not true in a legal sense. Shareholders are not legally liable for the actions of the corporation. The questioner wondered whether the rhetoric of 'shareholder ownership' made it more difficult to isolate who should be held accountable for the organization's actions.

A second questioner wondered how financial services companies were responding to both the opportunities and challenges posed by the increased use of 'big data'? The questioner wanted to know the executives' thoughts on how data should be acquired and how it should be used.

Kevin Gibson, Anika Horn, Rob Phillips, Rhonda Oberland and Greg Oberland at the closing reception.

A third questioner observed that there is persuasive longitudinal research demonstrating that students are increasingly comfortable with cheating. She wondered whether organizations were aware of this shift in values and how they were dealing with it.

A fourth questioner noted that they had been involved in a panel session that asked senior leaders which books had influenced them the most during the course of their careers. He noted that their responses indicated a certain understanding of capitalism as ethically wanting. He asked the executives to share books that had influenced them and whether or not these selections might convey a different way of interpreting the capitalist system in the 21st century.

CONCLUSION

The executives and academics all agreed that the candid sharing of opinions was very helpful. They were all grateful for the opportunity to spend the day reflecting on ethical issues and learning from one another.

Christopher Michaelson contributes to the discussion.

Introduction and Goals for the Day

Jim Mitchell began by observing that, when he was contemplating retirement, one of the things he knew he wanted to do was to promote ethical business leadership. “Over the course of my career, I learned that an ethical culture matters. I believe that if you can create an ethical culture and maintain it, you will get a whole bunch of highly engaged and highly competent employees who will create real value for your customers and your shareholders.”

He noted that academics and practitioners are two groups who do not interact very often. “I think this Forum is an opportunity for people to engage with one another. I hope that the academics leave with some real-life examples of ethical leadership. For the executives, I hope that this provides a day of organized reflection. We are all so busy that it is sometimes hard to step back

Rob Phillips and Kevin Gibson listen to Jim Mitchell's comment.

and think about what is good and true and right. I think that if you don't do that, it's hard to lead your organization to do the right things."

Kevin Gibson observed that while most of the talk in business schools was about rational decision-making, most people do not make important life decisions based on a utility calculation. "When people make decisions about what career to pursue, or what job to take or who to marry, they are making decisions that are based on their values. So, ultimately, these are moral decisions."

He added that when he began in the field of business ethics 25 years ago, people were not talking about concepts like 'sustainability' or 'stakeholders', and the introduction of these concepts shaped the field. "So one of the things that practitioners and philosophers can do is to change discourse and how we frame things. I think that is important. I am thrilled to be here since I am in a room of change agents, people who can actually get out there and do things on both the academic and practical sides."

Rob Phillips said that conversations about responsibilities in business focus on the language contained in the contract. "We tend to think that everything is there in 'black and white', but we only focus on the 'black' and we tend to forget about the white." Phillips added that he thought that the 'white' represented the values of both parties. "It's the

"WHEN PEOPLE MAKE DECISIONS ABOUT WHAT CAREER TO PURSUE, OR WHAT JOB TO TAKE OR WHO TO MARRY, THEY ARE MAKING DECISIONS BASED ON THEIR VALUES. SO, ULTIMATELY, THESE ARE MORAL DECISIONS."
–Kevin Gibson

stuff that the contract is printed on top of, metaphorically and literally in this case." He thought that when conversations focused exclusively on the contracts, it indicated that parties "were not in a good place relationally."

Phillips believed that business ethics has to be more than conflict avoidance. "Conflict avoidance is not aspirational." He is committed to the proposition that business should be a great deal more aspirational. "We need to find out what we can do better together. To me, that has a lot to do with shared values and looking to find values that we can share. This is much better than resorting to something like contracts and courtrooms, because that is always a dividing of the pie rather than a growing of the resources we are allocated."

Kirsten Martin believed that teaching ethics was about focusing on the struggle to get to the right answer, rather than only focusing on the right answer. "And I think that sometimes we, as professors, make a mistake of focusing on finding the right answer, but there can be a plurality of answers." Instead, her goal was to provide students the tools to know how to handle that moment of struggle. Martin emphasized that people can struggle over ethical issues of all kinds, both large and small. "The struggle is in the moments, as I tell my students, that give you pause, that make your eyebrows crinkle just a bit. It happens when you don't know what to do in that moment."

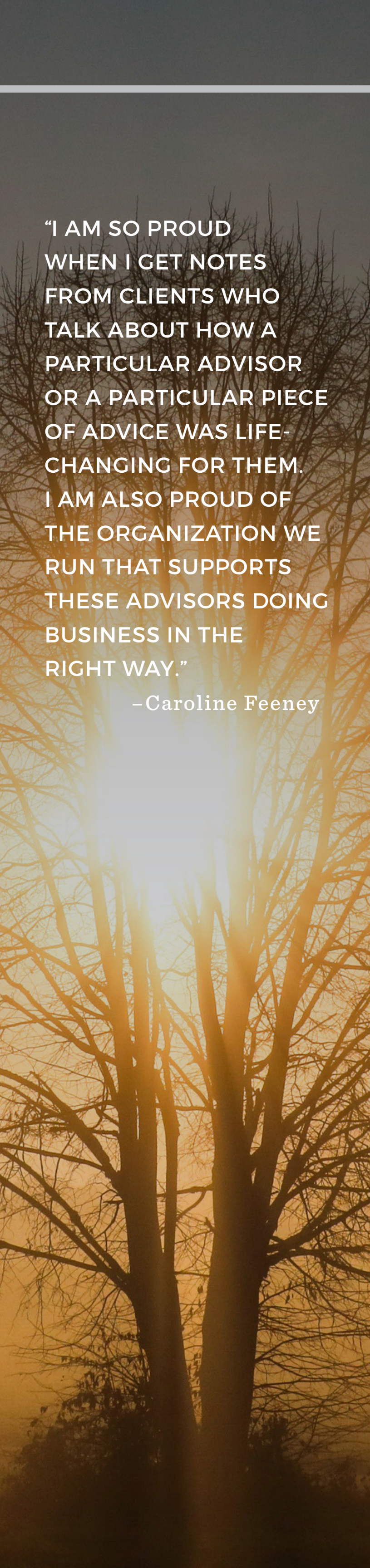
Roger Ferguson stated that, as the head of TIAA, an organization focused on the financial well-being of individuals who work in higher education and the non-profit sector, the question of ethics and values was pivotal. "We ask our participants to give us money every pay period on the trust-based view that we'll save it, invest it wisely, and return it to them when they are ready to retire. We believe that without our values we have nothing."

As the leader of a not-for-profit organization, Ferguson noted that his employees to rally not around the goal of increasing the share price but around the TIAA's mission. "Our values are really the glue that holds us together. Our employee culture survey shows that 98 percent of our employees understand our values and how their work supports our mission.

He was glad to spend the day in the company of academics. "In the business world, we're so in the moment. To take a day and sit back in a moment of reflection with folks who think deeply about these issues can only be a positive for me."

Annette Nazareth shared that she had spent most of her career as a regulator in the financial services industry before moving to the private

Greg Oberland, Christopher Michaelson and Aine Donovan listen attentively to John Howard's comments.



> "I AM SO PROUD WHEN I GET NOTES FROM CLIENTS WHO TALK ABOUT HOW A PARTICULAR ADVISOR OR A PARTICULAR PIECE OF ADVICE WAS LIFE-CHANGING FOR THEM. I AM ALSO PROUD OF THE ORGANIZATION WE RUN THAT SUPPORTS THESE ADVISORS DOING BUSINESS IN THE RIGHT WAY."
>
> –Caroline Feeney

sector. She believed that social values are deeply embedded in industry regulations. "Regulations represent what we think is appropriate behavior, whether they deal with sales practices or with insider trading. They reflect who we aspire to be as a culture."

Referring to people who leave the regulatory side to go to the private sector, she said that she often heard former regulators disparaged, "as if the purpose was to find every way to circumvent those values that you enforced when you were in government." On the contrary, she believed that most former regulators used their experience to educate their clients regarding the purpose of the regulations. "You try to assist your client in achieving their goals in a way that is consistent with those regulations. You become the person who explains that purpose to your clients. I find that by taking that approach, you end up representing people who share your values. It is a sort of self-selecting process. People don't come to you because they know that you're not the one who is going to figure out how to short-circuit the system."

John Howard shared that he led BB&T Insurance, which is a part of BB&T, a company with a long history. "We have 145 years of experience through periods of significant change. We know that the trust that our customers place in us is critical to our success. We earn that trust through our culture and our values."

As a leader, Howard noted that he expected honesty and integrity at all times. "I try to create an environment where associates are encouraged to speak up and ask questions. We encourage associates to acknowledge mistakes or errors without fear of negative outcomes. I am careful not to make quick decisions and take the time to gather necessary facts. I seek the opinion of trusted advisors when making difficult or complex decisions, and I regularly reinforce the importance of ethical decision making." He believed that this was especially important. "You can never assume that doing the right thing is a matter of common sense."

In terms of what he hopes to get from the day, "I'm confident that spending a day absorbing thought leadership from our academic participants, combined with real-world examples from my business colleagues, will expose me to the best practices in ethical leadership."

Caroline Feeney shared that she believed that, like the other organizations represented in the room, that her organization had a strong ethics infrastructure. This is important since in her role she oversees thousands of financial advisors. "I am so proud when I get notes from clients who talk about how a particular advisor or a particular piece of advice was life-changing for them and helped them to fulfill their dreams. I am also proud of the organization we run that supports these advisors doing business in the right way." However, she acknowledged that the answer to the question, 'what kept her up at night?' was that one or two advisors out of the thousands she oversees could put everything at risk. "I think about headlines that can come from the actions and decisions and lack of values of one or two people. I take that very seriously."

Feeney agreed with other executives who said that it was important to be accessible to her team, especially when things are not going well. "I find it's not so much what you say; it's how you react in that moment. If you make it is clear that failure is not fatal, it is just an opportunity to learn, and then people will bring those issues to you."

"WE ARE HELPING PEOPLE PREPARE AND MANAGE FOR UNEXPECTED EVENTS AND HELPING THEM TO REALIZE THEIR DREAMS FOR THE FUTURE. WE NEED TO MAINTAIN A STRONG ETHICAL CULTURE AS A FOUNDATION"

–Kurt Oleson

She was excited to spend the day in the company of academics. "I could have been a professional student. I'm absolutely thrilled with the idea of bringing academics and practitioners together. I know that we'll have a very rich conversation and I am delighted to be here."

Christopher Michaelson shared that before he became a full-time academic, he had a career in consulting. "My first client was a life insurer, and I was able to tag along with the partner on the project and have lunch in an executive dining room very much like this with people like those who are here. And it was very easy to feel early in my career that I was much more important than I was and had achieved more than I had."

The memory of that feeling was important since it reminded him that it was easy to become insensitive to the fact that organizations exist to serve the needs of people who don't eat in those rooms. "One theme I'd like to bring to this conversation is that this conversation exists for a world outside this room and sometimes it's easy to forget that."

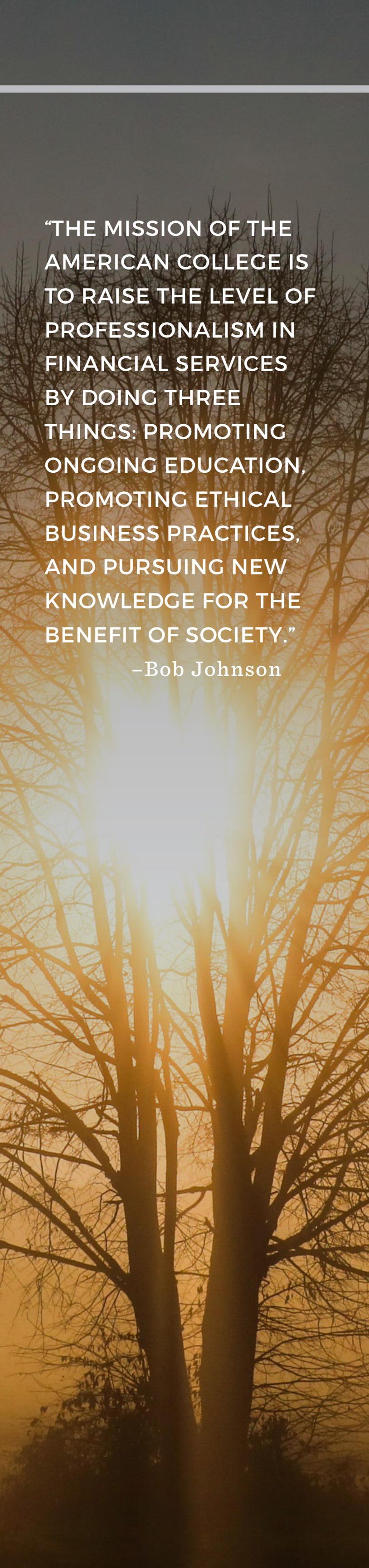
Michaelson believed that it was important to understand the complexity of choices facing executives. He recalled that during his time in consulting, "the chief executive of a client company drew a picture, literally on the back of an envelope, explaining his theory of ethics. There were things at one end of the spectrum that we absolutely cannot do. Then there are things at the other end of the spectrum that clearly are okay to do, but that is not where we want to be. We want to be in the dark gray. We'll have an advantage if we're a little less ethical than our competitors."

Michaelson admitted that some people might object that this executive's strategy was not sustainable in the long-term and, while that may the case, "it is an awfully compelling value proposition to most of the executive's sales force. When I tell that story to my students, I don't expect universal condemnation. I expect a debate around that proposition. And I think it reflects the complexity of our world."

He shared that part of the reason he left consulting was that he wanted to make a greater impact. While consulting provided an opportunity for an immediate impact, it was a shallow one. "When the consultants go away, that impact dissipates. I never owned things like those of you in this room. As an academic, I have the opportunity to make a deep, long-lasting impact. But that can take a long time. So today seems like the perfect place to find the happy medium."

Greg Oberland shared that Northwestern Mutual will celebrate its 160th anniversary this year, and that an event that happened two years after its founding that still shapes the corporate culture today. "In 1857, there was a train wreck in Wisconsin that killed five people, two of whom were our policyholders. The total amount of liability was slightly more than $3,500, which was more than the company had on hand. The first business decision was an ethical decision. Fortunately, our president at the time took out a personal loan and was able to pay off those death claims. If not for that act of personal responsibility by our company's president, we most likely would have gone out of business in our second year."

Oberland was appreciative of the invitation to participate in the event, which is especially important given some of the recent headlines about ethical failings. "If you look at what happened at Wells Fargo and at Volkswagen, it is startling how these things went on at companies that had such good reputations prior to these incidents." The digital disruption from increased technology also put added pressure on executives to



"THE MISSION OF THE AMERICAN COLLEGE IS TO RAISE THE LEVEL OF PROFESSIONALISM IN FINANCIAL SERVICES BY DOING THREE THINGS: PROMOTING ONGOING EDUCATION, PROMOTING ETHICAL BUSINESS PRACTICES, AND PURSUING NEW KNOWLEDGE FOR THE BENEFIT OF SOCIETY."

–Bob Johnson

make sure that they were doing the right things. "If something goes wrong it can go viral in a matter of seconds. So something that we have built up over a long period of time can go down in no time at all."

He was interested in learning from his fellow practitioners about the challenges they have experienced since there were always opportunities to learn and improve. "From the philosophers, I would like to learn about the frameworks out there that we can use to make ethical decisions."

Kurt Oleson believed that there was great clarity in his organization that the financial services business is a noble one. "We are helping people prepare and manage for unexpected events and helping them to realize their dreams for the future. We need to maintain a strong ethical culture as a foundation."

Oleson was grateful to be working at an organization with a proud ethical culture, but acknowledged that it is important to "keep the saw sharp and focus on broadening your perspective". He believed that the Forum provided, "a great opportunity to learn both from academics and from executives relative to the ethical financial services industry exist? "The 'why' is that we are in the business of trust. We're in the business of people giving us their hard-earned money trusting that if somebody gets sick or hurt, that they're going to have some money to buy groceries and pay their mortgage and that if someone dies that their loved ones are going to be okay financially."

Since he is in the business of making promises, the answer to the question 'what keeps him up at night?' is that, "I am making promises that are 30-, 40- and 50-year promises. I am depending on people like some of the ones siting in this room to be sure that those promises are kept because I am just an old guy. I'm not going to be here 50 years from now. But those promises need to be kept and I take that very seriously."

Bob Johnson focused his career on education and ethics, although he was not sure he ever made the conscious decisions that he was going to do that. "I was fortunate to grow up in Omaha, Nebraska and to know Warren Buffett, who was the father of one of my high school classmates. I've always kind of looked to him as a 'true north' in the financial services industry. Warren Buffett once said, "When you hire people, you look for three qualities: integrity, intelligence, and energy. And if you don't have the first, the other two will kill you."

He believed that he was fortunate to work at three organizations that had ethics at the forefront: Creighton University, the CFA Institute and The American College of Financial Services. "The mission of The American College is to raise the level of professionalism in financial services by

Greg Oberland, Christopher Michaelson and John Howard listen to Aine Donovan.

doing three things: promoting ongoing education, promoting ethical practices and pursuing new knowledge for the benefit of society. So ethics is really central to what we do at The American College. I believe that The College operates at the intersection of practice and academia. So I am basically here to listen, and I think that I can learn a lot from both sides of the aisle."

Aine Donovan shared that she was a philosopher. "I always ask my students the question, 'what is a good life?' and when I ask my students that, I can see that their immediate reaction is that they want a certain job, usually in financial services, because that is where the money is. Then I ask, but how does making that much money fit into your idea of the good life? So there is nothing at all wrong with making money, but it has to fit into a sort of thoughtful design for what it is that you're doing with your life."

Case Study

"SHOULD SOME FINANCIAL PRODUCTS NOT BE ALLOWED IN THE MARKET?"

Opening mail from constituents was the favorite part of Eleise Vernon's day. She had been interning with State Senator Keith Wilson for three months and had a variety of duties. Her least favorite task was sitting on the phone with various government agencies trying to work through bureaucratic logjams on behalf of his constituents. Senator Wilson took constituent services seriously and he spent more time than most of his colleagues walking around his district. Eleise knew that she was helping people and that felt good, but she sometimes felt that she spent most of her days waiting on hold. "At least if I ever have a noise complaint about a barking dog, I will know exactly what to do," she told her friends at the end of a particularly annoying series of phone calls.

Eleise always saved reading the mail for the hour after her lunch break. She liked to get a cup of coffee and read through the letters. You never knew what you were going to get. Senator Wilson was insistent that all constituent mail was opened promptly. Her job was to open each letter and then jot down some initial ideas as to an 'action

Bob Johnson and Bob Plybon listen attentively to Kurt Oleson's remark.

plan'. Sometimes no action was required, but most of the time that letter would form the basis of her next day of phone tag with a government bureaucracy. She liked to think of herself as solving problems. She was midway through the pile of letters when she opened the following letter from Mr. Cobbs:

> *"Twenty years ago I purchased Life Insurance with this company hoping to be able to cover my debts in the event of my death so as not to put a financial burden on my children. This is the main reason that most people invest in Life Insurance, right? I knew at the time that in 20 years my premiums would increase in order to keep my same rate of coverage. Well, I've been expecting maybe a 50% increase, which would be what I considered a hard enough pill to swallow at best. Boy, was I wrong. I just received a notice that in less than 2 months, in order to keep the same coverage with the same policy, my rates will increase 200%. Yeah…it literally took my breath away. There is no way I can afford to keep my life insurance. So here I am…59 years old…and unable to get life insurance. After investing all that money with this company for the last 20 years they simply raise my premiums to the point where I can't afford to keep it. They DID, however, offer me a 10 year term policy at just a 100% increase in my premiums. Nice of them, wasn't it?"*

Eleise put the letter down on her desk. She noticed that the envelope also contained documents, which appeared to be copies of financial

statements and formal communications from the insurance company. Marion Jones, Senator Wilson's Chief of Staff, always told her to 'look for the ask', but there did not seem to be a request, just a sad story. She put the letter aside into her pile of 'need to think more about' and went on opening the remainder of the letters. Eleise was troubled. She did not talk about it much, but her father died when she was young. Her father's death plunged Eleise's mother and her three siblings in a downward financial spiral that ended only when her mom was able to return to school and earn her degree in nursing. Her father did not have any life insurance, she was not sure that he had ever thought about it. It felt wrong that someone had so clearly thought about the importance of life insurance and had ended up in this situation.

She picked up the letter again. "Define the problem, gather more facts," Marion always told her and the other interns. "You can help the Senator by bringing him the information he needs to know." Eleise put the letters aside and sat down at her computer and googled "Life insurance policies increase" and that was sufficient to bring up a wealth of information.

Eleise, not too reluctantly, put her call list aside and spent the afternoon reading. After a while, a narrative began to emerge and she started to write down some initial impressions. The first thought was that Mr.

Cobb, the author of the letter, was certainly not alone. Indeed, there were several class action lawsuits filed from others in his same situation. A couple of clicks revealed that one of these lawsuits was against the company who sold Mr. Cobbs his policy. “Find a solution,” Marion intoned repeatedly. “They are asking us for help since they can’t find the solution on their own.” “Well,” Eleise thought about looking up the contact information for the lead attorney in the class action case against the company. “Here, at least, is the beginning of the solution for Mr. Cobbs.”

Marion always told the interns to ask, “Is it a bigger problem?” Eleise always thought that was a good point. There were some situations that were just ‘one-offs’, a particular community resident was troubled by the fact that her neighbor always parked too close to her driveway. However, other problems had implications for many constituents. The more Eleise looked, the more she realized that this was a bigger problem.

Even though she had vowed not to pick up the phone that afternoon, she decided to call a woman she knew in the State Insurance office. Alice Watson had worked for the insurance division for 30 years and she seemed to know the answer to every question Eleise had right on the spot. “If only everyone I had to talk to was like Alice,” she thought as she dialed her number.

Roger Ferguson makes a point to the group.

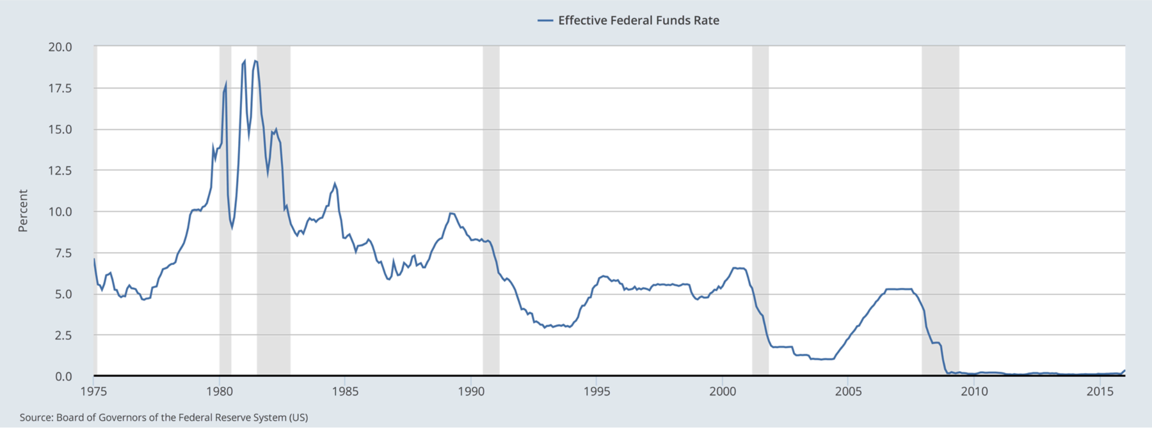
After a thirty-minute conversation, Eleise thought that she knew more than she ever wanted to know about the nature of insurance contracts. Eleise had read that the plaintiff attorneys in the class action were arguing that insurance companies had raised client premiums, from anywhere from single digits to up to 200 percent, in an effort to continue to pay generous dividend payments to their shareholders. The plaintiff attorneys argued that the life insurance companies failed to model, or even imagine, the implications of the current extended period of low interest rates. The only mechanism companies had to generate revenue was by raising premiums. The plaintiff attorneys allege that the insurance companies are raising premiums intentionally so that clients would be forced to abandon their policies. When this occurs clients turn their backs on the thousands of dollars (in some case, hundreds of thousands of dollars), they had already paid into the policy creating a windfall for insurance companies.

But Alice pointed out that this was not the whole story. The contracts issued by the insurance company clearly stated that premium increases, even at the large percentages experienced by clients like Mr. Cobbs, were allowed within the terms of the contract. While the plaintiff attorneys were arguing that these increases were only permissible under certain conditions, the insurance companies were making a strong case that they had every right to adjust the premium payments to deal with the new low-interest environment. It was simply impossible for policies to provide 8 percent returns when bond yields were only 5 percent. The implication was the consumers should not have thought of life insurance premiums as guaranteed when the potential for the very circumstances now occurring were presented in black and white in a document they signed. "It is due to be a long fight," Alice had said, "because the insurance companies have a lot to lose. We are certainly seeing more phone calls now that the media has picked up the story. I can only imagine that will continue."

Eleise added her notes from her conversation with Alice to the pile of information she prepared for the Senator. She placed Mr. Cobbs' letter and the supporting documentation he included at the very top and walked the packet to Marion's office. "It had been a good day," Eleise thought as she knocked on the door. "Maybe I actually made a difference."

NOTES:

EFFECTIVE FEDERAL FUNDS RATE FROM 1975-2015



UNIVERSAL LIFE INSURANCE POLICIES

"Universal Life (UL) insurance policies are unbundled (transparent charges/loads and credits), flexible-premium, adjustable death benefit contracts whose cash values and durations of coverage depend on the premiums paid into them. After deciding on the policy death benefit and pattern, the applicant must pay a premium of at least a certain amount to get the policy started. Thereafter, the policy owner pays as little or as much as he or she wishes into the policy, subject to insurer prescribed minimums and tax prescribed maximums. The higher the premium paid, the greater is the cash value, other things being equal. The policy remains in force as long as the cash value is positive, and terminates (lapses) when the cash value goes to zero. As with all cash value policies, UL policies may be surrendered for their cash surrender value, which equals their account value less any surrender charges. In addition to accessing policy value via loans, UL policy holders also may make withdrawals from the account value at any time. Withdrawals reduce the account value, and thereby interest credits, as well as the policy face amount dollar for dollar."[1]

[1] Skipper, Harold and Wayne Tonning (2011) The Advisor's Guide to Life Insurance. M Financial Group; 145-150.

STOCK LIFE INSURANCE COMPANIES V. MUTUAL LIFE INSURANCE COMPANIES

Stock life insurance companies, "are shareholder owned corporations authorized to sell life insurance products. Stock insurers have access to capital through the equity market to grow the business or support business risk. They are controlled and owned by their stockholders, with net profits inuring to those stockholders. Stock insurers can be owned by other stock insurance companies, mutual life insurance companies, or companies outside the insurance industry. Stockholders elect the members of the company's board of directors. Policyholders are purely customers of the insurer and have no rights to exercise any control over the insurer."[2]

Mutual life insurance companies, "are policyholder owned corporations authorized to sell life insurance products. Net profits inure to the benefit of policyholders. Only policyholders can own a mutual company. Mutual companies do not issue stock, which means they do not have direct access to the equity market to raise capital. Instead, to raise additional capital they must (1) grow internally through accumulated surplus (profits) (2) form mutual holding companies thereby allowing indirect access to the equity market or (3) issue state approved surplus notes – which are hybrid promissory notes that regulators allow to be counted as surplus. The ability to raise capital through surplus notes is limited compared to equity market capital funding. Policyholders elect the members of the company's board of directors. Policyholders are both customers and owners of the insurer."[3]

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[2] Ibid, 16

[3] Ibid, 17

QUESTIONS

1. Who are the stakeholders (e.g., is Eleise one?). How are the insurance companies distributing resources among the stakeholders? What forces are at work leading them to those allocations? What ethical principles should decision makers employ in making these allocation decisions?

2. How does the principle of informed consent operate in this case? What responsibility did clients have to ask the right questions about this provision that could affect them down the road? Under what circumstances should a firm go above and beyond its contractual obligations?

3. What is the role of the financial advisor in helping people to select the right policy, to understand its provisions, and to monitor the policy effectively? Given the proposed regulatory changes resulting for the recent Department of Labor conflict of interest rule, will it be possible for middle-income consumers to receive this sort of advice? If not, what are some possible solutions to fill the gap?

4. At the end of the case, Eleise prepares to present the information to a State Senator, since insurance companies are regulated by the states. Should the federal government have a role in mitigating

the harmful consequences of the low interest environment for both companies and consumers? What role does the financial services profession have to do the same?

5. Insurers are typically prohibited from paying out dividends unless their balance sheets are deemed sufficiently strong by state regulators. Reports show that some insurance companies made their balance sheets appear more attractive by shifting the company's future obligations to policyholders into special financial vehicles that do not appear on their balance sheets. Reports indicate that these companies did this with the blessing of regulators. If this is true, what does it reveal about the relationship of regulatory organizations and insurance companies? Does the current regulatory model work to protect consumers? Should it be strengthened or changed?

6. Are companies that have a mutual structure less susceptible to challenges like the one posed by the low interest rate environment? On the other hand, are there any particular advantages that publicly traded companies provide to their policyholders? Are there any particular challenges that mutual companies face that are not faced by publicly traded companies?

7. Some commentators have raised ethical concerns with class action lawsuits, particularly in terms of whether a class model can adequately represent the best interests of each member of the class. Moreover, some have argued that the option of class action lawsuits, which are often very lucrative for attorneys, creates an excessively litigious culture. On the other hand, others have contended that the class action model provides a degree of representation and protection for individuals who lack the resources to engage with the justice system. Which side has the better argument?

Case Study Discussion

Regarding the case study, Jim Mitchell began by referring the group to one of the questions they had been provided in the pre-work. "Who are the stakeholders in this case? How should the decision makers at the insurance company distribute their resources among the competing stakeholders?"

Aine Donovan believed that the primary stakeholder was the policyholder since, "he is the most affected by the decisions being made here"

Christopher Michaelson thought that the beneficiaries of the insured were a corollary primary stakeholder. Donovan agreed with Michaelson. "I think that it is clear in the case that the policyholder is principally concerned with his family."

John Howard believed that it was important to think of the clients of the company as a class of stakeholders. "It's not just putting the individual customer first. It's putting first all of the customers of that company. If you do something that advantages one customer, you need to make sure that it does not somehow disadvantage the other customers."

Leah Selekman, Roger Ferguson and Kirsten Martin pay attention to Annette Nazareth's comments.

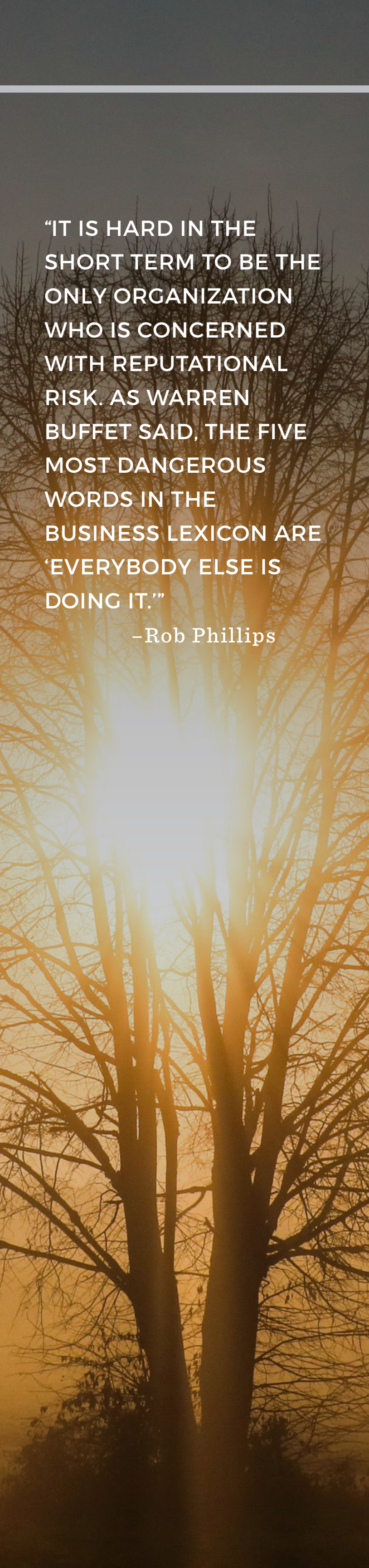
For Bob Plybon, it was important to consider the 'why' behind the decision to raise the premiums. "Are they raising premiums because of the challenges of funding payouts in a persistent low-interest rate environment, as the case suggests? Or are they raising them because they want a higher return on their stock to please shareholders. That would matter to me."

Roger Ferguson believed that Eleise was a stakeholder as well. "Since insurance is so heavily regulated, it is wise for us to think of regulators and policy makers as a class of stakeholders whose actions can affect how we do business."

Annette Nazareth agreed with Ferguson. "If you don't take into account policymakers and regulators, you do so at your peril."

Caroline Feeney observed that it was especially important to keep the regulators in mind given the current environment. "I have never seen so much change in the regulatory landscape as I have seen in the last 12 months, which can really present some challenges."

Mitchell saw this case as representing a significant reputational risk to the companies involved. "I don't think that there is a boardroom in



America where people aren't talking about reputational risk."

Feeney agreed that Boards of Directors have become increasingly more engaged and, in her mind, this is a good thing. "I am not worried about going before our Board of Directors because I believe that we have very strong controls. I am always open to whether there is anything else we can uncover to help us with our due diligence. I know that our Board is asking more questions, and I think that is warranted."

Plybon agreed and added that it was not enough to simply be concerned about your own organization. "If consumers see the headline that "XYZ insurance company is exploiting its customers, then they are going to interpret that to mean that all of the companies are doing the same thing."

Ferguson noted that the steady stream of bad news about the financial services industry has taken a toll. "For the average consumer reading the newspaper, it seems that every six months there is another ethics issue in the financial services industry. There is a steady drumbeat of failure."

Rob Phillips observed that it was likely hard for companies to think about reputational risk when other organizations were experiencing so much success for engaging in risky behaviors. "I can imagine that there are organizations who identify a 'shady' practice, only to see one of their competitors make a tremendous amount of money by engaging in it. It can be hard to defend yourself against charges that your organization is missing out on those rewards. It is hard in the short term to be the only organization who is concerned with reputational risk. As Warren Buffett said, “the five most dangerous words in the business lexicon are ‘everybody else is doing it.’”

ETHICS IS MORE THAN THE LAW

Kirsten Martin believed that ethics required more than adherence to the legal contract. “‘It was in the contract’ is a tough defense. When you get to the point where you are trying to defend your actions by appealing to the fact that, ‘it’s legal for me to do this, you knew about it 20 years ago,’ that does not seem to be a guiding sort of principle.”

Kevin Gibson wanted to know what the obligations were on the part of the agent who sold the policy. “Should someone have led him through the details of the policy and made it clear that there was a very big risk that the policy would not be suitable for his needs when he needed it?”

Jim Mitchell disagreed. “I would argue that no one would have looked at this policy and thought that it represented a big risk at the time. If you look at the graph [included in the Notes] of historic interest rates, no one would have contemplated twenty years ago that they would have stayed so low for so long.”

Roger Ferguson listens to Kirsten Martin.

"THE STANDARD IN THE INDUSTRY IS THAT SOMEONE SELLS A POLICY AND THAT THEIR JOB ENDS THERE. BUT THAT IS REALLY JUST WHERE THEIR JOB BEGINS."

–Bob Plybon

Kurt Oleson agreed with Mitchell. He indicated, "It is hard to contemplate a possibility that, according to all of the history, is such an outlier."

Roger Ferguson observed that when he was studying for his PhD in economics, "The thought of having nominal interest rates at zero and real interest rates at negative was not in the realm of the possible. It was not even thought about theoretically. How do you communicate to clients about the possibility of a "black swan" event?"

John Howard noted that part of the problem resided in the fact that it was simply very difficult to accurately price insurance products. "It is very difficult when you're designing and pricing an instrument to know how it is going to perform over a 50 year period of time when so many variables can change."

Rob Phillips wondered that, even if companies did not have an obligation to disclose a risk they could not foresee at the onset of the policy, did that obligation change over time? "When companies start to see that their assumptions are not holding up the way that they anticipated, don't they have an obligation to help the advisors inform their clients of this fact? Isn't that an important part of informed consent?"

Bob Plybon shared that he believed that Mr. Cobbs' agent did have an obligation to keep him informed about the status of his policy.

"In my office, we do an annual review of each policy. We go over with the client where we are with the policy, specifically whether we are ahead or behind the game." He worried that this was not standard practice in the industry. "The standard in the industry is that someone sells a policy and that their job ends there. But that is really just where their job begins."

Leah Selekman and Roger Ferguson listen to Annette Nazareth.

THE PROBLEM OF FINANCIAL LITERACY

Aine Donovan thought that the issue of the lack of financial literacy among the American public was important. "What's the obligation of the financial services industry to educate people about the basics?"

Annette Nazareth believed that part of the problem results from the fact that people, even those who are not financially literate, have access to sophisticated financial products. "That is the problem with 'the great democratization' of the market. There are people at SEC Roundtables who would ask 'why are you blocking retail investors from investing in hedge funds?' There is a conflict between wanting to provide every investor with the same opportunity and wanting to make sure that people are not making harmful decisions due to a lack of information."

"I AM WONDERING WHETHER SOMETHING LIKE INFORMED CONSENT IS EVEN POSSIBLE FOR THE AVERAGE CONSUMER WHEN DEALING WITH THESE COMPLICATED FINANCIAL INSTRUMENTS"

–Christopher Michaelson

Christopher Michaelson saw an analogy with the concept of informed consent in the medical profession. "Informed consent is a complicated issue in medical decision making because at times the patient lacks the expertise needed to make a complex decision on a complex issue. I am wondering whether something like informed consent is even possible for the average consumer when dealing with these complicated financial instruments. The situation is made even worse by the fact that consumers purchase these products only a few times in their lives."

Jim Mitchell observed that the medical analogy was not complete. "If you have a long-term prescription from a doctor, you will at least feel the need to check back in and make sure that this is still the right prescription for you. Consumers usually don't do that with their financial products, even though they should."

Kirsten Martin noted that the problem of a lack of literacy could not be solved through providing clients with more information. "There is a phenomenon called the 'transparency paradox', in which the more information you provide, the more confused the consumer becomes."

Caroline Feeney agreed with Martin. "I read some of the communications going out to clients and I have been known to say 'stop', we need to rethink this. The lawyers are doing their job, but we have to make sure that the consumer can understand what they are reading."

Nazareth believed that disclosure reform was a challenge for the SEC. She believed that the best strategy was to impose a sort of layered approach in which various classes of investors could access the level of detail with which they felt comfortable. "It would start with a summary document that discloses in plain English what the average investor really should know about the product. Then there would be an opportunity to 'click through' so that if someone was really interested in knowing all of the details, they could do so."

Roger Ferguson, Aine Donovan, John Howard, Annette Nazareth and Greg Oberland at the closing reception.

The Executives' Ethical Dilemmas

EXECUTIVE DILEMMA #1

While I had the honor of serving as the President of an industry organization which did a great deal of work with Congress, I was approached with an idea for an investment product. The product was to be developed by a company who had been very supportive of our trade organization over the years and provided significant financial support. The essence of the product was an 'investor-owned' life insurance scheme in which a class of investors would fund life insurance policies on all of the teachers within a particular state. When a teacher passed away, part of the proceeds from the death benefit of that policy would be given to that state's teacher retirement fund. The remainder of the proceeds would be distributed among the investors. The sponsors of the idea wanted me, in my role *as the head of this industry organization, to sort of 'bless' the transaction and defend it, if necessary, to the Treasury Department.*

On the one hand, there are clear benefits to the state's teachers of a policy of a transaction like this one since it will provide needed monies to the retirement fund. It also was going to be a good product for investors and a nice opportunity for the company who would issue the policies. But, at the end of the day, 'investor-owned' life insurance has a different answer to the question 'why?' and that is what made me uncomfortable. The 'why' of life insurance is not so that someone else, a stranger, can profit from an individual's death. On a practical note, the proceeds of a life insurance policy have historically been tax-exempt. This is because politicians and regulators have been convinced that life insurance is a 'protection product' rather than an investment vehicle. Schemes like the one proposed could ultimately undermine this justification, which would be devastating for the industry and for people who depend on the protection provided by the product. So, not only did I not agree to defend this proposition, our organization ultimately lobbied pretty hard against it.

Aine Donovan wanted to play the 'devil's advocate'. What happens if the consumer really wants to do this? What if they have a legitimate reason to sell their policy to an investor who is willing to pay them for it? It seems paternalistic to deny them that opportunity."

Bob Plybon agreed that it could be a thorny issue. "We have clients who are ill and would love to have the money, but I can't bring myself to have somebody sell a policy knowing that they're going to be disenfranchising their beneficiaries in favor of someone who just wants to make a 19 percent return on their investment." He continued that it was important to remember that people in this position had other options. "They can take loans against the cash value, for example."

Jim Mitchell observed that getting into what is referred to as the 'life settlement' business can be tempting. "From what I understand, financial advisors can make a lot of money in these transactions. The commissions are extraordinarily high."

John Howard thought it was important to look at the history of the life settlement business. "These transactions were originally called 'viaticals' and they began in cities in which there was a high percentage of gay men who were suffering from the condition we now know as HIV/AIDS. Many had life insurance policies with no clear beneficiaries and a serious need for the money in those policies to pay for their medical care." He acknowledged that while he understood the ethical issues that emerged as these transactions evolved, "we need to remember that not everything is black and white."

EXECUTIVE DILEMMA #2

I have noticed that there has been an increased tendency of issue-based organizations seeking to influence the decisions of corporations. One way that individuals and groups do this is to try to guide various investment decisions, for example, by requesting that the organization refrain from investing in certain industries, such as coal or tobacco. Perhaps this is the result of the tumult of the recent presidential campaign, but people seem more engaged and more committed to push on organizations in various ways. These groups include both outside organizations as well as employee groups who are advocating certain agendas. The challenge is to figure out, as an organization, how we should respond to these groups in a thoughtful way *that balances the interests of all of our stakeholders. It can be difficult to figure out the right course of action when peoples' definition of 'right' is in conflict.*

Rob Phillips thought that the increased emphasis on social responsibility had made some associations more critical. "I think that this pressure forces companies to make sure that the organizations they are associating with are in alignment with their values. I think it can force companies to make more intentional decisions."

Bob Johnson thought that it was ambiguous as to who should define the social responsibility of business. "In some ways, how to define 'social responsibility' becomes a very personal thing. For example, there are some investors who would not invest in Dick's Sporting Goods because in addition to selling football gear, they also sell guns." He wondered how companies could find the right balance. "There are certainly some things that a majority of society would agree are reprehensible, but this can be a slippery slope."

Christopher Michaelson believed that the conversation about social responsibility highlighted an important fact about human decision-making. "We have this idea that in a capitalist system every decision is made on the basis of self-interest, but most consumers don't make decisions solely on the basis of their material self-interest; they also make emotional decisions. And those emotions are tied to sentiments about what's a good company or a bad company."

Kirsten Martin believed that it was important for companies to be very clear about their values. "Robert Frank, an economist, argues that if you are going to talk about your values, it is important to do so in a way that is both deliberate and loud enough to get attention. If companies do that, it sends signals that other people with similar values will come and find you."

EXECUTIVE DILEMMA #3

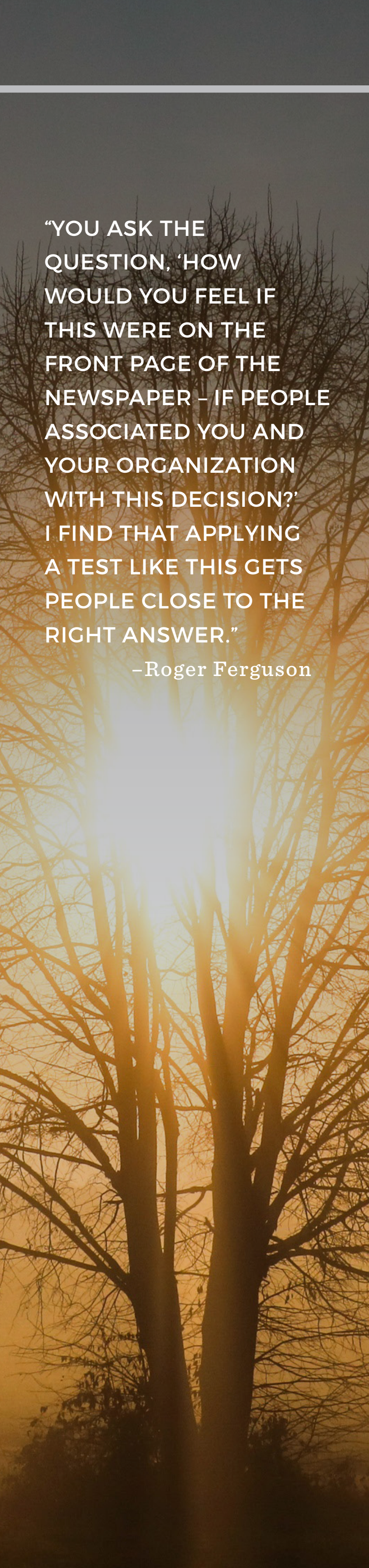
This dilemma dates back to the late 1980s and the early 1990s and involves the sale of disability insurance. It was viewed as a nice companion policy to life insurance and there were many companies that began to see that a lot of money could be made in this space. In order to gain the attention of agents and brokers, companies began to offer increasingly attractive products both in terms of pushing down the price and in terms of increasing the benefits, especially for physicians. As this was going on I remember asking our marketing team whether they were concerned that having so many policies issued under these conditions created an unacceptable level of risk for the organization. My concern was that, given the attractive nature of the benefits, that we have some people who would intentionally become disabled in some way or decide to make a fraudulent claim. I remember that the answer I got was that many of these physicians were so successful and had invested so much in their education and training that they would never file a disability claim unless they were forced to do so.

You may remember that in the early 1990s, First Lady Hilary Clinton was trying to pass her health care plan, which was perceived by some doctors as being financially disadvantageous. It was amazing that, in light of that proposed policy change, our organization and several others saw a rush

Kevin Gibson is amused by Jim Mitchell's remark.

of disability claims submitted by physicians who had purchased our policies. The claims were pouring in and this created a financial strain on our organization, both in terms of the benefits we were paying out and in terms how the influx affected the amount we needed to reserve to pay future claims.

In talking to my peers at other companies, some suggested that we get 'aggressive' in terms of shutting down the claims. One tactic was to offer the claimants a 'lump sum' payment to close the claim. While you did have to pay out the cash, you could release the long-term reserve, and this helped the bottom line. Other people suggested you get a bunch of 'junkyard dogs' to administer the claims with the attempt to minimize the amount of money the firm would pay out on the policy. The ethical question was to handle these claims, some of which we strongly suspected were fraudulent, in a way that looked out for the interest of the body of policyholders. We needed to consider the rights of the individual claimants, but also consider how these individual decisions might impact others who had purchased these same policies, but not made any claims. We needed to make sure that we could keep our promises to these people as well.



"YOU ASK THE QUESTION, 'HOW WOULD YOU FEEL IF THIS WERE ON THE FRONT PAGE OF THE NEWSPAPER – IF PEOPLE ASSOCIATED YOU AND YOUR ORGANIZATION WITH THIS DECISION?' I FIND THAT APPLYING A TEST LIKE THIS GETS PEOPLE CLOSE TO THE RIGHT ANSWER."

–Roger Ferguson

Jim Mitchell observed that both pricing and policing disability insurance was a much trickier proposition than pricing life insurance policies. "If you are investigating a life insurance claim, you usually simply need to confirm that the person is actually deceased." The matter was not so clear in the case of awarding disability benefits. "If you are investigating a disability claim, even if it is genuine, you need to have information about the claimant's occupational duties, as well as detailed information about the claimant's financial situation and how that is impacted by the disability."

Greg Oberland noted that pushing claimants to accept a one-time payment leads to ethical challenges as well. "Even making the offer can put pressure on them during a vulnerable period in their life. Since disability claims are assessed on a monthly basis to determine if they are still eligible, they can think that if they don't take advantage of the offer now, it is possible that their claims will be denied in the future."

Roger Ferguson shared that it can be helpful to think about how decisions like this will be viewed by a third party. "Some people call it the "Wall Street Journal test". You ask the question 'How would you feel if this were on the front page of the newspaper - if people associated you and your organization with this decision?' I find that applying a test like this gets people close to the right answer."

Annette Nazareth suggested that the company itself bore some responsibility for the situation in which it found itself. "It is clear that you asked the right questions early on, which is whether creating such an attractive product created the conditions in which fraud would occur. The problem is that no one gave you the right answers."

EXECUTIVE DILEMMA #4

The ethical dilemma that I want to discuss highlights a potential conflict of interest that companies create for their distributors. When prospecting for customers, agents market themselves as being professionals that will work for the client to obtain the best coverage, which technically creates a broker relationship. They usually do not disclose that they have a contractual obligation to the insurance company, which creates an agency relationship insofar as their first loyalty is to the insurance company, not the proposed insured. Additionally, their agency contracts might require certain production levels and possibly new business metrics to qualify for financial subsidies, employee benefits and contract renewals. The dilemma is that they obviously have obligations to two different parties, whose interests may be in conflict.

Bob Johnson and Kurt Oleson listen as Bob Plybon shares his thoughts.

This dilemma is heightened by the fact that it can be difficult to determine which product is the best product for the client. Some people make this determination on price, but while one company's products may be less expensive, that company may provide a lower level of service in the claims experience. Moreover, as we saw in the case, product performance is not guaranteed since current assumptions around investment portfolio returns and future crediting rates, as well as fees and expenses, are uncertain. So the challenge is that not only is the advisor conflicted in their loyalties, but even if they resolve that conflict, it can be difficult to determine which product truly is best.

Christopher Michaelson believed that part of the problem came from the challenge of measuring performance in non-quantitative ways. "I think that if we can get better at measuring performance in different ways we might get better at incentivizing things like good customer service. I wonder whether, because people in financial services deal so much with numbers, there is more of a tendency to rely on quantitative measurement than there is in other industries."

John Howard thought that part of the emphasis on measurement came from an increased emphasis on accountability. "I think that drives you towards an analytic and data-driven approach."

Bob Plybon and Kurt Oleson listen to Bob Johnson's remark.

Greg Oberland wondered if there was already a shift in the industry that might mitigate part of the problem. "Historically, our industry has been focused on finding people, whether they be captive agents or brokers, who will pound the street and sell your company's product in the marketplace." According to Oberland, this created an agent and client interaction that was very transactional, but this was changing. "Advisors in the marketplace are positioning themselves as 'financial planners'."

Bob Plybon noted that it was important to make sure that companies were hiring the right people. "Under certain compensation models, you've got to be very careful with the people that you hire because certain compensation systems definitely drive people to act to secure the incentives."

Caroline Feeney believed in the importance of the question 'why'. "I think that so much comes down to the 'why' you are in this business, as Bob Plybon mentioned. I have found that if people come into this business and their purpose is to help other people and to make a difference in their lives, then the money will follow. If you come into this business and the answer to the 'why' is 'to make a lot of money', that is where you see a disconnect with values."

EXECUTIVE DILEMMA #5

My dilemma is not really a dilemma but rather a case that highlights how it is possible to avoid ethical dilemmas. Specifically, it describes the luxury of being able to turn away business when you think that what you are being asked to do is not in the best interest of investors. I was approached by a firm who was interested in hiring me as a credible expert to advocate for the increased use of inverse and leveraged ETFs in retirement accounts. While there was some persuasive research supporting such a strategy, especially for retirees who need to compensate for the persistently low-interest rate environment, it just struck me as a terribly risky product. It seemed to me so inappropriate that I did not want to be associated with it. It was an interesting dilemma for me since there was nothing illegal about this product or what they were asking me to do, but there are times when you do not want to place your own reputation in jeopardy.

Jim Mitchell drew an analogy to equity-indexed annuities, "EIAs were not as risky a product, but they were pretty illiquid in the early days. They were popular because they paid high commissions to producers. I don't think that most consumers understood the illiquidity of these products at the time. EIAs have improved a lot since then, with both competition and regulation resulting in products that, today, are appropriate for a significant portion of the retirement market."

John Howard shared that he had been making similar arguments about the riskiness of some of these products years ago. "If you looked at the way that they were priced and designed, you would have said that they were not products that were likely to perform well for the consumer. In actuality, given the protracted low interest environment that we went through, they did perform better than other alternatives would have. So it's quite ironic."

Bob Johnson noted that it was hard to train students to make decisions like the one described above. It is one thing to turn away a profitable client as the result of a classroom exercise, but it is another thing to actually do it. "There's golf and then there is tournament golf. I can go to the driving range and hit 7 irons for an hour, but when you are on the course during the tournament and you need to hit that 7 iron, your heart is beating a little differently and you're thinking a little differently. The same is true when you are teaching an ethical dilemma and when you actually find yourself in an ethical dilemma. I think it's theoretical ethics versus applied ethics, and the distinction makes a difference."

EXECUTIVE DILEMMA #6

My company is very oriented around values. We measure and assess people both on the 'what' and the 'how'. The 'what' concerns your performance and the 'how' concerns the way people are living up to our values. Once in a while we are confronted with the dilemma of having to separate a person who does really well on the 'what' but not so well on the 'how'. In many cases, these people go wrong in terms of not treating their colleagues well or failing to act as a member of the team. So the ethical dilemma is how to balance the 'what' and the 'how', and when do you let go of a star performer because the way that they do things is inconsistent with culture?

Making the decision to separate an individual from the organization creates another challenge, which is how do you respond when leaders

at other companies call seeking a reference for that person? This leads to a conflict since you have a legal obligation to keep information confidential and you may have a moral obligation to prevent someone else– perhaps someone you know and respect– from making a mistake in hiring. A final issue is how you deal with the questions from other people in your organization who are seeking answers about why a high performer was separated when you face the same confidentiality restraints.

Roger Ferguson observed that in his experience when star performers who have had some cultural fit issues are separated from the organization, many times others in the organization are not surprised. "Suddenly everyone comes forth saying, 'oh my goodness, we were wondering when this was going to happen. This sort of behavior has been going on for months or years.'"

Greg Oberland thought that it was important to make it clear to the person why they were fired. "It has to be a conversation where you say, 'you know, you delivered results, but you did it in a way that does not work in our organization'. That way they may be able to walk away from that conversation having learned a lesson from the experience."

Annette Nazareth believed that it was important to err on the side of confidentiality in situations like these. "When people are dismissed, it is possible that they just don't fit into your culture but they could be a good fit somewhere else."

Bob Johnson shared that, "I once made a major mistake that I learned from and that I'll never make again. I hired a guy who was a rock star, he really was one of the brightest people I have ever worked with. But he was never wrong and could not play well with others." Johnson ultimately made the decision to let him go. "And the moral of the story is that he was a rock star. Well, what do rock stars do? They tear up hotel rooms and throw TVs out. They behave badly."

Academics' Questions

ROB PHILLIPS' QUESTION

One of the biggest myths is that the shareholders of a publicly traded company actually 'own' the company. This statement, in fact, is false in a lot of different ways. What the shareholders own is the rights to a set of residual cash flows. Shareholders are not legally liable for the actions of the corporation. They do not own the corporation in a meaningful sense. This relates to what I think is the biggest challenge of business ethics, which is this diffusion of responsibility for the actions of the organization, it is difficult to isolate who should be held accountable for the actions of the organizations. But whoever that person or group of persons is who should be held accountable, it is clear that it is not the shareholders. I wonder whether if we dispatched with the language of 'shareholder ownership' it would shift the way we think about who should be held accountable within the organization.

Roger Ferguson and Kirsten Martin listen to Rob Phillips' comment.

Annette Nazareth shared that, while she was at the SEC, she and her colleagues observed a shift in behavior when some of the major Wall Street firms went from being partnerships to corporate entities. "When they were partnerships, they knew that the risk that they took would have a direct impact on their personal financial well-being. But when they converted to a corporate form, there was a shift in thinking. If the firm performed well, they benefited in the form of a generous salary and enormous bonuses. And if they lost, it was the shareholders that lost."

Jim Mitchell noted that in his experience as a member of several corporate boards, he and his colleagues felt a responsibility to look out for the interests of the shareholders. "However, we got to define the time frame over which we did this. We were looking out for our longer term shareholders and we believed that we should be doing good work for them over a 3-5 year period."

Kevin Gibson wondered how we should conceptualize the organization. "Do we think that, beyond being a legal entity, a corporation is a moral entity, and therefore, a moral agent over and above the individuals who make up that entity?"

Rob Phillips believed that this was the case. "We have spent a lot of time talking about culture today and I think it is pretty clear that there is something that is non-reducible to the individual participants. Even after everyone leaves that organization, there will still be some culture that will continue on, although some cultures will be stronger than others and some more influenced by new membership.

KIRSTEN MARTIN'S QUESTION

I was wondering about how financial services companies are dealing with the ethical challenges of using 'big data' in their underwriting decisions. Part of the problem is how we collect the data, which is often scraped off social network sites. There is a real question of whether people meant for you to see that data in the first place. It may raise an issue of trust between the company and the client if the company is perceived as seeking additional data from a third party source. Another issue is the belief that once we have the data and place it into an algorithm, we have eliminated human biases from decision making. However, what we have learned is that, for many reasons, there are often huge biases in data sets that need to be reconciled. So, there are two issues: the first is how companies are collecting data from their customers and potential customers and the second is how this data is being used by the companies.

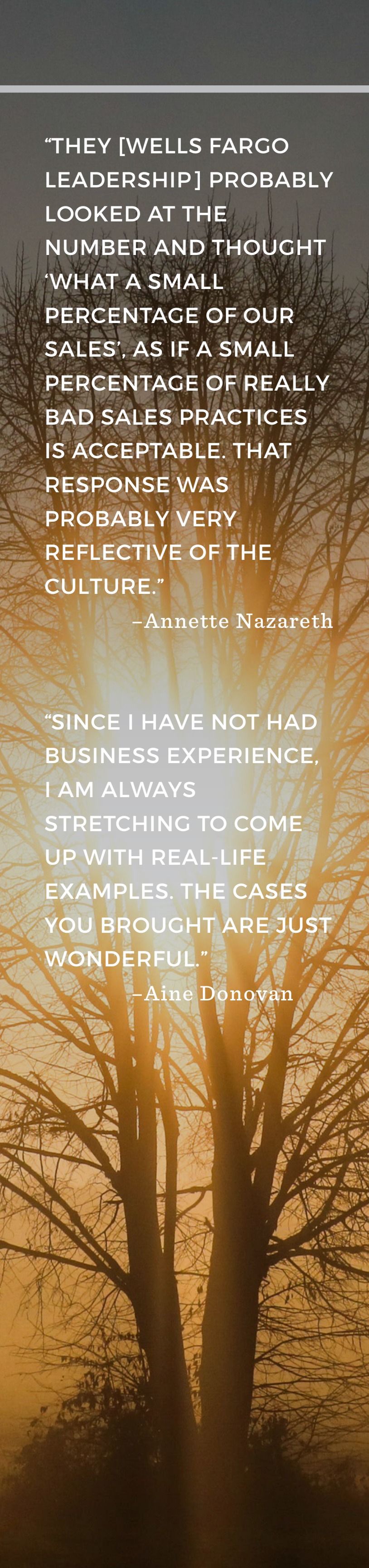
John Howard pointed out that using publicly available databases can actually get the companies more accurate information. "There are a surprisingly large number of people who misrepresent information on an insurance application. By using databases, you can get valid information about sensitive areas."

Roger Ferguson suggested that, based on some of the research he had seen, using algorithms did avoid some important human biases. "We have all heard of the example where you have two identical job candidates in terms of qualifications and experience, but the individual with the "ethnic-sounding" name is rejected in favor of the "white-sounding" name. So, I think that the question is whether or not using the algorithm puts us in a better place than we were before."

Greg Oberland observed that the drive towards using algorithms was pushed by consumers. "It's really being driven by the fact that consumers don't want to have to go through all of the steps they traditionally had to go through to get insurance. So, we try to grab this information from other sources and give the client a quicker response."

Ferguson believed that there was a larger issue at play. "We have to recognize that decisions around financial products are not neutral, in the sense that we have an interest in having good financial protection products that are priced fairly across society. In order to achieve this,

Aine Donovan shares her thoughts with the group.



"THEY [WELLS FARGO LEADERSHIP] PROBABLY LOOKED AT THE NUMBER AND THOUGHT 'WHAT A SMALL PERCENTAGE OF OUR SALES', AS IF A SMALL PERCENTAGE OF REALLY BAD SALES PRACTICES IS ACCEPTABLE. THAT RESPONSE WAS PROBABLY VERY REFLECTIVE OF THE CULTURE."

–Annette Nazareth

"SINCE I HAVE NOT HAD BUSINESS EXPERIENCE, I AM ALWAYS STRETCHING TO COME UP WITH REAL-LIFE EXAMPLES. THE CASES YOU BROUGHT ARE JUST WONDERFUL."

–Aine Donovan

we need to have as much information as possible when making underwriting decisions."

AINE DONOVAN'S QUESTION

There is a body of longitudinal research on student attitudes towards cheating conducted over a 25-year period. What is troubling is that is the recent results show that self-reported accounts of cheating have significantly increased.
Students self-report that they cheat for many reasons, but the top reason is that they believe that cheating is a necessary way to be successful in a highly competitive environment. My question is whether corporations are concerned and how are they dealing with this shift in values and behavior in which what is expedient for their career is seen as appropriate?

Kevin Gibson observed that when his kids were younger they played computer games. One of the first things they would do is to go and locate the 'cheat codes'. They would self-report that and I wonder if that has something to do with the fact the entire idea of cheating has been devalued?"

John Howard shared that his organization had a robust training program for new hires. "The new hires learn the values of our organization and how important these values are to our mission."

Linda Mitchell, Jim Mitchell and Elizabeth Lentini at the closing reception.

Kurt Oleson believed that organizations needed to make it clear that any sort of cheating is unacceptable, but that educational institutions needed to play an important role. "It is my expectation that educational institutions would educate students on the importance of ethics in the workplace and the consequences of unethical behavior in terms of their career prospects."

Roger Ferguson echoed Oleson's point. "I think that as executive leaders we expect that students may not have learned the technical skills to do the job; we can teach them those skills. However, I think that there is a belief that students will have learned the basics: how to work in groups, how to work hard and how to play fair."

Kirsten Martin agreed and believed that academics could contribute in another way. "We need to do a better job of actually enforcing the integrity rules when they are violated. The challenge is that it is so expedient not to do that. It takes a lot of time and energy to kick someone out for cheating. We have to move past that."

CHRISTOPHER MICHAELSON'S QUESTION

In 2010, I worked with the World Economic Forum to do a panel at Davos called "Reading Leaders Minds" that asked leaders to discuss 'what books have most shaped your personal and professional values?' I was expecting the participants to name more novels, because we often learn from fictional stories, but they ended up settling on a list of four classics of business literature, none of which were novels: The Wealth of Nations by Adam Smith, The Art of War by Sun Tzu, The Prince by Niccolo Machiavelli and The Origin of the Species by Charles Darwin. If you look at the list provided it is not any surprise that the notion of capitalism that dominated the 20th century was perceived as combative, manipulative and ethically wanting? If those four stories are not the right stories to shape 21st century capitalism, which has a set of far more diverse actors, what are the narratives of future capitalism? What should they be?

John Howard had a suggestion. "If it does not need to be written in the 21st century, I think that Fahrenheit 451 is a possibility."

Roger Ferguson believed that Shakespeare's plays could be very valuable, because they capture the dilemmas of the human condition in a timeless way. Especially in his tragedies, Shakespeare also captured some of the challenges of leadership, including the difficulty of choosing a course of action when you have only a partial and opaque perspective on a situation.

"Leaders often times are making decisions with incomplete information. I would say that part of the challenge of my job is that it is like standing on one side of the curtain – to use the metaphor of a performance - with people running around from the other side of the curtain to describe what's going on over there. By its very nature, their description will be incomplete and not totally objective, but I will still need to rely on it in making a decision."

Bob Plybon suggested a film, "Jerry Maguire". "It is just a good story of someone who was doing a lot of unethical things until he decides to do the right thing and it is then that he becomes a winner."

Bob Johnson, Heidi Johnson, Bob Plybon and Mary Plybon at the closing reception.

CONVERSATION ON ETHICAL CULTURE

Kevin Gibson wondered about the phrase, "tone at the top". "How does that tone get transmitted through the organization?"

Roger Ferguson said he believes that compensation systems are a powerful tool. "Compensation systems, as we saw in the Wells Fargo case, incentivize certain forms of behavior. In that case, you had a system that rewarded the 'what' and did not concern itself with the 'how'."

Annette Nazareth believed the response of the Wells Fargo leadership to the instances of fraud that they did know about was telling. "They probably looked at the number and thought, 'what a small percentage of our sales,' as if a small percentage of really bad sales practices is acceptable. That response was probably very reflective of the culture."

Jim Mitchell observed that at previous Forums on Ethical Leadership, we would talk about hard ethical issues resulting from problematic policies at organizations. "Some of the CEOs who attended the Forum were confident that nothing like this was happening in their organization. But Julie and her predecessor, Ron Duska, worked with many practitioners at these firms at The American College and they often reported something quite different." Mitchell believed that the CEOs weren't lying when they claimed that these things did not happen in their organization. "I think that one of the hardest things to do as a senior executive is to create the kind of climate where people will bring issues and problems to you, so that you know what is really going on."

Christopher Michaelson added that employees needed to feel empowered to speak up. "If you ask a lot of ethics officers, the one question on the employee survey that they want to know the answer is to whether people feel comfortable speaking up if they see a problem. If you look at what happened at both Wells Fargo and Volkswagen that probably was not the case."

Kurt Oleson believed it's important for companies to constantly communicate the importance of their values and to demonstrate, at every opportunity that they have, the importance of integrity and doing things the right way."

John Howard believed that ethical culture is built when the leader showed a willingness to make hard decisions. "If you are only doing easy things, then you don't prove that you're really committed to building an ethical culture. The example we heard earlier about the senior leader who fired a highly productive employee for not getting the 'how' or not living the organization's values is a great example of a tough decision."

Greg Oberland was convinced that building an ethical culture needed to be a top priority. "We need to apply the same rigor to building an ethical culture that we would to any other important business objective."

Bob Johnson shared an example of how employees and leadership lived the organization's values at The American College. "We have what we call "TAC Dollars" and employees can distribute them among their colleagues if they believe that colleague has really done something that has exemplified our values. I had my doubts at the outset, but it has really proved very successful. I think that people are very proud to be acknowledged by their peers."

CONCLUSION AND TAKE-AWAYS

Kevin Gibson asked the participants to share one of the insights that they would take away from the event.

Rob Phillips shared that he believed that it was important to always think for the job that you want, not the job that you have. “And it’s always been my impression that the higher one ascends in an organization, the more awareness there is of the importance of culture and in particular, the values that drive corporate culture.”

Kirsten Martin thought that she came away with a better understanding of the financial services industry. “For me, it was helpful to frame some of the core ethical issues in this industry as role conflicts, which suggest that people actually have conflicting responsibilities. This helps me conceptualize decisions in a more positive way.”

Roger Ferguson noted that while he always thought in terms of the ‘what’ and the ‘how’, he realized that the ‘why’ is important as well. “I think that focusing on the ‘why’ can help us in recruiting, and it may go a long way towards explaining why it is that some people don’t succeed. It could be because their ‘whys’ are different.”

Annette Nazareth was glad to have participated in “an incredibly rich conversation”. She was also impressed with how the academic participants presented their views in a thoughtful and pragmatic way. “I think that there is a lot to be gained by following up with you all and seeing what it is that you think we should be reading.”

John Howard was not sure what to expect from the meeting but believed it was a “wonderful group and a great discussion.” He was particularly interested in the idea of finding books to underscore the narrative of capitalism in the 21st century. “The one thing I wished I would have done differently is to take more notes. And, frankly, I wish I could sit in on your classes.”

Aine Donovan appreciated the interaction with senior business leaders. “Since I have not had business experience, I am always stretching to come up with real-life examples. The cases that you brought are just wonderful.”

Christopher Michaelson shared that he was, “really struck and pleased with how purpose- driven so many of you are.” He wondered whether it would be beneficial to include regulators in future events. “It strikes me that regulation could be more purpose driven. What I mean by that is that regulation focuses almost exclusively on the ‘how’ and could focus more on the ‘why’.”

Greg Oberland found the conversation very valuable and shared that he wanted to think about how to expand the assessment of employees’ willingness to speak up. “I really like the idea of asking something along the lines of ‘Did you experience or see something during the year that you didn’t speak and talk about?”. I think the answer to this question would indicate areas where there were problems.”

Kurt Oleson was glad to spend the day in the company of academics, especially to gain their insights on millennials and younger workers. “I try to stay close to individuals that are new hires, but that can be difficult. It was great to hear some good thinking about what is taking place in that space.”

Bob Plybon said he believed it had been a great day. “I think that the whole way that the event was put together really helped everyone to participate and share their views. We all come out of today knowing things we did not know before and thinking about things differently than we did before.”

Bob Johnson shared that this event was one of his favorites. “The reason is that I don’t have the opportunity to sit, think and reflect with other folks very often. This is a wonderful opportunity to get out of the role of running the organization and back into a role that I love, which is this ‘pracademic’ orientation.”

THE JAMES A. AND LINDA R. MITCHELL/ THE AMERICAN COLLEGE **FORUM ON ETHICAL LEADERSHIP IN FINANCIAL SERVICES**

The American College Cary M. Maguire Center for Ethics in Financial Services is the only ethics center focused on the financial services industry. The Center bridges the gap between sound theory and effective practice in a way that most ethics centers do not. Under the leadership of Director Julie Ragatz, the Center's mission is to raise the level of ethical behavior in the financial services industry. We promote ethical behavior by offering educational programs that go beyond the "rules" of market conduct, help executives and producers be more sensitive to ethical issues, and influence decision making.

The Forum is a groundbreaking, one-of-a-kind event that underscores the Center's emphasis on collaboration and conversation among academics and executives. t was recognized in 2008 for his dedication to business ethics and was included in the "100 Most Influential People in Business Ethics" by Ethisphere, a global publication dedicated to examining the important correlation between ethics and profit. The list recognizes individuals for their inspiring contributions to business ethics during the past year. The Forum is the cornerstone of the Center's activities highlighting how to bring industry leaders, accomplished producers, and prominent business ethicists together to reinforce the need to connect values and good business practices.

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