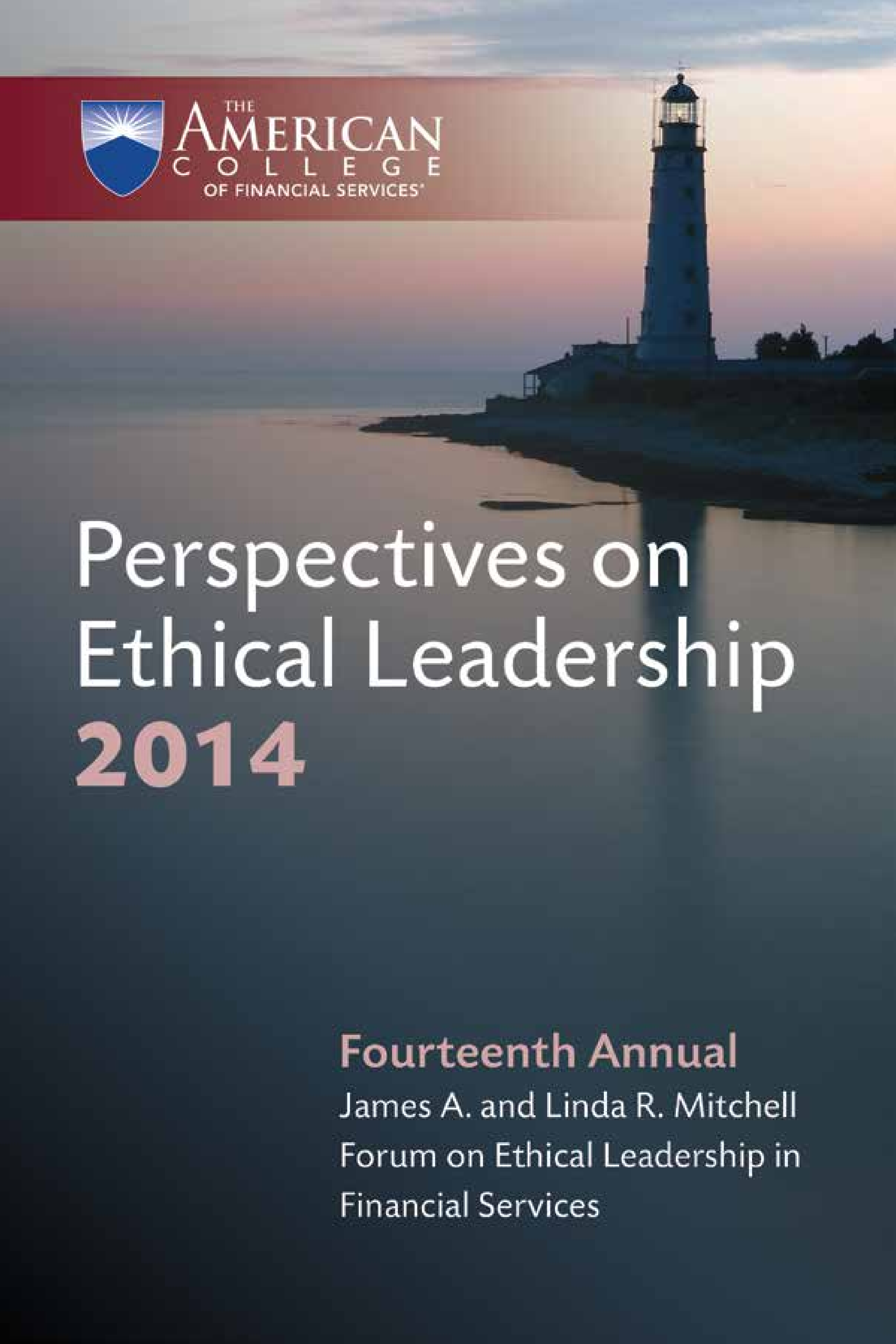


THE AMERICAN COLLEGE OF FINANCIAL SERVICES®

Perspectives on Ethical Leadership 2014

Fourteenth Annual

James A. and Linda R. Mitchell Forum on Ethical Leadership in Financial Services

FORUM ON ETHICAL LEADERSHIP

The Fourteenth Annual James A. and Linda R. Mitchell/The American College Forum on Ethical Leadership in Financial Services took place on January 11, 2014 in Phoenix, Arizona. 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.

ACADEMICS

Archie Carroll, Professor Emeritus, Terry College of Business, University of Georgia

Kevin Gibson, Associate Dean of the Graduate School, Marquette University

Kirk Hanson, Executive Director, Markkula Center for Applied Ethics and John Courtney Murray S. J. University Professor, Santa Clara University

Nien-hê Hsieh, Associate Professor of Business Administration and Marvin Bower Fellow, Harvard Business School, Harvard University

Marianne Jennings, Professor Emeritus, W. P. Carey School of Business, Arizona State University

EXECUTIVES

John Barry, Chairman and CEO, Barry, Evans, Josephs & Snipes

Edward Bonach, CEO, CNO Financial Group

James Mitchell, Chairman of the Advisory Board, Cary M. Maguire Center for Ethics in Financial Services, The American College

John O'Connor, Executive Vice President, Corporate Risk and Security, Fidelity Investments

EXECUTIVE SUMMARY

On January 11, 2014, a group of four executives and five academic ethicists gathered in Phoenix, Arizona to participate in the Fourteenth 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 that they confront on a regular basis, with questions posed to them by academics engaged in business ethics education, and

To afford academics the opportunity to engage in discussion about these issues with top-level executives, so that they can bring that experience back to their classrooms.

REBUILDING TRUST IN THE FINANCIAL SERVICES INDUSTRY

Following introductions and a discussion of their goals for the day, the participants turned to a consideration of the case study and the question of how to rebuild trust in the financial services industry. In this discussion, the participants referred to the case study and supporting materials provided as the basis for conversation. The supporting materials contain information that shows that the public trust in the financial services industry is lower than most industries. The participants agreed that the task of rebuilding trust was not simply the responsibility of the individual firms, but required a wider effort involving industry-wide organizations, regulators and government officials.

The participants listen as John O'Connor makes a point.

The participants also considered the role of government regulation in improving the level of confidence in the financial services industry. Participants noted that while the supporting materials indicated that even though people believed that the lack of government regulation was the least important cause of the recent financial crisis, many believed regulation was the most important solution to problems that led to the crisis. The participants agreed that this was a meaningful disconnect and expressed concern that misplaced faith in additional regulation may prevent consideration of alternative solutions.

The participants discussed how the industry itself was partially responsible for this lack of public confidence. Neither industry groups nor individual organizations have done a good job celebrating the people and companies who are doing the right thing. Part of this reluctance, participants agreed, results from companies' fear of 'putting a target on their backs' by publically trumpeting ethical successes. However, some participants also noted that part of the challenge might be who is celebrated when such acknowledgments do occur. Companies tend to celebrate 'heroes', people who go above and beyond the call of ethical duty, rather than acknowledging those who do the right thing every day.

Participants distinguished between two distinct forms of trust. The first is trust in the sense of reliance. In the financial services industry, this entails that clients are comfortable relying on the advice they receive from their financial advisor. The second form of trust is trust that the other party has their best interests in mind. Participants believed that this second form of trust was evidenced by practitioners who adopted a 'relationship-based' rather than a 'transaction-based' approach to their professional activities.

Participants also believed that there is an advantage in talking about 'values' rather than in talking about 'ethics', which can sometimes come off as sanctimonious. Moreover, the participants agreed that organizations should limit their discussion to a few values that reflect the ethical commitments of the organization. But it is not enough to merely mention these values; it is essential to spend time explaining important decisions in terms of values and making sure that employees are able to interpret what behavior is required by the values and what is not. For example, 'clients come first in every interaction' does not mean giving the customer whatever they want.

Finally, it is unfortunate that every organization has to deal with individuals who violate the values of the organization. Therefore, how to deal with these

'rogue' individuals is an important issue for every organization. The participants agreed that disciplining rogue agents was important, not only to sanction the deviant behavior, but also to send a message to internal and external stakeholders that this behavior will not be tolerated. However, participants noted that communicating the punishment of rogue behavior can be challenging. Organizations are bound by privacy rules from disclosing information about the punishment or termination of an employee or agent. In terms of communicating to external stakeholders, participants expressed a concern that being fully transparent with regulators may invite additional, and unwelcome, scrutiny. The participants noted that there may also be a deficiency of trust between regulators and the organizations they regulate.

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 issue concerned how to deal with a situation in which an individual, bound by a commitment he had made prior to the sale of his firm to a larger entity, was being asked to break that commitment by his new employers. Breaking of the original commitment would have had a good outcome for the client and the new employer, but not for the company that underwrote the product being sold. The dilemma for the practitioner was whether to violate the original commitment to the underwriting company in order to pacify senior management and create a good outcome for a client.

The second issue was an accounting dilemma. It is standard practice in the financial services industry for companies to allocate premium increases to their reserve funds in order to prepare for the eventual need to pay out on policies. However, Generally Accepted Accounting Principles (GAAP) rules seem to require that the increased revenue generated from premium increases be counted as profits. Later, when the reserve levels prove to be inadequate, companies are required to take a 'charge-back' to boost these levels. This 'charge-back' reflects poorly on the company and can have a negative impact in terms of shareholder reaction. The dilemma was whether to seek additional clarification from the Securities and Exchange Commission on the questionable treatment of revenues from premium increases, even though the firm's auditors had given the practice a 'green-light', when such clarification might result in an unfavorable outcome for the company.

The third issue dealt with the decision to go to the owner of a company regarding serious concerns about the impact that a new managerial team was having on the culture of the organization. This executive's concern was not only that the new team did not appreciate the values that had made the organization successful in the past, but also that they were engaged in cost cutting measures that would weaken the organization in the future. The dilemma that this leader faced was whether she was willing to risk her position with the organization to tell the truth to senior leadership.

ACADEMICS' QUESTIONS

In this portion of the Forum, each of the academics posed a question to the executives.

The first question concerned how senior leadership should communicate its commitment to ethics to the various stakeholders of the firm. The questioner was especially concerned about how to communicate and reinforce this message to the employees of the firm. A second questioner asked whether it was possible to develop a 'job description' for a modern business. A job description would differ from a mission or vision statement in that it would be functional and would presuppose working in the service of either a broader organization or a larger purpose. A third questioner asked about how to develop an incentive system that rewarded conduct that was aligned with the values of the organization. A fourth questioner shared that many people she encountered asked her why those persons who were responsible for the harm caused by the financial crisis were not personally held accountable. She wanted to know how organizations held 'rogue agents' accountable and whether companies were willing to do so if

Ed Bonach and Kevin Gibson enjoy the discussion.

it meant losing a top performer. The final questioner asked about the best way to fund ethics education and training in a company. What does the answer to this say about its place in organizational priorities?

BUILDING AND MAINTAINING AN ETHICAL CULTURE

The participants then turned to a conversation about what factors were necessary to build and maintain an ethical culture. The participants agreed that employees needed to have a credible way to transmit their concerns about ethics to senior leadership. Participants believed that anonymous employee surveys could be very helpful in alerting senior leadership about trouble spots within the organization. Moreover, a meaningful effort should be undertaken to determine how the organization and its representatives are viewed by other stakeholders, such as their customers and suppliers. These groups can offer an outside perspective that illuminates potential problems that might go unnoticed within the organization.

The participants agreed that it was important to communicate their values to all of the stakeholders of the organization. They noted that it was especially important to focus on the 'middle level'. While resources are dedicated to 'on-boarding' new people in a way that acclimatizes them to the values of the organization and to offering high-level ethics training to senior leadership, there is often little in the way of meaningful training to individuals outside of those groups.

Finally, the participants agreed that ethics has to be on the agenda of every financial services firm because of the nature of the business. The financial services industry is based on the trust of the public that the intangible products and services they purchase will be redeemable when they need them most. Without this level of public confidence, the industry itself is unsustainable.

In concluding the discussion, the executives and academics agreed that the candid sharing of opinions was very helpful. They were appreciative of the opportunity to spend the day reflecting on ethical issues and learning from one another.

INTRODUCTION AND GOALS FOR THE DAY

The Fourteenth Annual James A. and Linda R. Mitchell Forum on Ethical Leadership in Financial Services began by Jim Mitchell asking the participants two questions:

What does ethics mean to you in your organization?

How do you hope to benefit from today's discussion?

Jim Mitchell said that his experience of working for two highly ethical organizations led him to the conclusion that it is possible for them to be highly successful while doing the right thing. "I hope that today's discussion enables the executives to go back with renewed vigor and dedication to doing the right things, and the academic folks to go back to their classrooms able to share the message that there really are many leaders committed to doing business in the right way."

Kevin Gibson was appreciative of the opportunity to participate in the day's discussions. "I see this time together as an amazing gift, and I want to be able to receive this gift in a way that acknowledges what is being given." He also wanted to focus on listening for 'practical take-aways'. "My colleagues and I tend to talk in the abstract, and I want to think about practical steps that folks can use in the workplace."

Ed Bonach was also looking forward to the dialogue. "I am hoping to talk about how we can get alignment between the theoretical talk about ethics and practical implementation. For me, it's important to move from 'book knowledge' to

Nien-hê Hsieh and Archie Carroll listen to John O'Connor.

practical knowledge we can apply in business." He also wanted to explore how leaders, both in business and outside of business, lose their 'North Star'. "To me, that's part of why business ethics initiatives don't succeed in certain situations."

John O'Connor said that, before he arrived at Fidelity, he worked in the area of financial investigations. "We would come in as a white knight who was hired to figure out very quickly what happened in the organization, who was responsible for the fraud, how they did it and then, with management, put in place a process so it would not happen again." He hoped that his tactical experience would add value to the conversation. He shared that at Fidelity, the emphasis was moving beyond talk of ethics to inculcating a firm grasp of the corporate values in every day actions. "We want people to understand the reasons why something is wrong and to live by the spirit of the policy rather than a list of 'check the box' requirements."

Archie Carroll noted that he started teaching in the field of business ethics when it was just developing in business schools in the 1970s. "I remember that my department head told me that I would never get promoted teaching and doing research in business ethics." Not only did I get promoted, but business ethics eventually became a "field" of specialization. He was grateful for the opportunity to talk with executives who are 'doing it right' but wondered if maybe it was unethical people that we should be talking to. "What I would like to glean from the conversation today, and from the business folks in particular, is why ethics don't seem to be getting better even though we've been doing ethics training for a couple decades now."

Nien-hê Hsieh mentioned that he was very interested in the question of corporate political accountability. "My research explores when it's sufficient for companies to basically follow the law and what are the cases when it is appropriate to actually engage in trying to change the laws themselves." He also wanted to think about ways to continue the conversation and interaction between academics and executives. "I think that this is such a valuable opportunity. If there's a way we can continue this conversation, that is something I would certainly be really interested in, as well."

John Barry shared that his experience as a member of the Advisory Board at the Cary M. Maguire Center for Ethics in Financial Services at The American College helped to shape his thinking about ethics. "It's been a bit of an epiphany for me in the sense that when I really look at our business, the core of what we do is to strive to be the most trusted advisor. I learned early in this business that our organization was much more effective under a relationship model, as opposed to a transactional model. So one of the reasons why this conversation is important to me is because it will help us to sustain the success of our organization into the future."

Kirk Hanson observed that this was his second time attending the Forum on Ethical Leadership and he was glad to participate again. "My reservoir of trust in the capability of business to manage ethics has run a bit dry. I'm not cynical, but I am discouraged. It seems to me that there are so many pressures in the financial environment that it is impossible to support the sort of visionary leadership that we saw in the 1970s and early 1980s, such as Reginald Jones and David Packard. I'm interested in exploring how we create the conditions to support the return of this type of leader."

Ed Bonach speaks with Jim Mitchell.

A CASE STUDY: REGAINING TRUST IN THE FINANCIAL SERVICES INDUSTRY

Marcus, a successful financial advisor and his wife, Alissa, a professor of business ethics, meet up with David, who works in the government affairs office of KRN, one of the nation's largest broker-dealers. The three are attending a well-known financial services industry conference. Marcus and David have just come from a session in which the CEOs of three financial services companies, including KRN, discussed future challenges and opportunities for the industry. The session included questions from the audience, which sparked a lively debate among the attendees.

"I thought that the presentations were really good," David said to Marcus and Alissa. "I was not expecting the CEO panel to be that interesting; usually those sessions seem pretty scripted."

"I agree," Marcus confirmed. "Frankly, I thought it was all boilerplate until that question from the audience about rebuilding trust in the industry was 'tweeted' or 'texted' or however that works. Then it got pretty interesting."

"Was that you?" David turned to Alissa. "That would be just the sort of question you would ask."

"No," she admitted. "I wish I could take credit for it! Maybe you have another business ethicist in the ranks and don't know it."

Heidi O' Connor and Kevin Gibson at the closing reception.

"Doubtful," Marcus smiled at his wife. "But the question was right up your alley, 'How do you plan to restore faith and confidence in the financial services industry among the American public?'"

"And what did your boss have to say about that, David?" Alissa queried.

"He addressed it head-on," David responded, "and I give him a lot of credit for that. He didn't try to duck the issue. The article in The Wall Street Journal on FINRA's new initiative to go after high-risk brokers was damaging, particularly since of the three brokers profiled in the article, two were from KRN."[1]

"You must have been pretty involved in that," Marcus remarked, "given that FINRA seems to be accelerating its regulatory efforts."

"It has not been fun," David said ruefully. "FINRA is usually willing to at least listen to our side of the story, but they're always under pressure from the politicians. And, with the exception of a few journalists, most of the media aren't all that willing to listen either. But, I suppose, it could have been worse."

"I had a couple of clients ask me about the Journal article," Marcus noted. "If you actually look at the numbers, it's something like 87% of brokers have a completely clean record, with no customer complaints. And it is less than 1% of brokers who seem to have all of the problems."

"But," David chuckled, "that wasn't the headline, was it? Most people seem willing to believe the worst about the industry at this point."

"Can you blame them?" Alissa asked. "The reason for the lack of public confidence is that companies," she paused and corrected herself, "some companies anyway, failed to do the right thing by their clients, failed to uphold their mission and did everything in their power to subvert the few regulations designed to protect against risk that were in place. Why should they trust you?"

"But they should trust the government and regulators?" Marcus asked. "You can't place all of the responsibility on business. If you look at a company like KRN,

[1]FINRA stands for the Financial Industry Regulatory Authority. FINRA is the largest self-regulatory organization (SRO) in the securities industry in the United States. An SRO is a membership-based organization that creates and enforces rules for members based on the federal securities laws. SROs, which are overseen by the Securities and Exchange Commission, are the front line in regulating broker-dealers. Definition retrieved from Investopedia.com: please see http://www.investopedia.com/ask/answers/112.asp

they have thousands of advisors who do business in the right way, and yet its entire brand is taking a hit because of a couple of rogue producers." He turned to David, "What sort of impact do you think this will have on KRN's proposed acquisition of CapitalLink?"

"I'm not fully in the loop on that," David said thoughtfully. "I don't think it will scuttle it. It will help that CapitalLink is not one of our bigger broker-dealer competitors. Everyone at the table—including the SEC—is too sophisticated to be unduly influenced by a news article, but I'm sure that some of the key players are a bit skittish. This was terrible timing from that perspective."

"But the problems with the industry are bigger than a couple of negative articles in the Journal," Alissa interjected. "It wasn't just a few rogue brokers that caused the financial crisis. The real problem, like you said, is that the public is willing to believe just about anything about the industry. I talk to my students about this in class. I think it is going to have tremendous implications for how businesses will operate in the future. We're going to see decreased consumer loyalty, increased skepticism and an unwillingness to rely on professionals as experts. I want to know how the industry is going to fix that problem."

"That's a fair point," Marcus agreed. "I guess I don't see that lack of trust. Whatever people think about the industry, and I'll grant you, most of what they think isn't very good, it doesn't have anything to do with what they think about me. I think that most people distrust the company and really like their advisor. But what do you think, David?"

"It really troubles me," David confessed. "Even if it doesn't affect what your clients think about you, it is going to affect your business. The implications of the push for increased regulation and oversight will hit the individual producers. It will make it harder for you to do business. I can assure you of that."

"You have great relationships with your clients, Marcus." Alissa remarked. "You've known them for years. They know our kids and me. They believe in your honesty and integrity. But, what you had to do to earn trust is different than what you would have to do to earn it now."

"Okay," Marcus conceded. "That makes sense. But now you've got me worried, too. What are we going to do about it?"

"That's the million dollar question. All the increased regulation is going to make it harder and not easier to build that trust with clients," David remarked. "All the additional written disclosures, the forms, the signatures don't really protect people. They only create the impression in the mind of the client that their advisor is someone that they need to be protected from, not someone who is there to help them."

"But some of them do need that protection, David." Alissa noted. "Some people do need to be protected from advisors who don't have their best interests at heart and sell them products they don't understand, or place them in investments that generate massive fees, or whatever."

"But the regulators did not stop it then and they won't be able to stop it in the future," Marcus said. "More regulation isn't going to improve the situation, Alissa."

"Neither is relying on the integrity of every person in the industry to do the right thing," Alissa countered. She turned to David with a smile, "As you can see, this is not our first go-around on this topic."

David chuckled, "They should have put the two of you up there on that panel instead of the CEOs. But, I think that the question that was asked today was the right one; it was what are the organizations going to do to increase trust. I am not even sure that this is an industry-level question. It may be, but I think

Kevin Gibson, Jim Mitchell and Kirk Hanson listen to the discussion.

it needs to start at the level of the organization. That's why it was scary that the CEOs didn't seem to have the answers."

"You're right," Alissa agreed. "It is about organizations focusing on creating policies and procedures that incentivize and reward people for doing right by their clients. It is about creating a culture focused on values, in addition to focusing on profits."

"But," Marcus interrupted, "you've got to convince the shareholders that this is the right path to take, that it will pay off in terms of the bottom-line. You've got to convince producers that they can earn money in that sort of environment."

"I agree," Alissa said, "but I have to believe that the public will respond, at least in part, to the people who work for a company like that. I'm not sure how you go about rebuilding that trust, or even if it's possible, but it seems that this is the way to start."

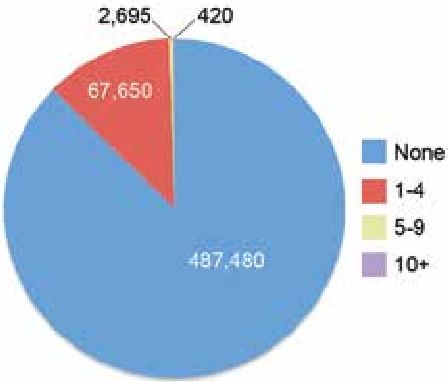
Ed Bonach, Linda Mitchell, Jim Mitchell, Heidi O'Connor and John O'Connor at the closing reception.

NOTES

NUMBERS OF DISCLOSURES FOR FINRA REGISTERED BROKERS[2]

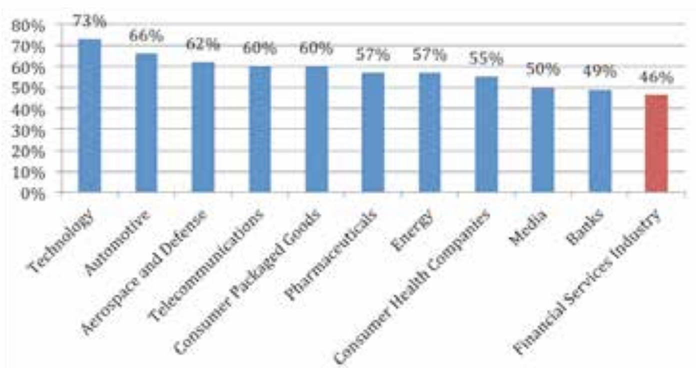
Disclosures refer to the releasing of an individual's disciplinary incidents by FINRA.

The figure below is based on data for 558,245 brokers gathered in the first half of 2013. The Journal's analysis included records for more than 85% of U.S. brokers.



TRUST IN THE FINANCIAL SERVICES INDUSTRY RELATIVE TO OTHER INDUSTRIES[3]

Globally, trust in the financial services industry is lower than trust in other industries, although not by a large margin.



[2] Eaglesham, Jean and Rob Barry, "FINRA is Cracking Down on 'High-Risk' Brokers" The Wall Street Journal. November 21, 2013. Accessed on 12/1/13 http://online.wsj.com/news/articles/SB10001424052702304607104579212321072458370

[3] All survey data comes from the 2013 Edelman Trust Barometer in Financial Services Industry. Please see http://www.edelman.com/insights/intellectual-property/trust-2013/trust-across-sectors/trust-in-financial-services/

CAUSES OF DISTRUST IN THE FINANCIAL SERVICES INDUSTRY[4]

Survey results reveal that more people attribute their lack of trust in the financial services industry to the perception of corporate corruption or fraud.

Corruption or Fraud	27%
Wrong incentives driving business decisions	23%
Poor performance/incompetence	16%
Transparency Issues	16%
Lack of regulation or control	16%

DIFFERENCES IN LEVELS OF TRUST WITHIN THE FINANCIAL SERVICES INDUSTRY (IN NORTH AMERICA) [5]

Survey results reveal that North American respondents trust credit card companies and operations LEAST among divisions within the Financial Services Industry.

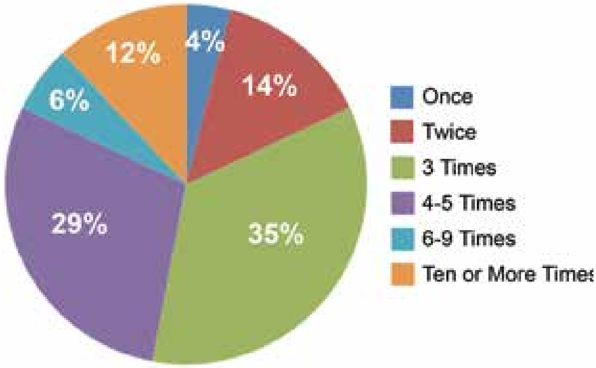
Banks	44%
Credit Cards/Payments	39%
Insurance	45%
Financial Advisory	45%

[4] *In response to the following question: "Which of the following is the main reason why your trust in business has decreased over the last year?"*

[5] *Results from the following survey question: "Now thinking about specific sectors within the financial services industry, please indicate how much you trust business in each of the following sectors to do what is right. Again, please use the same 9-point scale where one means that you 'do not trust them at all' and nine means that you 'trust them a great deal.'"*

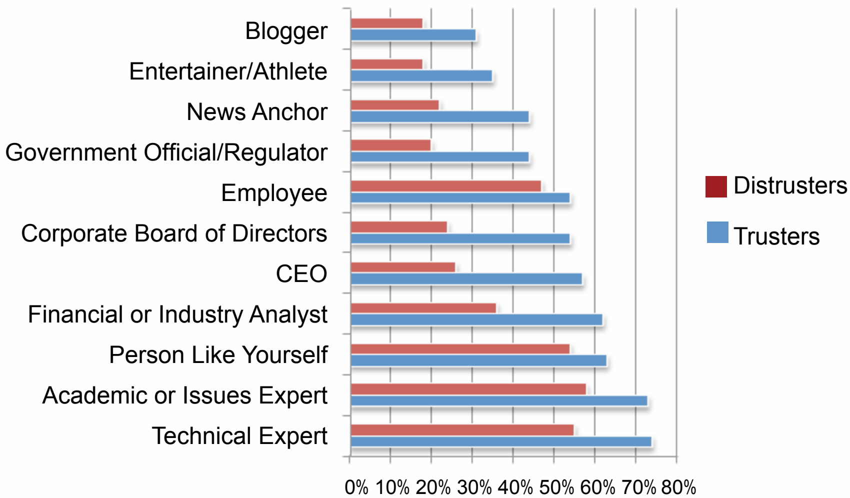
HOW TRUST IS BUILT - FREQUENCY OF COMMUNICATIONS[6]

Survey results reveal that most people need to hear a message at least three times in order to view that message as credible.



HOW TRUST IS BUILT – THE MESSENGER MATTERS[7]

Survey results reveal that the messenger matters. People who trust the financial services industry are more willing to trust each messenger than distrusters. Both groups are most trusting of academics or technical experts.



[6] Results from the following survey question: "Think about everything you see or hear every day about companies, whether it is positive or negative. How many times in general do you need to be exposed to something about a specific company to believe that information is likely to be true?"

[7] Results from the following survey question: "Below is a list of people. In general, when forming an opinion of a company, if you heard information about a company from each person, how credible would that information be—the following answers reflect the very/extremely credible box. The question tracks the difference between people who trust the financial services industry and those who did not."

TRUST BUILDING ATTRIBUTES HAVE BEEN GROUPED INTO FIVE PERFORMANCE CLUSTERS[8]

ENGAGEMENT

- Listens to customer needs and feedback (67%)
- Treats employees well (59%)
- Places customers ahead of profits (64%)
- Communicates frequently and honestly on the state of its business (62%)

INTEGRITY

- Has ethical business practices (63%)
- Takes responsible actions to address an issue or crisis (65%)
- Has transparent and open business practices (64%)

PRODUCTS AND SERVICES

- Offers high quality products or services (63%)
- Is an innovator of new products, services or ideas (45%)

PURPOSE

- Works to protect and improve the environment (48%)
- Addresses society's needs in its everyday business (54%)
- Creates programs that positively impact the local community (49%)
- Partners with NGOs, Government and 3rd parties to address societal needs (39%)

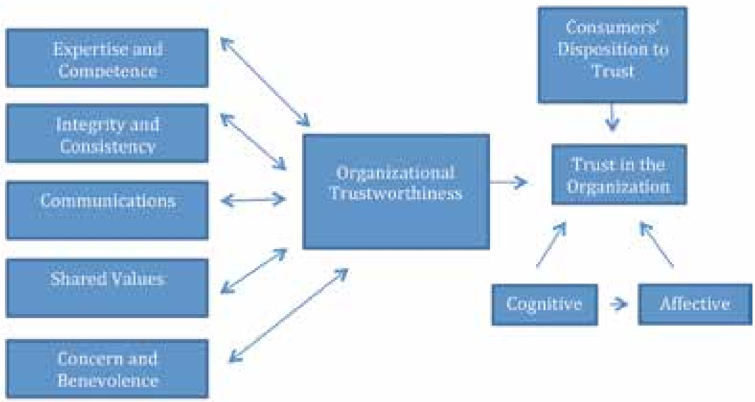
[8] Results from the following survey question: "Please think about businesses in the Financial Services Industry. How important is each of the following actions to building your trust in businesses in the Financial Services Industry? Please use a nine-point scale where one means that action is 'not at all important to building your trust' and nine means it is 'extremely important to building your trust.'"

OPERATIONS

- Has highly regarded and widely admired top leadership (45%)
- Ranks on a global list of top companies, such as best companies to work for or most admired companies (42%)
- Delivers consistent financial returns to investors (49%)

BEST SOLUTION TO SCANDALS IN FINANCIAL SERVICES INDUSTRY[9]

A FRAMEWORK FOR TRUST IN THE FINANCIAL SERVICES INDUSTRY[10]



[9]*In response to the question, "Which of the following is the BEST way to resolve the issues in the banking/financial services industry that caused these scandals?"*

[10]*Ennew, Christine and Harjit Sekhon (2007) "Measuring Trust in Financial Services: The Trust Index" Consumer Policy Review 17(2): 64*

QUESTIONS FOR DISCUSSION

(1) While David and Marcus attribute the lack of public confidence in the financial services industry to the media reports of 'rogue practitioners', Alissa attributes the lack of public confidence to suspicion regarding the structure and practices of the industry. Is this difference attributable to their relative positions inside and outside of the industry? How do members of the industry account for recent problems? What is the impact of their beliefs?

(2) The case study refers to the possible impact of negative publicity on KRN's proposed acquisition of CapitalLink. What are some concrete steps that KRN's leadership could take to ameliorate the concerns of both regulators and investors?

(3) Both David and Marcus discuss how media coverage has exacerbated the mistrust between the financial services industry and the general public. Is this a valid criticism? What role does the financial media have in any 'crisis of confidence'?

(4) According to the Edelman survey results, consumers of financial products believe that the best way to resolve issues in the financial services industry that caused such scandals as J.P. Morgan's 'London Whale' and the LIBOR scandal is through increased government regulation. Do you agree with this assessment? Why or why not?

(5) It is evident that consumers of financial services products need to trust the manufacturers and distributors of such products. This is the case for a multitude of reasons including product complexity and a lack of consumer sophistication about financial markets. What are the likely results of this disconnect between this need for trust and the lack of trust among consumers?

(6) According to Chen and Mau (2009), "Customer trust in the salesperson is a property of the ongoing relationship and not merely based on a single exchange episode, and trust is developed through repeated interactions between both parties in which the customer observes the salesperson

to be consistent, competent, honest, fair, responsible and benevolent."[11] If this is true, then how does the process of building trust get 'off the ground'? How can individual financial planners and insurance professionals increase the trust of their clients?

(7) What steps can financial services institutions (financial planning and insurance companies) take to increase the level of trust in which they are held by the American public?

(8) What steps could financial services regulators take to improve the level of trust in which financial services professionals are held by the American public?

(9) According to the Edelman survey results, only 6% of respondents believe that a stronger Board of Directors could help resolve the issues at the heart of recent banking scandals. What steps can Boards of Directors take to restore confidence in their abilities and commitment to sound corporate governance?

(10) According to the Edelman survey results, the financial services industry is the least trusted industry on worldwide basis. Do you see its ranking changing in the next five years? Why or why not?

(11) "The specific features of financial services and the importance played by front line staff and sales staff mean that trust may be based in the organization, brand or individual."[12] Which level of trust is most important for the sustainability of the financial services industry? Why?

(12) According to the Edelman survey, consumers who already distrust the financial services industry are most likely to believe information about financial services organization from an academic or issues expert. This seems to create an important opportunity for academics to help to rebuild trust in the financial services industry. Is this an appropriate role for academics to play? What are some ways that academics could partner with business leaders without undermining their credibility? What are some barriers to this sort of collaboration?

[11] *Chen, Mei-Fang and Liang-Hung Mau (2009) "The Impacts of Ethical Sales Behaviour on Customer Loyalty in the Life Insurance Industry" The Service Industries Journal. 29(1): 63*

[12] *Ennew, Christine and Harjit Sekhon (2007) "Measuring Trust in Financial Services: The Trust Index" Consumer Policy Review 17(2): 63*

"I think that some ethical people are afraid to talk about those intangibles because they don't want to look weak in this macho quarterly earnings environment."

Kirk Hanson

DISCUSSION OF THE CASE

REBUILDING TRUST: WHO IS RESPONSIBLE?

Archie Carroll didn't think the task of rebuilding trust in the financial services industry was the sole responsibility of the individual firms. "As you read the case, you're left with the impression that it's up to the organization to rebuild this lost trust. And I agree with that, but there are so many stakeholders—the media, investor groups, social activists—that this issue needs to be addressed at multiple levels." He also wasn't convinced that more government regulation was the answer. "If you look at the recent problems with J.P Morgan, the company is going to pay its $2.6 billion fine, which will somehow be incorporated into the budget and passed on to its customers and shareholders. I don't think that is a solution to the problem, because it does not prevent the problem."

Nien-hê Hsieh agreed with Carroll and pointed to the chart contained in the Notes section of the case. "If you look at the chart of what people believe to be the cause of the financial crisis, lack of government regulation is cited as the least important cause, but it is also cited as the most important solution to the problem. This seems to be a meaningful disconnect."

John Barry thought that part of the problem lay with the industry. "We do a bad job of taking the time to acknowledge and celebrate those individuals who make good decisions on the things that aren't quantifiable. Public acknowledgment is an incredibly powerful thing when it's done in the right way."

Kirk Hanson agreed with the importance of recognizing people for acting well on the intangibles, but added that this strategy presented challenges. "Unfortunately, people in your positions, in my view, are scared to death of telling those stories because it'll look like they aren't bottom-line oriented. I think that some ethical people are afraid to talk about those intangibles because they don't want to look weak in this macho quarterly earnings environment."

Kevin Gibson thought that it was important to make a distinction between moral decency and heroism. "We expect people to be morally decent, but we don't actually acknowledge morally decent behavior. We talk about the 'hero' stories, where people have gone above and beyond, like people who 'blow the whistle'. What we need is a mechanism for talking about people who do the right thing and who are committed to doing business in accordance with the core values."

TRUST AND VULNERABLE CLIENTS

Nien-hê Hsieh distinguished between two conceptions of trust. "There is trust in the sense of reliance. For example, given the regulations in place and given the incentive structures, I can feel pretty confident that the advice I receive from my advisor is going to be sound. The second conception of trust refers to the belief that the other party actually has some goodwill and my interest in mind. Both forms of trust are important; the reason we want good government regulation is to create a system in which we can reasonably rely on the advice we receive. But government regulation cannot create the second kind of trust, which is created as a byproduct of demonstrating benevolence, goodwill, and competence."

John O'Connor shifted the discussion to a practical example. "There are a tremendous number of people in this country suffering from dementia. So you have a financial advisor who is saying, 'You know, I've never seen Bob make a transaction like this before' or 'Bob is calling in again and he seems a bit confused about his accounts'. Does that financial advisor reach out to Bob's family even when there isn't a legal document that authorizes him to do so? Many advisors in his position would not, because they're fearful of the legal liability. But is this really benevolence? Does avoiding the issue really serve the client's best interest?"

John Barry thought that this dilemma got to the heart of the difference between an advisor who is relationship-oriented and one that is transaction-oriented. "If you're transaction-oriented, you're just booking the ticket and you move on." But it's a different situation if the advisor is relationship-oriented. "By definition, it's understanding the client's situation and seeking to do the right thing. However, this can open a sort of Pandora's box if your definition of doing what's right runs into compliance prohibitions."

Kevin Gibson thought that part of the problem is that society has lost sight of the idea that business is about service. "You're adding value. It's not just wealth creation; it's providing something to enhance people's lives. Somehow we have to restore this notion of service to the narrative about business. We have to include the idea that benevolence is built into the notion of what it means to be a business."

ETHICS, VALUES AND PUTTING THE CUSTOMER FIRST

Kevin Gibson noted that he was trying to move away from the term 'ethics' and focus instead on 'values'. "I find that ethics is perceived as having a 'Sunday school' or 'preachy' tone, or at least some people perceive that it does."

Jim Mitchell shared that as a senior leader, he talked about values rather than about ethics. "Our first value was 'Customers come first in every interaction'. However this does not mean that we always did whatever the customer wanted. You would not have a business very long if you did whatever any client wanted. Leadership has the responsibility to help its people interpret each value and know where the boundaries are."

Archie Carroll referred to the work of Peter Drucker. "Drucker argued that the purpose of business is to create a customer. If executives are always focused on creating and retaining a customer, social responsibility and ethics are going to take care of themselves. Trust, in other words, is the residual that comes from always putting the customer first. So, for me, the management challenge is how to push this message down through the organization."

> "If executives are always focused on creating and retaining a customer, social responsibility and ethics are going to take care of themselves. Trust, in other words, is the residual that comes from always putting the customer first."
>
> **Archie Carroll**

Kirk Hanson talks with Nien-hê Hsieh and Priscilla Carroll at the closing reception.

Ed Bonach agreed with Mitchell and Carroll. "We had a situation in which an employee, trying to empathize with a policyholder who was irate about a number in their annual report, agreed that the number 'didn't seem right'. This statement became the basis of a lawsuit that this policyholder filed against the company. It just shows that there is no 'silver bullet' in helping employees understand how to interpret our values."

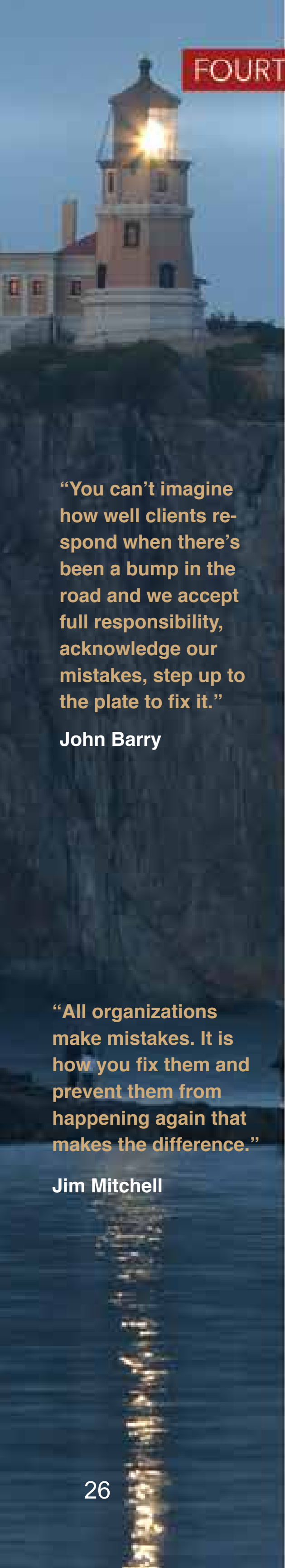
John Barry thought that the distance from the customer could explain some of the ethical issues in the financial services industry. "At big wire houses, the people on the trading floor are executing institutional trades. Someone is going to have to sit down with them and say, 'I know as a firm, we want to compete, win and be profitable, but you need to understand that these trades translate into actions that have real consequences for thousands of people.'"

DEALING WITH THE "BAD APPLES"

Kevin Gibson wanted to know how firms dealt with the 'rogue agents'. "We did have those perp stories where people were dragged away in handcuffs. Did those do any good? Did they send an effective message to firms and the market?"

Ed Bonach stated that it was hard to publicize stories of how 'bad apples' were dealt with inside of the organization. "Even internally, we are very guarded in saying that we terminated someone. In fact, at one point, we did terminate a large branch manager and the biggest producer. Through 'informal' channels, people knew what had happened and why it happened. But we did not formally promote it internally because of the concern that we would get sued."

John O'Connor raised another obstacle to publicizing the sanction of rogue agents. "Not only do you have employment law issues, but you may have publicity that hurts your brand, even if you're trying to do the right thing." He found that it's quite effective to train employees using a variety of actual examples—combining internal "generic" scenarios with information publically available about other organizations. Examples tend to stick best with people's memories and training of this type allows you to show them how they can avoid the guardrails that others have missed. Bonach noted that volunteering information to regulators poses its own set of challenges. "One of my mantras is that 'the key to making mistakes is finding your own'. Everyone makes mistakes, but you need to find them and do the right thing. But if you tell the regulator, one of the risks is that he'll say, 'Well, how many more of those do you have?



"You can't imagine how well clients respond when there's been a bump in the road and we accept full responsibility, acknowledge our mistakes, step up to the plate to fix it."

John Barry

"All organizations make mistakes. It is how you fix them and prevent them from happening again that makes the difference."

Jim Mitchell

Maybe we need to come down there and take a closer look.'" Part of the problem is the way in which many state insurance regulators are funded. "They don't have real budgets; their budgets are funded by the fines that they bring in. So they are focused on assessing fines because that is how they sustain themselves."

O'Connor mentioned that another dimension of this challenge pertains to how regulators will perceive what is found, even when a firm proactively investigates, eradicates problems and discloses results to them. "One of the things most people assume when they sit with a financial professional, is that this person has been properly vetted for criminal and credit blemishes. You would think all companies run criminal and credit background checks on their employees, but they don't. We always did this; however, one of the proactive steps we took several years ago was to take it further and redo credit and criminal backgrounds on a periodic basis. There was initial pushback from some, expressing concern about the uncertainty of what we would find and then have to report to third parties if we terminated the individual. You want to believe the regulator will credit proactive work in support of protecting the underlying customer but unfortunately, the opposite can occur from time to time. In this case we chose to do the right thing and take the risk of uncertainty and embarrassment – a real tribute to senior leadership and the DNA of ownership. I think there are ethical dilemmas like this throughout the industry. We need to ensure companies are vigilant in how they ferret out issues and likewise, we need regulatory leadership to recognize those who are going the extra mile at risk of being the next headline."

Archie Carroll thought that this was an important story to get out to the industry. "It strikes me that so many in the industry are managing out of fear, fear of what the regulators will do with this information if you are transparent."

Jim Mitchell thought that this example reflected on another trend, which was the failure of senior leadership, on the advice of their general counsel, to take responsibility for mistakes. "But how credible can you be as a CEO if you don't admit that you screwed up once in a while? All organizations make mistakes. It is how you fix them and prevent them from happening again that makes the difference."

Nien-hê Hsieh brought up a similar analogy in the medical profession. “For a long time, attorneys advised physicians against apologizing or acknowledging a mistake to patients. But then some hospitals changed their polices and it turns out that all of the measures of the quality of care actually improved when physicians admitted they made a mistake and offered an apology. I think that it goes back to the issue we discussed earlier, which is that an apology reveals concern for the genuine interest of the other party.”

John Barry said that this resonated with his experience. “You can’t imagine how well clients respond when there’s been a bump in the road and we accept full responsibility, acknowledge our mistakes, step up to the plate to fix it. I would say that 99 percent of the time we’re able to retain that account. Some of those clients have become ambassadors for our firm, because this is not how a lot of people operate.”

THE EXECUTIVES' ETHICAL DILEMMAS

EXECUTIVE DILEMMA #1

I work in a firm that is a member of a larger, life insurance distribution company. Essentially, this distribution company is a collection of other firms like my own. One of the benefits of membership is that certain insurance companies design products that are exclusive for our members. These are primarily life insurance products that are designed to be marketed to a select risk pool (a group of clients who have a better risk profile). Because of the nature of the pricing model, if we do a good job on the front end of creating a select risk pool, we can actually pass on a better value to the customer. Our distribution company that manages the product development process, uses member firm agreements to control who can sell these proprietary products. The distribution company has developed incentives for members to identify and sell those prospective clients who would qualify for the select risk pool. The goal is to control distribution in an effort to maintain the integrity of the select risk pool and the pricing model in general.

When our firm agrees to be a member of the distribution company, we sign an agreement to protect the proprietary nature of the product and to abide by any restricted distribution covenants. We've been a member of this distribution organization for more than 25 years. Seven years ago, we sold our individual firm to a large, national bank. We were allowed to maintain membership in

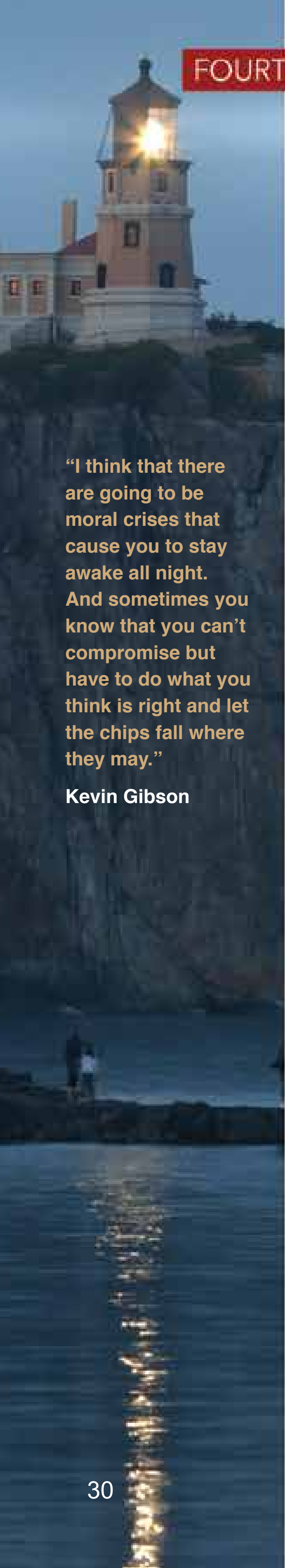
Nien-hê Hsieh, Archie Carroll, John O'Connor and Marianne Jennings listen to the discussion.

Linda Mitchell, Ed Bonach, and John Barry listen to Archie Carroll at the opening reception.

the distribution company as long as we protected the proprietary nature of our products. Only designated producers could market and sell the products offered through the distribution company.

During our involvement with the bank, one of my managers gained access to these proprietary products through the design team and put together a presentation to a prospective client that was going to generate about a million dollars in commissions, which is a sizable transaction in the context of the life insurance business. The product was, in fact, the best fit for the client and so the situation had the appearance of benefitting all involved: the client would get the best product, the broker would earn a generous commission, and I would look like a good team player for providing the bank (my new employer) access to a great product for all of their customers.

However, my ethical dilemma was that the manager who was making the sale was not allowed to distribute that product. While the bank could have offered the client the product through my firm, since we were eligible to sell the product, they chose not to do that. I pushed back on their plan to sell the product and was told, essentially, since they purchased my firm, they 'owned it' along with all its resources and assets. They could have brought me into the sale, but this would have created tensions over compensation. Are they going to pay me because it is only through me that they can access the product or are they going to pay the



"I think that there are going to be moral crises that cause you to stay awake all night. And sometimes you know that you can't compromise but have to do what you think is right and let the chips fall where they may."

Kevin Gibson

other broker who found the case? In the end, they simply wanted me to go along with the sale as it was structured for the benefit of the client.

The challenge that was presented was how it could be wrong to sell a product that was in the best interest of the client? But on the other hand, our firm had made a promise when we signed the limited distribution agreement. There are reasons why the rules were established in the first place and if we start allowing exceptions, this leads to a violation of the agreement. It sets a dangerous precendent. If I'm willing to bend the rules for this prospective client, then what's going to happen the next time a new opportunity comes down the pipeline?

Kevin Gibson said that he understood the focus on the best interest of the client, "but you're talking about a stream of clients over a long period. It's a larger universe than just this particular case."

Jim Mitchell agreed. "You made it clear that the market for this product was pretty selective; it was not designed for anyone who could walk in the door. The business model could be diluted if it was not sold appropriately."

Archie Carroll added that this case involved the question of the assumptions we make of the trustworthiness of the people we do business with. "There was the assumption that everyone would be honest and deal fairly and clearly but, as you discovered in your interactions with management, this was not the case."

Jim Mitchell and Kirk Hanson talk at the opening reception.

Gibson believed that this was a story about the importance of moral courage. "I think that there are going to be moral crises that cause you to stay awake all night. And sometimes you know that you can't compromise but have to take a stand, and in cases like that you may have to do what you think is right and let the chips fall where they may."

Mitchell observed that if the attitude of management was that they 'owned you', an encounter like this was inevitable. "Something else would have come up pretty soon if this one didn't."

EXECUTIVE DILEMMA #2

Insurance companies typically must have at least three sets of financial statements. First, state insurance regulators require insurance companies have statutory statements that govern solvency and are required to protect the security of consumers. Second, companies have GAAP (Generally Accepted Accounting Principles) statements for public reporting and finally, companies must use a third set of financial statements that are required for tax purposes. Each of these statements is governed by different principles, which makes sense since they are used for different purposes.

Our company sells Long-Term Care insurance and over the years, there have been many questions concerning accounting for the reserves needed to pay the future benefits on these policies. For regulatory purposes, companies may prospectively change reserve assumptions for long-term care policies when the actual policy experience differs from original assumptions. This reserve assumption change results in premium increases to the policies.

We used this method and put the premium increases into the reserve to pay future benefits. In its simplest form, we were not letting that increased revenue from premium increases fall through to the bottom line as we treated the additional revenue in the same way in the GAAP statements that we are required to file since we are a publicly traded company.

However, GAAP rules also have provisions that direct companies to allow the increased revenue to fall through into the bottom line in the form of profits and then, once the reserves become inadequate based upon policyholder experience, take a large reserve charge. Obviously, companies are reluctant to take such a large charge since it is likely to cause a negative reaction from your shareholders and other stakeholders.

Even though our methodology was supported by GAAP demands, and our auditors had allowed us to use this treatment which was standard practice among companies selling long-term care products, I was faced with the dilemma on whether to go to the Securities and Exchange Commission and ask for clarification on how these revenues should be treated. If it turned out that we should not have been increasing the reserves, then we would have to submit a restatement of prior earnings and revise earnings upwards. Even though the restatement would be positive to our earnings, the term "restatement" potentially leads to a negative reaction from stockholders and analysts. Since as an organization we were working hard to regain the trust and credibility of regulators, analysts and the public, this sort of incident could potentially have a harmful impact on our organization.

In the end, I believed it was the right thing to do to go to the SEC. There was a school of thought that it was better not to ask and, since our auditors had signed off on it, we were 'in the clear'. However, in my mind, this was not the right way to move forward and continue to build credibility in the eyes of our stakeholders.

Kevin Gibson wondered whether it was possible that restatements could be seen as a positive by shareholders. "For those of you who remember the Ford Pinto case, managers at Ford were reluctant to recall the Pinto because they felt that a recall demonstrated to the market that this was a shabby product. Whereas now, I think that the perception is that you recall a car, it shows that you're being upfront and responsible. Is it possible that the market could react in the same way to financial restatements?"

Archie Carroll and John O'Connor listen to Marianne Jennings .

John O'Connor did not think so. "In my previous work, I was involved with a number of revenue recognition cases. Management is usually kicking, screaming and doing whatever they can to avoid having to go through the restatement process. It normally has a big impact in terms of the level of confidence in them and in the company itself."

Ed Bonach agreed and noted that restatements usually resulted in serious consequences for the management and members of the Board. "We spoke about institutional investors that use ISS (Institutional Shareholder Services) to vote their shares. In a situation where there has been a restatement, ISS typically votes against members of the audit committee at a minimum, if not more than that."

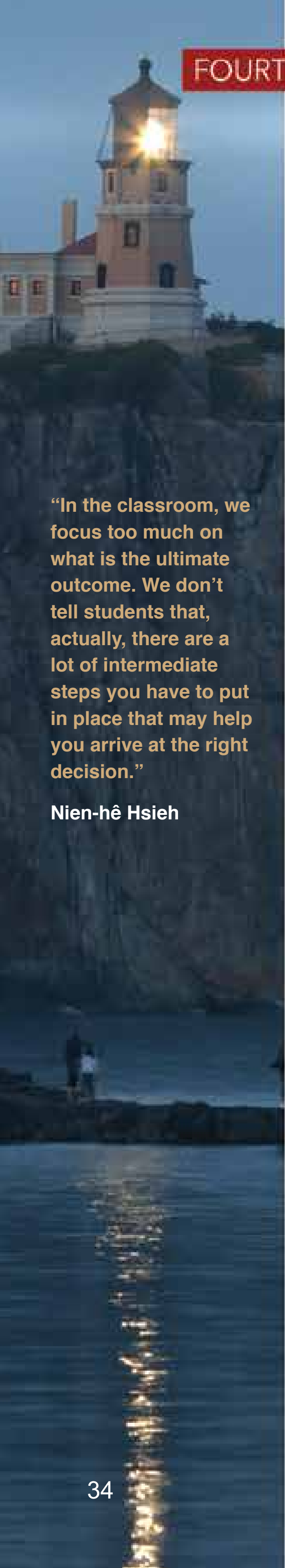
EXECUTIVE DILEMMA #3

A woman whom I have known professionally for a number of years recently shared this dilemma with me. I didn't know her well at the time she was going through this situation, but I did know some of the people involved. She gave me her permission to share it with the group so long as I changed some of the circumstances to preserve confidentiality. She worked as the head of Legal, HR and some other staff departments in a relatively small firm, where the CEO owned most of the stock. As you would expect in a small firm, she had a personal relationship as well as a good business relationship with the CEO.

The CEO felt that the firm needed more professional management, so he brought in a new Chief Operating Officer from the outside. The new COO decided that, in order to improve results quickly, he would cut expenses. So every part of the company, hers included, was ordered to cut expenses by 10%. From her perspective, it was a challenging, but doable request.

But after everyone had made those cuts, the COO was not satisfied. He ordered another 15% across-the-board cut. When she protested that such a deep cut could not be made in her area without completely undermining the effectiveness of her departments, he told her to "just do it." She knew this was not the right thing to do, but also knew that he was her boss.

After losing sleep about this for some days, she decided on an approach. She wrote up a report on how to cut an additional 15% in her area, together with the adverse consequences of doing so. In her report, she made clear that she thought cutting this deeply would be a mistake. She included her letter of resignation, stating that she was not going to make these additional cuts.



"In the classroom, we focus too much on what is the ultimate outcome. We don't tell students that, actually, there are a lot of intermediate steps you have to put in place that may help you arrive at the right decision."

Nien-hê Hsieh

She took a copy of this report to her boss, the COO. After outlining to him what was in it, she told him that she was also taking a copy to his boss, the CEO. She told him that he could come with her if he wished. He did come with her, and defended his decision to make the additional expense cuts quite vigorously. She calmly told the CEO that she would not make the cuts and that, if he insisted on implementing them, she would resign. The CEO wanted time to think the matter over.

The next week, the CEO fired the COO, concluding that he did not have the longer-term best interests of the company at heart. She was gratified, and stayed on for several more years. She did eventually leave for a better opportunity, but always felt good about that CEO and the ethical decision he made.

Kirk Hanson remarked that he had seen similar scenarios play out at a number of companies including HP, but without an executive willing to stand up and predict the adverse consequences. Then when dire outcomes do come to pass, senior management acts surprised. They shouldn't be.

Archie Carroll thought that the executive handled the situation very well. "What I liked about the way she handled it is that she carefully analyzed what the consequences were going to be if the cuts had been made and then made a good faith effort to explain this to her bosses. It showed that she was working within the system."

Nien-hê Hsieh believed that this case study was an excellent example of the importance of process. "In the classroom, we focus too much on what is the ultimate outcome. We don't tell students that, actually, there are a lot of intermediate steps you have to put in place that may help you arrive at the right decision."

Kevin Gibson referred back to Ed Bonach's earlier reference to the 'North Star'. "I'm struck by the fact that she had a clear idea of what the right thing was to do and that she did it anyway, even though it did not feel good at the moment."

John Barry felt it was important to capture these stories and pass them along to the next generation of management. "We need to capture these values and share them in perpetuity."

John O'Connor felt that was an ongoing challenge. "It is a constant challenge to help leaders understand the balance between efficiency of significant cuts and foolishness when it comes to critical control functions. It's absolutely critical to have leaders who are willing and able to make these arguments for the good of the company. It can very well decide who will have the reputational disasters in years to come."

THE ACADEMICS' QUESTIONS

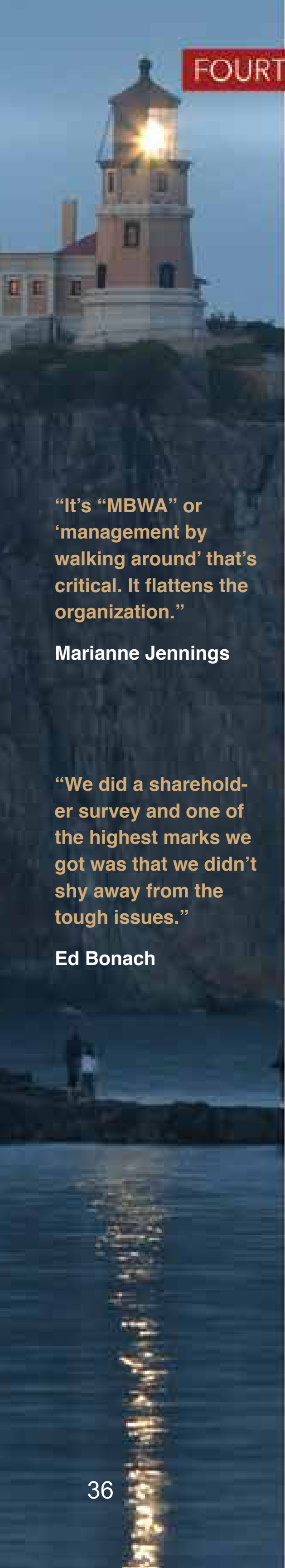
KIRK HANSON'S QUESTION

For leaders who are exceptional and who want to lead with the sort of values that we have all agreed are important, what's our guidance about how to communicate this commitment to the proposition that we need to be concerned about other stakeholders for their own sake, not just because it's going to produce more transactions or help our reputation? How does this message get pushed down through the organization?

Nien-hê Hsieh and Jim Mitchell listen to John Barry at the opening reception.

Jim Mitchell thought that it began with emphasizing the difference between compliance and ethics. "I have had a lot of conversations with different executives over the years about the importance of ethics training in organizations. All too often their response is that we are too busy with compliance to spend time focused on ethics. If I'm being a smart aleck, I'll say, 'maybe if you spent more time on ethics you wouldn't have to spend so much time on compliance.'"

John O'Connor thought it was important to be able to communicate success stories and celebrate the things that are done well. "It's also important for lead-



ers not only to educate employees about the rules, but also communicate their values–and it has to be genuine. Most employees tune out very quickly if they sense people are being disingenuous."

Marianne Jennings focused on the importance of senior leaders knowing what was going on in every level of the organization. "It's "MBWA" or 'management by walking around' that's critical. It flattens the organization. Research shows that the closer a company gets to a headline, the more isolated the executive becomes. It's absolutely critical that interactions with people are unplanned. It's a lot like having teenagers and coming home early and unannounced; you never know what you're going to find."

Ed Bonach agreed and added that interaction with all stakeholders was important. "We did a shareholder survey and one of the highest marks we got was that we didn't shy away from the tough issues. The survey showed that the shareholders believed that we were available and proactive about reaching out. It can't stop with employees, we need to reach out to all stakeholders."

Jennings added that 'management by walking around' also enabled leaders to personally interact with stakeholders. "When a journalist asked all of these top college football recruits why they committed to play for Nick Saban at Alabama, the recruits said that it was the personal touch. That he wrote them notes, that his attention was focused on them. It really matters to people."

NIEN-HÊ HSIEH'S QUESTION

"I have been trying to find a way to articulate the concept of responsible behavior in business. One approach is to write a 'job description' for business today. We have job descriptions for various positions. And everybody who works has some sense of what their job function is, both in terms of the function they play within the broader organization, and how they relate to other people in the organization. What I would like to do is to think up a job description for the modern business organization and use that as a vehicle to talk about all of the issues that have been raised today."

Ed Bonach asked, "How is the notion of a 'job description' of business different from vision, mission or strategy kind of statements?"

Hsieh responded that one difference was the job descriptions were very functional. "Mission statements and vision statements are about what motivates companies and the kinds of ends that they want to pursue. Another difference is that a job description presupposes working in service for either the broader organization or a larger purpose."

Jim Mitchell thought that this was an important question. "A lot of things like mission, vision and values statements are aspirational. I think what you're trying to get at is what we do every day when the 'rubber meets the road.'"

John Barry agreed that this was a valuable exercise. "I don't really like the exercise of writing a mission statement because I always felt like that was a bit of a masquerade. We were focusing more on portraying an image and not thinking about our value proposition and what it means for the client. I found

Priscilla Carroll, Archie Carroll, Jim Mitchell and Linda Mitchell at the closing reception.

it useful to ask, 'why do we think our company exists?' Now if I take it another step and ask my various constituents–my employees, clients and the advisor community–that same question and then compare the results, I think we will see where they overlap, and that is going to tell me a lot."

ARCHIE CARROLL'S QUESTION

My question is how do you design a reward system that aligns the employees' conduct with the ethical standards and values of the organization? I wonder if it can be done mechanistically like we do in grading schemes. For example, when I want to ensure good class participation, I structure the class so that 25 percent of a student's grade will be based on class participation and then define very clearly what that means. Can we do something similar in the financial services industry?

John O'Connor believed that the most important thing you can do is to spread out the stream of revenue. "Then if there is anything in terms of a producer's conduct that turns out inappropriate, he would risk anything he was still scheduled to earn. It mitigates the quarterly bumps and people with bad behaviors trying to inflate the numbers. When you're dealing in a sales cycle, there is only so much you can do here, but it is really important to create a longer view whenever possible. It may not be able to incentivize good behavior, but it does avoid incentivizing bad behavior."

John Barry agreed, but thought that the longer-term compensation models could incentivize good behavior. "If you believe that ethics are at the core of building long-term, sustainable relationships, then spreading compensation over a long period of time, is going to incent me to work on maintaining that relationship. Essentially, good ethics will translate into good relationships, which will improve the prospects of earning all the future compensation out of that deal. In that case, the compensation model supports that goal."

Ed Bonach said that it would be possible to move the sales force to a more levelized commission as opposed to a more front-loaded commission

Nien-hê Hsieh, Kirk Hanson and John Barry enjoy the opening reception.

Archie Carroll listens to John O'Connor.

process, but there were challenges. "How do you get there if you're the first one to make that move? You run a big risk of losing distribution if you are the only one who moves to that model."

Jim Mitchell noted that persistency was probably the best variable to determine the quality, rather than the quantity, of a book of business. "Do you guys compensate people on the basis of the persistency of their business?"

Barry shared that his compensation did reflect the persistency rate. "If we have a much better persistency rate than our peers, then there's a bonus added into our incentive compensation plan. And if our persistency is less than our peers, there will be a charge which can reduce our incentive compensation."

Barry added that the producer is able to choose the model they think is right for the facts and circumstances. "There's a lot of training that helps the producers understand the differences between each model and how to communicate them to the client. Interestingly enough, if you take these levelized commission schedules and you took the present value of that compensation, it's sometimes higher than if you took all of your money up front. And the clients value it because, if you don't take all of your compensation up front, you're leaving more money in the product to enhance initial performance and deliver better value for the client."

Mitchell wondered if this sort of compensation model would work with less experienced producers. "It's a big investment to finance a new person just getting their start in this business, especially given that a lot of them don't make it."

Barry responded that his new producers were given a salary with the possibility of a bonus. "We don't want a new person under pressure to perform or perish on immediate sales in the first year. You need to pay attention and learn this business. You'll have the opportunity to be compensated based on sales performance alone. But right now we want you to learn this business. And I think that's important, because if you're putting them in the position where it's perform or perish, that may lend itself to unethical behavior."

MARIANNE JENNINGS' QUESTION

One of the most frequent questions that I am asked when I speak is why nobody went to prison for what happened in 2008. Trust is lost if people continue to believe the same actors are still there in the same places, or that they are still doing the same thing in a different place. For example, here in Arizona, CPAs have been found guilty of a lot of fraud in the last two decades, and the perception is that they were censured for a year and then they're back. So how is it handled in your organization if someone really crosses the line?

Ed Bonach agreed with Jennings' observation about the failures of regulatory organizations, industries and the companies when dealing with rogue actors. "The theme is the power of making the next dollar. That motivates so much action or inaction, at least on the part of some companies. That explains why a rogue producer may get picked up by another entity even after he or she is separated for bad behavior at another firm."

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

John Barry thought that rogue behavior is explained, in part, by the different motivations for getting into this business. "One of the things that I have noticed is that there is a considerable difference between those who come into the business and truly view it as a profession versus those people who are looking to make a quick buck. I am trying to get some sense as to whether people feel like they owe something to the business. If they view this as their livelihood, they are far more likely to pay attention to the rules. They want to take care of the business so the business can take care of them for the long term. It's an investment in protecting their careers.

John O'Connor suggested government regulators have shown mixed results in white-collar crime enforcement. "There are some agencies with incredible talent while others have a lot of people, but very limited capability. So long as white-collar criminals have big pay-off incentives and relatively small jail terms, this problem will not go away. We need sophisticated enforcement, schooled in the industry and strategic in their approach. They need to be supported by sentences that will actually provide a real incentive for the subject to stop and think before they commit that crime. From our firm's perspective, we are extremely conservative in our approach and take quick action where we believe someone's actions are inconsistent with our philosophy."

KEVIN GIBSON'S QUESTION

Assuming that ethics education is a good thing, what is the best way to do it within the company? How does it get financed? Which line item does it come out of?"

Jim Mitchell responded that he thought ethics training should be a part of leadership development. "I know a couple of companies, and I wish I knew more, where ethics training is an integral part of leadership development and that seems to work pretty well."

John O'Connor thought that it was important that ethics training be funded at the corporate level and not in an individual business unit, because if it's not, it becomes discretionary and one of the first things to go when it's time to cut costs. "In addition, we have to be a lot more creative in terms of education. We are experimenting with some different forms that have been effective using scenarios. It is important to get as much engagement as possible."

BUILDING AN ETHICAL CULTURE

In this section of the discussion, Jim Mitchell asked the group to think about two questions:

(1) What are the advantages of an ethical organization?

(2) What are the obstacles to creating and maintaining an ethical culture and how can these obstacles be overcome?

John O'Connor thought it was important that employees believe they have a credible way to transmit their concerns to senior leadership. The challenge is how to communicate to the employee that their concerns are being dealt with. "When people submit a concern, they want to be able to call back and find out how you've addressed it. And as we discussed, for all sorts of reasons, legal and otherwise, that is not always possible."

Jim Mitchell believed that anonymous ethics surveys could be very helpful. "If people believe it's anonymous, they will tell you the truth. You can spot the couple of departments where there are ethical issues; the numbers jump out at you." He also believed that it was important to communicate how you are handling the issues that emerge in the survey. "We would say, 'here's what you reported to us, and here are the top three issues we are going to address.' And then you report regularly on how you're doing at addressing them. And if you do that consistently for a year, you'll get even better participation in the survey the next year."

Archie Carroll thought it was important to ask employees about their perceptions of dealing with customers. "Left to their own devices, employees are going to talk about their own issues. That's why 60 percent of the issues that come up in these surveys are human resources issues." He also believed it was necessary to talk to consumers. "Unless you do this, you're not going to get information about whether customers are being treated in an ethical manner."

Marianne Jennings agreed with Carroll and shared the example of an insurance company who hired a professor to survey its customers. "The surveys did not rate the agents very high on ethics. And the agents could not understand why they got these results. It turns out that when agents would miss appointments or be late for appointments, for the customer, it was an ethical issue."

Kevin Gibson said that it could be helpful to look at the question from another angle. "It may be tricky to establish the advantages of being an ethical corporation, but the converse is absolutely simple. If you have an unethical corporation, it's very clear that there are huge disadvantages."

Mitchell asked a follow-up question. "How do you encourage ethical behavior as a leader in the organization? What sorts of things do you do?"

Ed Bonach believed that it began with recognizing and promoting people who lived the core values of the organization. "But you have to be careful about this. The focus needs to remain on the individual person, rather than on the corporate message."

John Barry shared a situation in which an employee shared with him some concerns about a case he was working on. The employee was concerned that some aspects of the project could raise red flags from a regulatory perspective. "We handled the situation, and the next time we did a team huddle, I wanted to bring it up in front of the entire company. I wanted everybody in the room to hear that, first of all, it's good to celebrate that he did the right thing. I also wanted them to get a sense that there is a process that we, as an organization, follow when ethical questions emerge. I hope that the takeaway is that 'it's safe to raise your hand and say something'."

Mitchell agreed with Bonach on the importance of promoting the right people. "A lot of this is about who you promote and don't promote. People know who's behaving consistently with the values and who's not. If you promote a couple of those people who are not, whatever else you do is not going to get heard very well."

O'Connor believed that it was important that everyone in the organization was empowered to monitor risk and unethical behavior. "Once people in the business, whether low-level or high-level, believe that they don't bear the risk or responsibility for monitoring, you've got a big problem."

Bonach agreed. "We don't have a chief risk management officer because we believe in and preach that risk management is everyone's job, so we don't want the perception to be that someone over there is in control of that and I don't have to worry about risk."

Carroll agreed about the importance of the 'middle level'. "It's axiomatic in business that ethics begins at the highest level of the organization, but the ethical tone is also set at the middle level and the lower level. The way that I see it, it's the responsibility of the top management to ensure that the ethical standards of the organization are infused in middle management and it's the responsibility of middle management to ensure that these ethical standards are pushed down to the lowest level."

Kirk Hanson wanted to know why ethics was important to senior leaders. "Is it important because you simply want to be ethical yourself or is it important for your companies? Why is ethics even on your agenda?"

O'Connor believed that ethics was the difference between a short-term and a long-term perspective on business. "My experience shows that those companies that don't have ethics in their DNA, whether they plan on it or not, end up with a short business lifecycle. I think that people who go into business without a moral compass tend not to be in business for the long term."

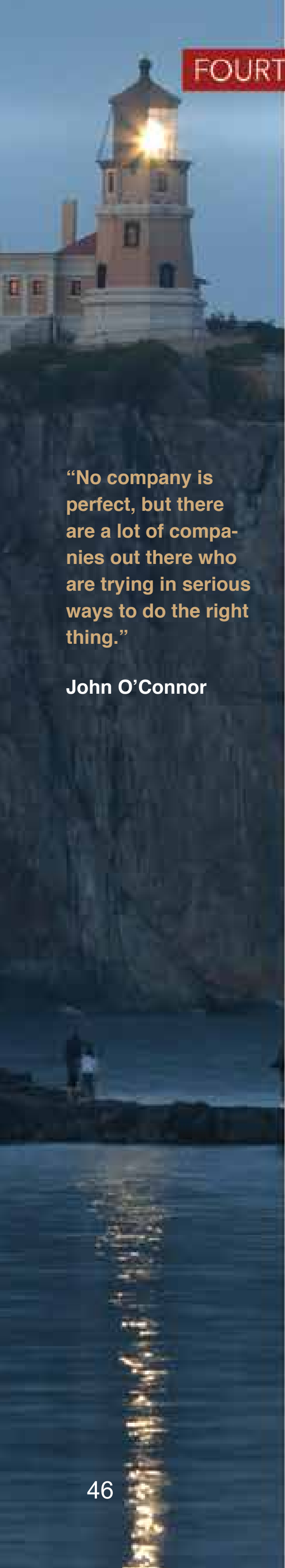
Bonach thought that ethics was even more important in the financial services industry. "In what other business do you expect people to let you take money out of their account every month for a long period of time with the expectation that when you need it, we'll be there and we will pay you? We don't sell anything tangible and that is why the customer's trust is so important."

Barry shared that his goal was to be the most trusted advisor to his client. "Being the most trusted advisor means that the client will pick up the telephone to call and ask for my counsel even when their issue or concern has nothing to do with products and services I provide to them. We have the greatest opportunity in this business because we have some of the most intimate conversations an individual can have with clients. You get there by engaging in the cultivation of a relationship where they feel comfortable enough to tell you everything, and as you learn more and more about the client, you can be far more effective as an advisor."

Hanson said that his experience working in Silicon Valley had given him a different perspective. "I live in a world of start-up companies that are not trying to be long-term players. Their ideal is that you're in existence for a year and you sell out for a billion dollars to Google. These are not companies, they are financial instruments. If they can get out of town before their customers realize they're screwing up, then they want to do it."

Barry also thought that the question of who you won't do business with is just as important as who you will do business with. "You have to ask yourself whether these clients embrace your values. And if they don't, you have to be willing to let the relationship go. If your employees think that you're willing to go running after a client who is a total jerk, it can undermine the atmosphere you're trying to create in your organization."

The Arizona Biltmore in Phoenix, Arizona.



"No company is perfect, but there are a lot of companies out there who are trying in serious ways to do the right thing."

John O'Connor

CONCLUDING THOUGHTS

In conclusion, Jim Mitchell asked the group to answer two questions:

(1) What did you get out of today?

(2) What will you reflect on tomorrow?

Kirk Hanson shared that he had the chance to think about answers to the question of how to conceptualize the task of leadership. "So listening to the business leaders talk about their experiences has been just wonderful." In terms of what he will think about tomorrow, Hanson noted that he was going to think hard about how he could use the insights he gained in his immediate research and presentations.

John Barry remarked that it was a change to talk openly and candidly about ethics with a group of academics and executives. "If I stop someone at a conference or some other industry event and bring up the word 'ethics', it's almost like people recoil and become defensive, as if you were implying that they have a lack of ethics. So something I will think about is how to overcome that and continue this conversation with people in the industry."

Nien-hê Hsieh shared that, like Hanson, he has concerns about the future of business. "But having the opportunity to sit with you and hear about your work and what you're doing in your firms is a powerful antidote to that concern, so I really appreciate that." He also learned about the different ways in which leaders can try to encourage, support and inculcate values in their individual organizations. "We tend to think there is one model that always works, but I'm not sure that this is the case. For example, it can require a judgment call when someone engages in bad behavior. Sometimes it is best that the organization takes the approach of 'zero tolerance' but at other times, this approach does not make sense. The picture's been complicated for me, and I really appreciated today's conversation."

Archie Carroll shared that he had a greater appreciation of the circumstances that business people face. "We've also been able to listen to some great success stories of how you and your organizations have handled ethical dilemmas. There's a real shortage, for those of us who are ethics educators, of those sorts of success stories."

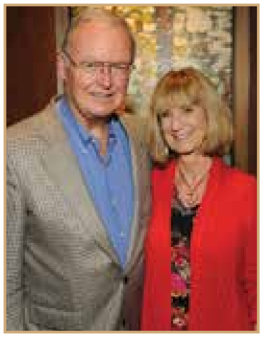
John O'Connor offered that it was very interesting to hear the perspectives of both the other business leaders and the academics. "I hope that this made a little dent in the concerns voiced by the academics that this is just an area run amok. No company is perfect, but there are a lot of companies out there who are trying in serious ways to do the right thing."

Marianne Jennings was struck by, "how enormously complicated financial services is and how little I know." She was also concerned about how people seem to be able to rationalize their behavior when caught. "There are situations where companies have lied, stolen or cheated and then people are sent out to explain those behaviors to the public. It seems to me that those spokespersons don't understand–or perhaps they don't want to understand–that what seems so wrong to the outside observer becomes so 'complicated' and murky for people when it's in their own context."

Ed Bonach appreciated the opportunity to participate and looked forward to sharing insights with his team. He also took away from the conversation the reinforcement of the idea that ethics is complex. "It is not so cut and dried all of the time, it's not always straightforward, and ethics can mean different things to different people to a degree."

Kevin Gibson was grateful for the opportunity to participate and would think about the fact that although ethical decisions can be emotionally distressing at the time, and that the circumstances can be complicated, sometimes, "once you can get rid of the clutter and the noise, it can be very simple." He also looked forward to taking the message back to his classroom that you can do well by doing good. "It seems that middle managers and MBA students often feel pressure to increase efficiency, to the exclusion of all other aspects of business. It's very helpful for me to take the message back to business schools that CEOs with a demonstrated history of success maintain a broader perspective than short-term profit maximization."

Jim Mitchell concluded the meeting by thanking the participants. "It's been an absolute joy to have this conversation with all of you today." He added that he would think seriously about, "how we can continue the conversation and how we can have a broader impact going forward."



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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 Mitchell Forum is a groundbreaking, one-of-a-kind event that underscores the Center's emphasis on collaboration and conversation among academics and executives. Jim Mitchell 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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