

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

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PERSPECTIVES
ON ETHICAL
LEADERSHIP



THE
AMERICAN
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THE LEADER IN FINANCIAL SERVICES EDUCATION



FORUM ON ETHICAL LEADERSHIP

The seventh annual James A. and Linda R. Mitchell / American College Forum on Ethical Leadership in Financial Services took place January 13, 2007, in Boca Raton, Florida. The event featured discussion of several key issues confronting the financial services industry along with 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.



THE EXECUTIVES

Eugene Choate, President, Bankers Fidelity Life, Atlanta, Georgia

J. Barry Griswell, Chairman, President, and Chief Executive Officer, The Principal Financial Group, Des Moines, Iowa

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

Catherine H. Smith, CEO, ING US Insurance Group, Hartford, CT

THE ETHICISTS

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

Alfred Gini, Professor of Business Ethics, School of Business Administration, Loyola University Chicago, Chicago, Illinois

Dennis Moberg, Gerald and Bonita Wilkinson Chair of Management and Ethics, Leavey School of Business, Santa Clara University, Santa Clara, California

Donald P. Robin, J. Tylee Wilson Professor of Business Ethics, The Wayne Calloway School of Business and Accountancy at Wake Forest University, Winston-Salem, North Carolina

Linda K. Treviño, Professor of Organizational Behavior, Cook Fellow in Business Ethics, and Director of the Shoemaker Program in Business Ethics, Smeal College of Business, The Pennsylvania State University, University Park, Pennsylvania

An attitude of “customer paternalism” would result if customers bear no responsibility for their purchases of products.

EXECUTIVE SUMMARY

On January 13, 2007, a group comprised of four executives (“practitioners”) and five academic ethicists (“philosophers”) gathered in Boca Raton, Florida, to participate in the seventh annual James A. and Linda R. Mitchell / American College Forum on Ethical Leadership in Financial Services.

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

- 1) To provide executives 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.
- 2) 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.

EQUITY-INDEXED ANNUITIES

Following introductions of the participants and discussion of their goals for the day, the first topic discussed was equity-indexed annuities. The case study focused on the aftermath of a sale of an unsuitable product. In this case, the product was an equity-indexed annuity with a high surrender charge that was sold to a widower in his late 60s. In this case, the participants were encouraged to consider the following questions: Should someone be considered morally culpable for the sale of this unsuitable product? Should the agent who sold the product be considered morally responsible? Should the company who designed and promoted this particular product to its agents bear any sort of responsibility? Finally, what level of responsibility does the client have to be an informed and conscientious consumer of financial services and products?

Some participants objected to an attitude of “customer paternalism” which would result if customers bear no responsibility for their purchases of products, arguing that the market is predicated upon autonomous individuals freely contracting in their own interest. Still, it is difficult to assume that all of the actors in this exchange are autonomous, given the fact of asymmetric information. Several of the participants pointed out that clients remain



vulnerable to unscrupulous brokers because of the complexity of the financial products. The point was also made that perhaps these products are simply too complicated. Is it even possible for the average consumer to understand the nuances of equity-indexed annuities and to make comparisons to other products on the market that may be more suitable?

Because of consumers' lack of information about financial services, they rely on professional intermediaries. In this environment, the participants agreed, earning and maintaining the consumer's trust was extremely important. Therefore, a good reputation, within the community has become of paramount importance. Also, the participants agreed that it is becoming increasingly necessary for the industry to "police" itself and establish standards in order to maintain the trust that is necessary for both the industry and the customer to benefit.

The final point of discussion of the case dealt with the issue of disclosure and its importance in maintaining the trust of the client. It was noted that the standard practice in the United Kingdom is for full disclosure of all commissions. The group examined whether this sort of transparency would benefit the American market as well.

EXECUTIVES' ETHICAL ISSUES

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 discussed raised the question of what happens when you are legally bound to perform an action that you, as a representative of your corporation, believe is not only unethical but also actually detrimental to welfare of your shareholders. Do "well off" corporations have an obligation to challenge laws or regulations that appear to be unjust? The benefits of settling lawsuits, rather than going to trial, were debated as the increasing costs of doing business in a litigious society. The second issue discussed the matter of treating all customers fairly and equally. How much should a corporation be held responsible for the imprudent choices of their clients? The third issue dealt with the problem of whether to make a client whole after a mistake was made by representatives of the corporation. This raised the issue of how to balance the interests of both customers and stockholders.

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Don Robin and Dennis Moberg listen intently.

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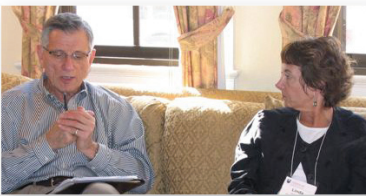
Jim Mitchell

ETHICISTS’ QUESTIONS

In this portion of the program, each of the academics posed a question for the executives. The first question dealt with adjudicating a claim settlement to a widow who was without legal counsel when the proposed settlement appeared to be grossly unfair. The second question asked how to deal with corporate information leaks and maintain the trust of your board of directors. A third issue dealt with whether the discipline of ethics is an art or a science. Should instructors teach their students to search for the “correct answer” or to envision moral possibilities? The fourth issue investigated the incentives created by the reward systems. What behaviors are incented when particular reward systems are established and what sort of reward systems should executives and other decision makers attempt to put in place? The final question considered the conflict of loyalty an agent experiences when there is tension between serving the best interests of the client and the best interests of the corporation.

CONCLUDING THOUGHTS

The Forum concluded with each participant indicating what they took away from the day’s proceedings. The executives and ethicists all agreed that the candid sharing of opinions was mutually helpful. They were grateful for the opportunity to spend the day reflecting on the ethical dimensions of crucial issues facing the financial services industry today. ■



*Al Gini makes a point while
Linda Treviño listens.*



INTRODUCTION AND GOALS FOR THE DAY

Host Jim Mitchell, retired CEO of IDS Life, welcomed the participants and asked them to share what ethics means to them in their own organizations and how they hoped to benefit from the day's discussion.

THE PRACTITIONERS

Mitchell reflected upon his 40 years in the financial services industry and recalled that, as CEO of the insurance and annuity company of American Express, "We tried to do it right, tried to be ethical. By treating clients and employees very well, we achieved outstanding results for our stockholders. I am proud about that. My goal for the day is to learn your views about some of the current issues facing the industry. I hope that discussing issues facing this industry and promulgating your views will make a difference in improving ethical behavior in the financial services industry."

Catherine Smith of ING noted that she "works for an organization that is helping people in a very responsible way, which is what insurance products do." She continued, "What I'm interested in learning and talking about is how an individual with a strong set of values can communicate those values to an organization."

Gene Choate from Bankers Fidelity Life pointed out that he started out as an agent and worked his way to where he is today. "You talk about ethics and fair dealing and everything. I have seen it all." He noted that, when he took charge of Bankers Fidelity, he handled "approximately 400 cases of ethical wrongdoing or just not doing what the regulators said they were supposed to be doing. But now we enjoy a good reputation."

Barry Griswell of the Principal Financial Group said, "The thing I am most proud of is that for the fifth consecutive year Principal has been named to *Fortune* magazine's '100 Best Companies to Work For.' We work very hard on our culture in a variety of ways. It is one of the top priorities for me as a CEO." He added that, "One question I want to discuss is how we, as hopefully ethical business executives, influence the broader environment where business practices go awask for seemingly good reasons—how do we help the industry navigate away from those things and still be competitive and still operate in ways that are good for our shareholders?"



Michele Griswell with co-host Linda Mitchell and Barry Griswell at the opening reception.

THE PHILOSOPHERS

Don Robin of Wake Forest University said, "I am here to learn as much as anything else. As an academic you only read about the particulars of the cases we teach. Whenever you hear first hand of special problems in any industry it forces you to think in a deeper way about those cases. So I am looking forward to learning as much as I can today."

Dennis Moberg from Santa Clara University mentioned that he is primarily interested in "the ethics of the ways employees treat each other. As an ethicist I am obviously also concerned about strategic planning, ethical leadership, and other more general areas." He anticipated learning more about "the executive take on leadership. I am fascinated with trying to add some meaning to the phrase 'tone at the top.'"

Al Gini of Loyola University Chicago said that he looked forward to addressing "this problem of two realms, with the business community on one side and the academics on the other side." He hoped that we would examine why it is so hard to integrate the two "realms." He noted that, "Those things that we strive for and insist on in our partners and our mates in our private lives we don't always insist on with the people we do business with. And yet business is where we spend most of our time."

Linda Treviño of Penn State says she is interested in pursuing the problem of authority. She has studied a lot about ethical cultures, organizational behavior and leadership. Today she is most interested in "why it is so difficult for people to say 'no' to an authority figure."

Ron Duska, co-host of the event with Jim Mitchell, commented that he is frustrated with a "real gap between theory and practice." His work at The American College allows him an opportunity to narrow that gap. He had "a lifelong dream to see would happen if a group of academics sat down to talk to a group of CEOs." He is looking forward to "the opportunity for the participants just to talk to one another one-on-one."

Mitchell concluded the opening comments. "I want to point out something that might not be totally obvious to somebody who doesn't work in the

"Those things that we strive for and insist on in our partners and our mates in our private lives we don't always insist on with the people we do business with. And yet business is where we spend most of our time."

Al Gini



Jim Mitchell, Ron Duska, and Gene Choate listen to Barry Griswell's (second from right) comments.

financial services industry. Financial services are essentially a three-person game—it's not just the customer and the company. There is almost always, one way or another, an intermediary—it could be an agent, it could be a broker, or it could be a web site. But there is usually a third person between the customer and the company." This provides opportunities for two of the three parties to collude against the third one, or to engage in other questionable behavior. He added, "Maybe we should be pleased how frequently people do the right thing, because most of the time they actually do." ■

EQUITY-INDEXED ANNUITIES

The participants were provided with the following case study on equity-indexed annuities:

THE STORY

Tom's 70-year-old father, George, had changed over the past two years since the death of his beloved wife from cancer. George's minor memory lapses had turned into serious forgetfulness. As Tom arrived at his father's house, he saw his father hunched at the kitchen table with a pile of papers in front of him. "Cheated out of a retirement with the love of his life, and now this," Tom mused as he walked through the door.

"Dan seemed like a nice young man," George told Tom. "He was so concerned about me and my financial future." George had met the agent, Dan, at the monthly social sponsored by his Senior Center. Every month, the Center sponsored talks and discussions on many subjects, which were meant both to entertain the seniors and also provide them advice on a variety of topics. Dan received George's contact information from the Senior Center as a part of the \$500.00 fee he paid the Center for the "privilege" of speaking to their residents, and soon called George to set an appointment.

At their meeting, Dan told George that he needed to protect his life savings and that, the way his finances were set up, he was in grave danger of losing everything. Dan had told George that he needed to begin drawing money from his IRA immediately, and he had the perfect vehicle to put it in, an equity-indexed annuity. Dan also told George that using his house as an investment vehicle was the absolute worst thing that he could do. Didn't he know that if he ever had to go into a nursing home or ran into trouble with Medicare, that they

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Jim Mitchell

could simply claim his house as collateral? They could even do that if he was late on his payments. "I was shocked," George remembered. "It did not seem possible that people could just take your own home from you, but Dan insisted that they could. He told me that if I wanted to leave anything for you and your family, I should act now. He seemed so sure. . . ." Dad's voice trailed off and he looked down at the table. "He just seemed like he wanted to help."

It turned out that George took out all the equity from his home, as well as from his IRA, and invested it, as Dan had suggested, in an equity-indexed annuity. Dan gave George a lot of paperwork which talked about complicated things like crediting methods and surrender charges, but George could not even read the small print in which it was written. He remembered asking Dan about it but Dan just laughed and said, "You know those lawyers."

In retrospect, knowing about those surrender charges would have been pretty important. When it became too hard for George to drive to the hospital for his dialysis, he needed money to pay for a nurse to come in during the day and administer the dialysis for him. Only then did he discover that he was not going to be able to access his money without paying a 20% surrender charge. That was when George realized he needed his son's help. After listening to all this, Tom left George's house with a heavy heart, but also with a strong determination to get his father's money back.



Barry Griswell explains his perspective to Gene Choate and Catherine Smith.

Tom made significant progress the next day. He discovered that Dan was neither a CFP nor a CLU as he had claimed. He visited the Senior Center and, after threatening the social director with a lawsuit and the police, he secured both Dan's contact information and the Senior Center's commitment to refuse to accept monetary payment unless they disclosed this fact to the members. He filed complaints with the Securities and Exchange Commission, the National Association of Securities Dealers, and the State Insurance Board.

"That guy at the Insurance Board was pretty helpful," Tom told his wife. "I don't think that this is the first time they have seen a situation like this." Tom explained that, while it was possible for Dad to get his money back, it was going to cost him about 20% of his investment in surrender charges to do so. The representative from the State Insurance Board had given him some



websites to look at and, despite himself, Tom was impressed. “These are not all bad products,” he told his wife. “EIAs offer a minimum guaranteed interest rate combined with an interest rate linked to a stock market index. Because of the guaranteed interest rate, EIAs have less market risk than variable annuities. EIAs also have the potential to earn returns better than traditional fixed annuities when the stock market is rising.” A look at the websites convinced Tom that there were good EIAs out there, but it was very difficult to develop any sort of comparison between the different products. Tom discovered that finding a quality product was crucial, since certain EIAs performed far better than other, similar sounding ones.

After his research, Tom believed that his father’s case combined all of the elements of a “perfect storm.” Dan had persuaded George to use all the equity in his home to purchase a \$300,000 annuity with the argument that, even if George’s house were taken away, he would never be a burden on his family. George felt his money was perfectly safe, since the EIA would mimic all the gains of the stock market with none of the risk. But Tom knew, after reviewing the paperwork with the representative from the Insurance Board, that his father’s return was capped at 6.5% per year, no matter how well the market performed. Moreover, George’s EIA was credited with something called the “monthly averaging” method which further reduced his earnings. He was also charged an “asset fee,” which was a percentage of all of his remaining gains. Finally, any remaining gains were taxed as ordinary income, since EIAs are not securities and the gains are not considered capital gains by the IRS. At the end of his analysis, Tom believed that this was a very bad investment for someone in his father’s situation.



Ron Duska makes a point while Barry Griswell listens.

It was 4:00 pm by the time he looked at the tattered slip of paper his father had given him the night before and the business card the Senior Center coordinator had given him this morning. The information matched, which was a surprise in and of itself. However, the biggest surprise was the company logo on the card. It was the well-known logo of one of the biggest brands in the insurance business. Tom couldn’t believe it. “They actually hired that crook,” he muttered out loud furiously. “They let this happen!”

Days turned into weeks and weeks turned into months as Tom and his attorney, Joe, battled it out with “the Enabler” as they referred to the Fortune 500 insurance company. Six months after the night his father had first called, Tom and Joe finally managed to get George’s money back, minus the \$23,000 that Dan took in commissions. That, it seemed, was untouchable. Joe celebrated their victory, but Tom could not feel good as he continued to see his father diminish a little bit everyday. The price that had been paid in George’s declining health and self-esteem was way too high!

OBSERVATIONS

In recent years, there has been a stream of discussion concerning the merits of Equity-Indexed Annuities, both in terms of their design and the manner in which these products have been marketed. This debate was amplified with NASD Notice to Members 5-50 in August 2005.¹ In this Notice, the NASD addressed the “responsibility of broker-dealers to supervise the sale by their associated persons of equity-indexed annuities,” even though these products are not securities. The response to Notice 5-50 was swift and copious. The National Association of Insurance and Financial Advisors distributed an “action alert” with the subject “NAIFA Members Urged to Submit Comments to NASD Asking NASD to Back Off Equity-Indexed Annuities”. The Financial Planning Association expressed their intention to request SEC action on EIAs.



Co-host Linda Mitchell with Gene Choate at the opening reception.

Various publications joined the conversation as well, either offering advice as *Money Magazine’s* “Retirement Deals You Can Do Without” or answering questions as *The Wall Street Journal’s* “Why Big Insurers Are Staying Away From This Year’s Hottest Investment”. Morningstar’s Advisor edition got into the act as well, with Dr. Donald Moine providing a series of articles designed to help the advisor negotiate the complexity of EIAs while avoiding the regulatory gaze of the NASD.²

Clearly, the questions of whether and how to buy and sell equity-indexed annuities remain unresolved. Some other observations are:

1. Sales of EIAs (according to Advantage Compendium) have exploded over the past few years, reaching \$27 billion in 2005. Moine says they are so



popular that “they are becoming known as ‘financial crack cocaine’ for senior citizens.” However, EIA sales in the first half of 2006 were down 8% from the prior year. *Dow Jones Newswire*, among others, has speculated that this drop was partly caused by negative publicity surrounding these products.

2. EIAs are complicated investment products, with returns determined by four features. First, there are various crediting methods for determining the changes in the relevant stock market index. Second, a “participation rate” determines how much of the gain in the index will be credited to the annuity. Third, many EIAs impose a “cap rate” that represents the maximum annual return allowed to the investor. Fourth, some EIAs subtract an asset fee from any return credited to the investor.
3. The average commission for the sale of an EIA is 8%. As Moine states in his article [Suggestions for Improving the EIA Industry](#), “It seems the magic cut-off point is about 8%. A number of EIAs that pay agents 8% or more of the client’s money have become ‘best sellers.’” Moine goes on to state that although there are a few excellent EIAs that pay 8% (or slightly higher) commissions, these products are extremely rare.
4. The average first year surrender charge is in the 17–18% range, and there is an average 12-year surrender period (although some are as long as 18 years). Some EIAs do provide the option of a 10% annual penalty-free withdrawal, while others are less generous.
5. The average sale (single premium) of an EIA is \$50,000. However, some advisors have designed an ingenious sales tactic to convince buyers that they should purchase several EIAs at one time. This sales technique is called the “bucket system” and it has come under heavy criticism.
6. According to *Advantage Compendium*, during 2006, “There was a small but growing trend for state insurance departments to adopt a desk-drawer rule calling for . . . annuity surrender charges to have a maximum length of 10 years and a maximum first year surrender charge of 10%. Although commissions were not specifically addressed, a carrier would be hard pressed to pay out a 12% commission when the maximum that could be recaptured from a surrendered policy would be 10%. The net effect of ‘10-10’ was to drop agent commissions. . . . in the affected states.”



Michele Griswell with Dan Treviño at the closing banquet.

QUESTIONS

1. Why would an insurance company choose not to market an equity-indexed annuity product?
2. What disclosures should be made to the purchaser of an equity-indexed annuity? Should a uniform one or two-page “plain English” disclosure statement be required? Should commissions be disclosed?
3. Equity-indexed annuities have some characteristics of variable annuities, which are securities, and some characteristics of fixed annuities, which are not securities. If EIAs were deemed to be securities, they could only be sold by people with a securities license, and would be subject to more rigid “suitability” requirements. Should EIAs be treated as securities?
4. The SEC has held that equity-indexed annuities are not securities under certain conditions, including that “the contract is not marketed as an investment.” But aren’t most EIAs typically positioned as something that will participate in the returns of the stock market?
5. All sorts of products on the market can be used in harmful ways. Someone whose parents lived into their nineties might find an EIA with a long surrender charge a fine investment. Should equity-indexed annuities with long surrender charges be banned for those over 65? Is it appropriate for states to limit surrender charges by adopting a rule such as “10–10?”
6. Is it possible for sales agents to effectively gauge the state of mind of a potential client in order to determine whether a particular product is suitable? How can a sales agent know when a client is getting senile? Are we demanding too much from agents?
7. What responsibilities do companies have to monitor their agents?
8. Do suitability requirements change depending on whether you are a company representative or a broker? How do companies that provide a product protect clients from abusive practices of independent agents or brokers?
9. Is there a difference between meeting suitability requirements and meeting fiduciary responsibilities?



*Al Gini, Jim and Linda Mitchell,
and Ron Duska at the closing
banquet.*

discussion of equity-indexed annuities



10. In this case, would a mutual fund that paid a lower sales commission have been a better investment than an equity-indexed annuity?

11. Consider the amount of influence that the NASD and other groups are able to exert not only over the market, but also over state regulatory agencies. Is this appropriate? Why or why not? ■

¹. NASD Notice to Members regarding equity-indexed annuities. August 2005.

². Moine, Donald "Suggestions for Improving the EIA Industry"; December 7, 2005. Please see <http://morningstaradvisor.com/articles>.

THE DISCUSSION

Ron Duska opened the discussion by asking, "Are equity-indexed annuities good products?" He commented that, because of the concerns surrounding them, there are some companies that do not offer them at all.

According to Gene Choate, "Just from a common sense standpoint we don't sell them. We don't have any dog in this fight." He did, however, serve on a legislative committee that examined equity-indexed annuities. He once asked for someone on the committee to explain the product; of the more than 32 companies represented there, not one person could. At that point he told them, "You are building a new market for the plaintiff attorneys." He added, "If you look back in history, the insurance industry comes up with many great ideas and great products, but we risk ruining them if we abuse them."



Linda Treviño ponders a comment.

Barry Griswell recalled the history of equity-indexed annuities. They emerged largely as a result of insurance companies trying to compete with variable annuities. He explained that, since some companies did not have "the wherewithal to have broker/dealers of registered products, they were trying to find a way to sell something to the customer that did not require a securities license, and this is what they created." According to Griswell, the key lies in disclosure. "I think it is an okay product if it's sold properly," he said.

Choate agreed. He commented that this product is "... something that you can sell without the people understanding what it is." Then, when something goes wrong, he noted, the customers will come back and say, "I didn't understand what it was." That is where the legal problems begin.

“At the end of the day, this trust may be broken in a number of different places, starting with allowing people to sell when they aren’t trained.”

Barry Griswell

Catherine Smith interjected, “I think this is a great example of a product that, if used in the right place, makes perfect sense.” Her view was that an equity-indexed annuity could be a suitable product—even for an older customer—for example, if it is part of an estate plan or otherwise met the financial needs of the customer. The problem is not necessarily with the products, but with companies ensuring its distributors sell them appropriately. “At ING,” she explained, “we have virtually all independent producers, so we rely on the integrity of our distribution force to do right by our customers with the products. We take that seriously. We have stepped up to try to produce a product that is good for the customer that doesn’t have these unbelievably high surrender charges as well as providing training and support to our sales force. We are really focusing on managing the producer.”

Griswell asked, “Why are some companies so heavily into this market? Why are they promoting these products considering the market conduct problems with equity-indexed annuities? I think if you got underneath and took a close look, you would find a reasonable, but complex product, but when you examined some of the business practices, I think you would probably really be appalled. For example, I believe some companies have arrangements with telemarketing organizations. They call to get appointments with seniors and it makes you wonder about the tactics used.” He added that this is of concern since senior citizens are particularly vulnerable in this situation. “The elderly person does not really understand, but puts trust in the producer, and makes a decision based on trust. At the end of the day, this trust may be broken in a number of different places, starting with allowing people to sell when they aren’t trained, and for not having some kind of internal check to make sure that these products are suitable.”

At this point Al Gini raised a new issue, suggesting that the variety of insurance products available is connected to the industry’s attempt to fill a niche being vacated by the government. Gini said, “It seems connected to the fact that Social Security is going to be the new oxymoron for a lot of baby boomers.”

Choate agreed. “We have a serious crisis in this country. On average, baby boomers have saved \$59,000 or thereabouts outside of the equity in their homes, and they are living longer. It doesn’t take a rocket scientist to figure out that we have a serious problem, and Social Security is not going to take care of it.”



For Griswell this represents an opportunity. He suggested that if the companies have the right kind of products available, they will not only be able to serve customer needs and but also have business success. “That accounts for some of this product innovation. It’s all good in theory, but some of it is borderline in practice.”

SUITABILITY REQUIREMENTS

Dennis Moberg shifted the conversation by noting, “There are two forces here. One force is professionalism, which involves your producers—whether they disclose appropriately and how well trained they are. The other force is ‘customer paternalism.’ To what extent are you going to set up certain kinds of rules so that you protect certain classes of customers from themselves?”

Smith agreed and described how an internal emphasis on suitability can help protect customers and offset the potential negative consequences of selling equity-indexed annuities. “This is a tricky situation because, as an insurance company, you would rather not be in the business of determining suitability of products—that is the responsibility of broker/dealers. At the same time, however, the company’s reputation is at stake. . . . We decided we are going to do it (determine the suitability) anyway. We are going to ask the questions we think the consumers should be asking themselves. If the producer isn’t asking them, we are going to ask them directly so we can see the answers when the application hits our new business area.”

Moberg wondered about the risks of this soft kind of paternalism. He claimed that a reasonable objection might be “I’m 61-years old, I have a mind of my own, and I’m perfectly capable of making decisions. You tell me, ‘I’m sorry, you don’t qualify.’ What do you mean, I don’t qualify?”

Griswell responded that suitability requirements are the responsibility of the producer, not of the customer. “It says to the producer, ‘in your own mind, you have to think what you are recommending is appropriate.’ It doesn’t say the customer has to agree or disagree. Suitability requirements should not mean that you are prevented from buying the product.”

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Gene Choate

“It’s a matter of making sure people at least have basic information so that they make good decisions.”

Don Robin

THE ROLE OF INFORMATION ASYMMETRY

Don Robin reflected on the “knowledge gap,” that large disparity between what customers know about particular products and the information that producers selling those products have available to them. In financial services, the difference between the expertise of the agent and the limited knowledge of the client creates the possibility of ethical abuse. “However, this difference is masked by the trust that consumers have in their agents and the companies which they represent. Customers simply trust in the company that represents those products.”

“That’s why the reputation of both the company and distributor is critical,” added Smith.

Robin remarked, “Then it’s a matter of making sure people at least have basic information so that they make good decisions.”

Duska agreed. “Equity-indexed annuities are such interesting products because we can say disclosure is a good thing, but it is still difficult to figure out what this product really is.”



Linda Treviño with Don and Sarah Robin at the opening reception.

Smith added, “Equity-indexed annuities can be unbelievably complex. . . . But this is not the only insurance product that’s really complex. The issue is how do we make sure that people are buying the right products when the products have become so complicated? I think it is an industry issue in general.”

WHAT SHOULD BE THE ROLE OF REGULATION?

Duska raised a new issue, asking if anyone thought “the industry was going to push to have equity-indexed annuities recognized as securities”? This process would put additional safeguards in place in the sales and marketing of this product.

Jim Mitchell responded that there is no industry consensus to push for regulation, though he personally believes that equity-indexed annuities should be regulated as securities. But he pointed out that individual companies are free to take action to try to ensure their products are sold properly, just as ING is doing. He recalled that, when he arrived at American Express twenty years ago, everyone in the Field organization was a registered representative.



He said, "I looked at our sales processes, and we were selling fixed annuities and whole life insurance, in effect, with a prospectus. We were selling all our products as if they were securities. When I asked, 'Do you guys really want to do that?', it was the Field leadership that said, 'Absolutely we do. This helps ensure that we are selling properly, and it protects our sales people as well as our clients.'"

PRODUCT COMPLEXITY

Griswell asserted, "You are going down the wrong road if you think the only issue is whether it is a registered product. As an industry, regardless of regulation, I think that the question becomes how we allow products to be produced that are so complex that the CEOs and actuaries of companies can't understand them."

Smith agreed. "I think we're picking on this one product. . . There are plenty of complex products in this world. In our industry, problems occur with variable products sold by registered representatives, and sometimes people still buy the wrong product or don't understand the product they bought. So I think there is a fundamental question, whether the product is registered or not, which is 'How do we do a better job of helping our customers understand?' It is the same thing with televisions or other gadgets, if you ask me. I have a Blackberry. I can't figure out how to use three quarters of it. How much of a responsibility do we, as consumers, have to find out what we need to know about these products? If we do not understand the products, why do we buy them? There are plenty of other options available."

Robin responded, "My first degree is in mechanical engineering, and I can walk into a new car showroom feeling comfortable that there are a lot of important things that I already know. However, there will be many things important to me about the products I buy for which I am going to lack information. I have to be able to trust somebody else (the person who is selling me the car) to tell me if there is something really bad here that I don't know about."

Duska added that the variety and complexity of products makes it difficult for people to have sufficient knowledge of what exactly it is that they are buying and how it is going to affect them. "I deal with these products everyday on account of what I do, but these products can be so complicated that I think it may be disingenuous to say the customer ever knows what

"When I arrived at American Express twenty years ago, we were selling all our products as if they were securities. When I asked, 'Do you guys really want to do that?', it was the Field leadership that said, 'Absolutely we do. This helps ensure that we are selling properly, and it protects our sales people as well as our clients.'"

Jim Mitchell

he or she is getting. I don't know what I am getting from my policy, and I am in the industry."

"As a company, our responsibility is to make sure that the consumers ask the right questions so they can make at least partially informed decisions. At the very least, they need enough information to know the right questions to ask."

Catherine Smith

Smith said, "As a company, our responsibility is to make sure that the consumers ask the right questions so they can make at least partially informed decisions. At the very least, they need enough information to know the right questions to ask."

Mitchell agreed with Smith. "It is a company's obligation to try to have its customers informed."

THE IMPORTANCE OF TRANSPARENCY

Griswell asserted that times are clearly changing. "I would argue that there is an environmental trend that will change this landscape over the next decade: that is the trend of transparency. I think everything is ultimately going to be disclosed."

Moberg offered, "My understanding is what you are trying to do is to move in that direction slowly and gradually."

Robin emphasized the value of disclosure from the perspective of the customer. "I think what the customers fear is that they are being ripped off or that they could have gotten a greater deal someplace else, and that's the sales issue. But I think that most consumers of any product are going to recognize that both the sales person and the company have to make some money."

Griswell agreed, but pointed out that a major obstacle to disclosure of commissions is likely to be with the customer's perception of how that commission is paid. "We take the majority of the money that the agent is going to get and we put it in the first year, rather than spreading it over the life of the policy. The unfortunate part is that this creates a perception that the producer is getting a windfall, when that is not entirely true."

According to Griswell, it is worth considering what has happened in other countries. About fifteen years ago, both Australia and the United Kingdom moved toward full disclosure of commissions. The result in those countries is that "quite frankly, insurance products are less popular in those countries



than they were before.” To the extent that companies in the United States advocate full disclosure, this is something to keep in mind.

CAN THE INDUSTRY POLICE ITSELF?

Mitchell inquired into the possibility of the industry instituting its own restrictions. “I could see where that might be difficult,” he admitted, “but, if you are trying to preserve the reputation of the industry, don’t you need some kind of limits?”

It was suggested that the American Council of Life Insurers (ACLI) could be the policing entity. Griswell noted, however, “The problem we would have at the ACLI is that you are going to find exactly what you think you are going to find. Those who are heavily in this market are going to work to protect themselves.” He added, “Once you get down to it, the question becomes, ‘Are you willing to run off your member companies who are selling these products—because you have decided that ACLI should be the arbiter in this case?’”

“One option is to handle it up front,” said Smith. “You make it clear that if you are interested in being a member of the ACLI you will abide by the standards that it develops. Of course . . . that makes it a little harder for some companies to jump on board, but as an industry, we need to raise the bar on ourselves. Otherwise it’s too easy for others to point fingers.”

Griswell noted that the ACLI’s primary role lies in promotion and support. “Our industry is trying to find a solution to not having enough life insurance and not saving for retirement. We are trying very much to promote retirement security—that is what we as an industry are about. . . One of the problems we have, which makes our industry so terribly complicated, is that we are regulated by the states, and every state has its own insurance commissioner. We constantly struggle trying to get the weakest state to come up to an appropriate standard.”

Linda Treviño raised the issue of industry collaboration. In her experience with the defense industry, she has found that companies can overlook dif-

“I would argue that there is an environmental trend that will change this landscape over the next decade: that is the trend of transparency. I think everything is ultimately going to be disclosed.”

Barry Griswell



Catherine Smith and Gene Choate listen to the discussion.

“Integrity means honestly living up to your commitments, keeping your promises.”

Barry Griswell

ferences in order to work together to overcome shared challenges. “In the defense industry,” she explained, “companies benchmark with each other to raise the bar, and this leads to a degree of self-regulation. They really do a lot together. The industry has its own unique issues and challenges; it is highly regulated and companies have to deal with all sorts of government contract issues, and they are able to address many of these issues together.”

Griswell noted that almost ten years ago, when the insurance industry became bombarded by sales practice issues, the ACLI created the Insurance Marketplace Standards Association (IMSA). “Its whole purpose is to give a kind of ‘Good Housekeeping Seal of Approval’ to a company. They go out and hire a group to look at you, your business practices, and your literature in order to determine if you get the seal.”

Choate believes that IMSA’s impact, even in the absence of a large budget, can be far-reaching. In fact, states are relying on IMSA audits to cut down on the work they have to do. “In this year alone,” he pointed out, “nine states now are looking at IMSA audits of companies to cut down on whom they audit and how much they audit.”

ETHICS, VALUES, AND THE INDUSTRY



Linda Mitchell with Ron and Brenda Duska at the closing reception.

Griswell was concerned with corporate values. “Our first core value is integrity,” he stated. “Integrity means honestly living up to your commitments, keeping your promises. A lot of people say, ‘We believe in customer focus.’ Yet, when you call them, you can’t find them.” He added, “If you call my company, you will talk to me.”

Mitchell recalled his days at American Express and the importance of values there as well. One way he approached values was through employee surveys. “We at American Express did employee surveys as do many others today. But we were one of the first to do them. A third of my bonus was a function of how my group did.” He explained, “We tried to have this really ethical culture. And the question that we scored lowest on year after year after year was, ‘I feel free to take truth up the chain of command.’ While that score improved over time, it was always a challenge.”



Treviño commented that this is an area she has been researching lately—i.e., that of employee “voice.” “I have started thinking that maybe we need to equip people more with these sorts of skills. What do you say and how do you say it when you need to confront your boss ethically?”

The other side of this is that leaders have to be able to accept this sort of feedback. Gini referred to this as the “grammar of criticism.” Leaders cannot become personally affronted by criticism—they need to be able to accept it and respond to it in a productive way.

“Values play an integral role in the financial services industry,” Mitchell explained. “As we were interviewing prospective new employees, we told them a lot about who we were in terms of values and what that behavior looked like.” Mitchell continued, “It was quite remarkable the number of people that self-selected themselves out. There are a lot of people out there who just want to put in their time. But they didn’t get to work for us, because that’s not who we were. We were really serious about ‘customers come first’ and our other values.”

Smith said, “I think putting the customer first goes back to basic values. If you do that, and if you are effective in making sure that you are communicating along the way to your producers, customers, and shareholders, you may have some short-term pain, but it pays off in the end, and it becomes a winning strategy. . . . Ultimately, consumers are going to pick companies that they think are there to help them, not ones that are trying to make a quick buck. That is exactly how you get to long-term success.” ■

“I think putting the customer first goes back to basic values. If you do that, and if you are effective in making sure that you are communicating along the way to your producers, customers, and shareholders, you may have some short-term pain, but it pays off in the end and it becomes a winning strategy...”

Catherine Smith

PRACTITIONERS' ETHICAL ISSUES

The group then turned its attention to some ethical issues the executives had encountered during their careers.

Issue 1: Confronting Legal Challenges in an Ethical Way

A few years ago, a new standard emerged in the industry to try to prohibit people taking advantage of other people by frequently trading within a mutual fund. Since our products are much longer term in nature, we implemented a policy that provided that we would—not only for our own mutual funds but also for our products themselves—abide by rules that were more stringent and put a stop to people using the funds inappropriately.



*Al Gini makes a point while
Linda Treviño listens.*

One of our customers who bought his policy in 2002 said that he felt that that was unfair. One of the reasons he bought a life insurance policy with us was that he found attractive this ability to manipulate and make money with the asset accumulation of a variable life insurance policy through trading. However, our contract said that he had to abide by the policies and procedures of the funds and the company that he was doing business with.

When we put an end to his frequent trading through this policy, he sued us. Just last week we received an order from the court to allow him to trade. We are now stuck between a rock and a hard spot because in order to be in compliance with the court order we need to allow this person to trade. At the same time, in order to be in line both with our own policies and with a new SEC Rule, we should not allow him to trade.

The court order did recognize that the mutual funds companies with whom we do business could in fact stop the trades themselves after one or two of these trades. The court has thus basically allowed us to use the outside fund companies to prohibit trades that we ourselves cannot prevent. We have already alerted them that this individual is going to be trading again, because it has to be stopped.

We have been trying to settle with the customer, but we have not been able to reach an agreement regarding the financial aspects. It would be



possible to give the money back, but that is not a desirable option since it is a huge policy in the neighborhood of \$20 million dollars. We decided ultimately to obey the court order.

The discussion began with a question of whether this was a legal dilemma or an ethical dilemma. Jim Mitchell thought it more legal since there is a court order, while Al Gini thought it might just be a business problem. Gini noted, "Actually, that person was just acting in the way that's best suited to his interests in a capitalistic marketplace."

Catherine Smith indicated that her company has instituted rules against this sort of behavior. "The issue has been that there are certain funds, and it happens only in those kinds of funds. . . where customers have found a way to take advantage of the nature of the fund through frequent trading. . . so they make money, while other clients. . . actually lose out since they lose the benefit of the increased value. This practice was stopped, because it was disadvantaging the long-term investor against the short-term investor. . . . But the (plaintiff's) argument would be that the contract you signed with me allowed this, and you are limiting my upside by doing this. Therefore you should make me whole."

Linda Treviño said, "If there are a whole lot of people who are going to be harmed because of this situation, then I think that's an ethical issue. It is an ethical dilemma because of the potential harm to all of the other investors."

Barry Griswell stated "I thought that the customer was first. His trading wasn't prohibited when he bought the contract."

Don Robin agreed. "He (the customer) has found a way to make money, perhaps in an unethical way. This person is trying to get around the rules through your operation. . . It's not your company's fault. You're locked in, I guess. It's an ethical dilemma, but it is not your fault."

Gini added, "But it's on your watch so it seems like a blemish."

Smith commented that, in her organization, they have talked a great deal about doing the right thing. She would not want to put herself in a spot

"If there are a whole lot of people who are going to be harmed because of this situation, then I think that's an ethical issue. It is an ethical dilemma because of the potential harm to all of the other investors."

Linda Treviño

where she was allowing someone to do something that she thought was wrong, particularly when it could hurt other investors.

“If not the people with the resources, who is going to fight the fight? If nobody fights the fight, then everybody goes down.”

Ron Duska

Ron Duska asked, “What would happen if the company said, ‘No, we are not going to go along with the court order because our principles are high?’”

Smith thought the company would then be in contempt of court.

Duska opined, “I think that this is the ethical dilemma. Is this important enough to defend even if it brings you into contempt of court? That’s what we are wrestling with.”

Treviño raised another problem. “What happens in your industry when you have this court order competing with what the SEC and the NASD are telling you to do?”

Smith answered, “The SEC and the NASD have already gone after companies . . . there is clear case law that they will go after you if you are allowing this to happen with your products. So it is actually a very sticky issue for the industry.”

Gini commented that a lot of things come up in business ethics courses that are not ethical issues, while Robin felt this had both an ethical side and a legal side.

Duska interjected, “But there is the larger ethical question of when it is time to fight the law and when it is time to litigate. I am saying, ‘fight the court order.’ You’ve got a principle here to defend. It may cost your shareholders, but then you set an example. You say that this is a company with integrity. It seems that executives are always willing to settle so they don’t have to go through litigation. But then what happens is that everyone starts to do that.”

Mitchell recalled a situation that he had been involved with. “What persuaded the company that it should settle was not just the risk of losing a lot of individual trials, though that is a big risk. A major benefit of settling is that the class members agree not to sue for anything else that might have gone on in the past. So the company gets a sort of ‘vaccination’ against future



Barry Griswell enjoying the conversation.



lawsuits for about ten dollars a client, say. That's why companies wind up settling some class action lawsuits that appear to have very little merit."

Treviño recalled her experience with someone who was legal counsel for Merck. Merck decided to fight every case against Vioxx. "They have been fighting them for the last three years, but, on average, they have won more than they have lost. Still, they lost the first couple, and it's costing them a fortune. They decided to fight it because they believed it was the right thing to do. They felt they hadn't done anything wrong, particularly in light of the fact that they had taken the high ground by recalling the product before anybody asked them to. The FDA told them they didn't have to."

Duska concluded, "If not the people with the resources, who is going to fight the fight? If nobody fights the fight, then everybody goes down."

"They (Merck) decided to fight it because they believed it was the right thing to do."

Linda Treviño

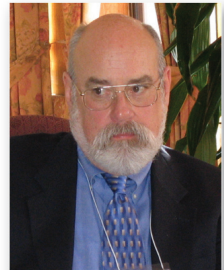
Issue 2: Fair and Equal Treatment of Customers

The insurance business is regulated by the states, and policy forms are approved at the state level. In some lines of business, when a policyholder leaves in the middle of a policy term, we would be required to return a pro rate portion of the premium that we have not yet earned—the so-called "unearned premium". But in our main line of business, Medicare Supplement insurance, the great majority of states do not require us to give back unearned premiums when customers leave in mid-term. Only two or three states, like Florida, require us to give back the unearned premiums.

We have to price the business differently in those states that require us to give back the unearned premium, so as to try to keep our loss ratios the same. Every state's plan has to stand on its own. You have to be very careful on pricing.

In the majority of the states, our contracts say that we do not have to give back the unearned premium. The contract is very clear and always has been since 1983. We also disclose this to customers when they apply for insurance.

I feel really bad when I get calls from seniors that they have paid an annual premium and they want six months of their premium back. These people are on fixed incomes in many cases, and the money would be important to them.



Dennis Moberg contemplates a point.

“So the only way to get out of this dilemma is to go to each state and get them to agree to a more uniform approach.”

Catherine Smith

But I know from all of the lawsuits I have been involved with that I cannot make exceptions for some individuals. Pattern practices are a big legal issue. If you have not done something consistently across the board, the courts are going to hold that against you. If you do it for one, you have to do it for all. But it really makes me feel bad that I can't refund unearned premiums when people need the money.

Theoretically, we could charge a higher premium and give back the unearned premium even in those states that do not require us to do that.

But the states require that our loss ratios (ratio of losses paid or accrued by an insurer to premiums earned, usually for a one year period) be at a certain level before we could charge the higher premium. Also, if we charge higher premiums for very similar coverage, we will lose business to competitors.

Smith opined, “So the only way to get out of this dilemma is to go to each State and get them to agree to a more uniform approach and say we are always going to refund unearned premiums.”

Gene Choate pointed out that, “Every state is different and not every state has an actuary that understands the products.”

Griswell commented that the company can't just be giving back money to customers that was not contemplated when the rates were set. If they do that, they will not make the profit which they expected to.

Treviño asked whether offering quarterly premiums was an option, and was told that the company did, in fact offer quarterly premiums. Many people, though, pay annual premiums because that is cheaper than four quarterly premiums.

That caused her to conclude, “I think that you have done your duty.”

Issue 3: Making it Right for the Wronged Customer

A few months ago, a potential customer called me and he was outraged. We had gotten him to move his health insurance over to us and he complained that, after he switched to our company, we raised his premiums. He said he was paying something like \$500,000 more than his prior coverage and around \$600,000 more than he said he was quoted.



Once I began to look into the situation, I found that it involved an experienced broker, from a national firm. Although we had done business with this firm in the past, we had never worked with this broker.

The broker had gotten some census data and other skeletal information about the business. Our underwriters gave him a very preliminary bid, since there was no medical information on the people, no clear estimate of how many would actually take coverage, or anything like that.

The broker apparently took the bid to the owner and sold it as gospel. Beyond that, he convinced him to cancel coverage with his current carrier right away instead of using the standard process of waiting for the new policy to go in force.

The broker does all of this on a Friday and the new policy isn't effective until Monday. By then we had all the data, and we got back to the broker and told him, "By the way, the premium is not going to be a \$1.3 million, it's going to be \$1.9 million."

Obviously, the broker should never have encouraged the owner to cancel the original policy. But now, I am brought in, and I have got to figure out what the right thing to do is.

One of my options was to say, "You know, Mr. Client, I'm very, very sorry, but your broker screwed up, and, if you really want restitution, you have to sue your broker." You can imagine what that does to my relationship with the broker who is part of a national firm that we do business with all over the country.

So I call the business owner and he tells me, 'Look, this all sounds like your problem. I was promised that I would have this coverage from your company at a certain rate.'

The first thing my people said to me is, "Here is what we are going to do. We can't get him reinstated with the old company, but we are going to honor the rates we said for one month and give him a chance to go somewhere else—that would be the fair and honorable thing to do."



Catherine Smith, Gene Choate, Barry Griswell, and Ron Duska take in the discussion.

“The philosophy that a customer comes first really has to be embedded, because otherwise it is too often expedient to make decisions that are contrary to this view.”

Catherine Smith

So we went back to him, but the owner wasn't happy with that solution. He said, "You promised me a year-long policy, now you are telling me that it was a one-month policy. I don't really like that."

We decided to honor the policy for the year, and we are going to swallow the difference in premium since our reputation is more important than anything else. We did go to the national brokerage firm and got them to agree not to take a commission, since it was their broker who had messed up. But we still ended up several hundred thousand dollars in the hole. The rest of our policy owners are going to pay a portion of that. Theoretically, you have to raise your prices for everybody else to pay for someone's incompetence. Is that ethical?

Our customer said that we were really first rate and that he was going to work with us to keep his claims down as much as he could. He assured us that he would do a 401-K with us when the time comes. In that sense, we made the absolute right decision.

Gini commented, "It seems that you took a loss on this one, but even though you got burned, you still saved your reputation. And if you are still looking at this as a service industry, aren't you in business because of your reputation?"



The Philosophers: Dennis Moberg, Al Gini, Ron Duska, and Don Robin.

Smith responded, "Sure, but you also have an obligation to your shareholders. It's always a balancing act. Since you compete in the marketplace for capital, you have to be fair to both sides. You need a reputation for taking care of both your customers and your shareholders."

Duska posed a question: "Let me play devil's advocate: What if somebody at a lower level had made that decision? Wouldn't that be out of their competency? I can't imagine anybody at a lower level making that decision."

Smith answered, "All companies have certain dollar thresholds, but we have levels of approval authority so that we don't let somebody on the ground floor make a decision like that."



Dennis Moberg noted that this sort of behavior does affect the future behavior of others. "You might have a manager who is developing in the business. He sees this decision being made and says to himself, 'When I get to that level, maybe that's how I should make decisions.'"

Smith agreed. "The philosophy that a customer comes first really has to be embedded, because otherwise it is too often expedient to make decisions that are contrary to this view."

Griswell echoed Smith's view and shared an example: "We have an Internet bank. A customer wanted to make a transfer over the phone, and we wouldn't do it without seeing an ID. We had security protocols, and it ended up costing him a hundred dollars to get a certified check. We sent the customer a \$100 check and said, 'We are sorry for the inconvenience. That's not the way we do business.' . . . But I think that it is a balancing act. You don't want to create a culture where you 'roll over' when you shouldn't."

Moberg commented, "What you are doing is applying something called 'practical reason'. It is based on years and years of experience in seeing cases like this. My sense is that you are 'feeling' the facts and looking at the narrative, making sure that it is coherent and seeing that it hangs together. You make the determination whether this is a case that I am going to support or does this 'feel' like a case that I am not going to support. Then the question becomes, how do you take these 'rules' or this knowledge and make sure that the next man or woman down the line has it? How do you pass 'practical reason' on?"

Gini added, "I think that there is an obligation to pass those sorts of experiences on. To say to someone, 'This is a learning experience. This is why I acted in this way in this situation, and if you haven't thought about it in this way, maybe you should.' You may be at the top because you accumulated the greatest amount of experience, but in order for you not to be last person there, you have to share it with people." ■

"What you are doing is applying something called 'practical reason'. It is based on years and years of experience in seeing cases like this."

Dennis Moberg

PHILOSOPHERS' QUESTIONS

The discussion next turned to the questions asked by the philosophers of the practitioners.

Question 1: How much is enough?

I had the opportunity to develop a questionnaire for an insurance company looking for things, feelings, and attitudes to avoid. We posed the following scenario:

A company adjuster had settled a claim involving a fatality in which there is clear liability with a claimant who is not represented by counsel. The claimant is also a widow. The supervisor, who is a CPCU, noted that the claim was close to \$50,000. He also noted that this type of claim would normally settle for many times that amount. The policy involved had a \$1 million limit. The supervisor congratulated the adjuster on reaching such an advantageous settlement.



Ron Duska listens to a dialogue between Al Gini and Linda Treviño.

The respondents—the employees of the company—were asked if they thought this was fair.

I'm particularly interested in whether this settlement is enough? "How much is enough?" We can't obviously give away the company because we have a responsibility to the stockholders as well, but this seems one-sided.

The employees of the company, for the most part, agreed. On a scale of one to seven, it scored maybe a 5.4 in terms of unfairness.

Gene Choate said, "I think that you have an obligation to be fair. If this person is not represented by counsel, then I think you also have an obligation to not settle on the low side, even if you could do so. But it is a difficult case since the adjuster has an obligation to settle as low as he can. He is just doing his job."

Catherine Smith asked, "How much is enough? If you are the adjuster here, where do you draw the line? My feeling is that, if you offer as low a settlement as possible, sometimes these situations come back and haunt you later, and then it becomes a much bigger problem. So to me, the right answer is to go back to the claimant and suggest that she get legal representation or other appropriate advice."



Barry Griswell noted, "If I were running this company, I would want to have a process in place that is built on some kind of database that asks, 'How old are you? How long do you have to live?'—something that would give me a reasonable way to determine if "X" is a fair and equitable settlement. I wouldn't want to have an incentive for claims adjusters to go below that—then you are just opening up Pandora's Box. I like that approach a lot better than to suggest getting representation."

"I think that you have an obligation to be fair."

Gene Choate

Ron Duska said, "I'm always concerned about the unintentional reward system—you are going to get what you pay for."

Linda Treviño agreed and provided an example. "That reminds me of a company that had in place the sort of incentives you are talking about. They were basically rewarding people for closing disability claims on the low side. The evidence was pretty damning."

Choate recalled his experiences. "We took the position that our claims files were never closed—if there was a problem, and it hadn't been settled properly, then we would reconsider that claim. That saved us on many, many cases."

Question 2: What do you do about corporate information leaks?

All of us read last summer about the Hewlett-Packard Corporation. Former CEO Carly Fiorina had problems with her Board, particularly two or three Board members. During her regime, these Board members were leaking information, not only to the Hewlett family, but also to the New York Times, The Wall Street Journal, and so on.

Patricia Dunn came in as Board chair, and the leaks continued. She has been described as very angry about the situation. So she decided not to take the more temperate approach, which was used under Fiorina, namely, to send corporate counsel around to Board members and talk to them about the importance of confidentiality and about keeping things contained on the Board. Instead, she decided to authorize an investigation.

My question is, "What do you do about information leaks from task forces, strategy meeting groups, off sites, things like that?" The experience at Hewlett-Packard suggests that an aggressive response that involves pre-texting is not the right answer.

“Of all the producers I deal with, every one of their codes of ethics has confidentiality as one of the major points. They are attuned to it in a way other industries are not.”

Ron Duska

You often meet with your executive team to discuss very touchy, sensitive issues. What do you do to make sure that your task forces, committees, and off sites aren't leaking? And what happens when you detect a leak?

Choate said, “We have good Board members, and most of them have known our company and have been on the Board for probably thirty years. There is a trust there that sticks.”

Griswell mentioned an experience of his. “When we became a public company it afforded us an opportunity to have a very robust dialogue with all of our people about this very issue. And, because of that, I think we have been able to instill a culture where everybody understands the sensitivity of information. We really build a lot of training programs around what is acceptable to talk about and what is not. Today the consequences of leaking something are so severe that it's hard for me to fathom it happening. The Board would have that problem. We have created videos—vignettes—where we demonstrate where a simple little talking about something at the water fountain could be leaked out.”

Griswell continued, “I think the overall awareness starts with the admonition that ‘you shall keep quiet.’ Then you have to be vigilant and have very serious punishment if leaking happens—not a slap on the hand, but maybe termination. The other thing that we do is that, anytime we get involved in a sensitive product, we have everybody sign a confidentiality agreement. I guarantee you, when you see that if you leak something you're going to be terminated, it means something. If you do enough of that, you get a culture of people who understand that it's not okay to leak.”

Dennis Moberg and Al Gini listen to the discussion.



Duska pointed out that confidentiality is ingrained in the financial services culture in general. “Of all the producers I deal with, every one of their codes of ethics has confidentiality as one of the major points. They are attuned to it in a way other industries are not.”

These sorts of issues are becoming increasingly important in light of the expanded role of information in our society, and our increased vulnerability to it—such as

through identity theft. Treviño noted, "People have to be sensitized. Many are learning the hard way. They put pictures of themselves doing really stupid things on the Internet. Then, when they go apply for a job, the company finds that, and they are not hiring this person. With new technology, it takes a while for everybody to figure out the downside. We, as professors, have a responsibility to help people understand the ramifications."

Question 3: The nature of ethics; is it a science or art?

My dilemma is that I believe that applied ethics, business ethics in particular, is considered as a science rather than an art. I think that ethics is the ability to reach out and help another person, even if we don't know them. In the business world, ethics means to try and do the right thing and treat others well. I think that, in the MBA programs in particular, we teach ethics the way we teach all business. We teach that ethical situations are like algorithms. They can be resolved if you know the right formula. But sometimes there are no answers, and the ethical dilemmas do not have any solutions. Even if there is a solution, ethics is not mathematically precise. I think we forget business is all about people, and people cannot be explained by metrics. That's why most business problems are not just algorithms, and that's why philosophy can never be taught as a mathematical equation.

This raised a question for Griswell. "Why do businesses exist? Do businesses exist to provide goods and services, or do they exist to provide income or, . . . what is the role of business? There is a higher level of debate as to whether businesses are operating ethically or not. No industry is perfect in the way it carries out its function in the marketplace, but this industry still provides capital for corporate bonds, and other investments that make the economy grow. I think the interrelationship between what our businesses do at the macro level and what we do on a one-on-one basis is quite intriguing."

Al Gini responded, "I think that it is impossible to have one personality at home and one at the office, and a different set of values for each. Everybody knows that you can't sustain that. You can't be Machiavellian in the day and Alan Alda at night. And my experience has been with executives who are really concerned about ethical values. They don't come to places like this

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Al Gini

“If you think about it, we spend more time on the job than we do anything else in our lives”

Al Gini

and feign interest. This is an extension of themselves. In point of fact, if you think about it, we spend more time on the job than we do anything else in our lives. We don't sleep as much; we don't spend as much time with friends and family as we do at work. So what we do at work is really who we are.”

Smith agreed. “That is why I think it is so important that you align your work with your values. And I also think it's why companies like Principal, which has high employee satisfaction, probably also have a correlation between their results and the relationships that they have with their employees. The company has values that attracted those employees.”

Treviño at this point talked about the importance of cognitive moral development. Cognitive moral development “represents an individual's level of cognitive sophistication in thinking about ethical issues. We know that it is related to an individual's quality of ethical decision making. I know of no company that is measuring it. It's not simple to measure, but it is measurable. It doesn't tell you everything, but it tells you a lot. And I think it would be particularly useful at the executive level, because the people you want at the executive level are those people who are going to be able to reason through dilemmas on their own and make very good decisions in ambiguous situations.”

Question 4: How do we structure reward systems?

Through their lives, people develop not only their grasp of moral concepts but also the tools that they will use to think through ethical dilemmas. This process of cognitive moral development begins when you are a young child and once you develop to a certain stage and have the ability to reason in a sophisticated way, you will find it cognitively uncomfortable to reason and think at a lower stage. However, a large majority of people in our society live at the “conventional level” of moral development, and this means that they are looking for other people to provide moral guidance. If a leader does not provide the guidance that people are looking for, they will find it elsewhere, most likely in their peer group. This can lead to less than optimal results for an organization.

These theories of cognitive moral development allow us to explain and predict a lot of ethical behavior. Using these tools, I can certainly help you predict which executives are going to make ethical decisions. This is



important since not only are top executives decision makers, they also influence their subordinates and peers within the organization.

My concern goes to the heart of the question of how you manage behavior. How are reward systems structured in the financial services industry with regard to ethical and unethical behavior? Do you have any ideas about what you might need to do to alter those?

Griswell responded, "My sense is that some people get to a stage of development where incenting them to do the right thing is a waste of money. Some people come to a point where they want to do the right thing, and they want to help you build the business. These motivations go far beyond incentives. I think we create environments. For example, in the agent world, we give them lucrative compensation and take them on elaborate trips and give them lots of recognition. Many of us say, 'I'm not sure it really matters, but if I don't do it somebody else is going to do it', so it becomes a competitive thing."

Don Robin pointed out that there are many different types of incentives. "Sometimes a verbal reward or a pat on the back can lead people down the path and encourage the right kind of behavior."

Smith recalled, "I ran customer service. It had the lowest paying jobs in the whole company. To many of these people, the bonus money was more important than salary. I think you have got to have incentives. The issue to me is getting the right balance. Money—compensation—is only one element. You have to be providing both compensation and recognition. I think companies fail to reward leadership skills enough in their compensation schemes, and that the schemes are too weighted in terms of sales and financial metrics. If we really want to create an ethical business culture, then I think we have to put that incentive in the compensation."

Duska asserted that there is a frightening emphasis on bottom line profitability. He explained, "We have a large part of the culture out there pushing the bottom line. Our business schools should take a lot of responsibility for that, because they do push profit, profit, profit, and they use that to justify a whole lot of behavior. On the other hand, I work with producers, and we talk about the commissions all the time. For the ones who are affluent and who

"I'm always concerned about the unintentional reward system—you are going to get what you pay for."

Ron Duska



Don and Sarah Robin at the closing banquet.

“If you are a CLU, which suggests you should do for your customer that which you would do for yourself, then you have to ask yourself, ‘If I were in the free market, would I buy my own company’s products?’”

Barry Griswell

aren’t under a whole lot of pressure, compensation is not that important. I think they are probably like your senior executives—they get satisfaction on the job. If you get satisfaction on the job, doing the job is its own reward.”

Question 5: “Whose agent are you, anyway?”

A question that interests me involves what I call the “agency conflict.” The American College Code of Ethics states that you must “look out for the best interests of your client.” It is evident how this admonition applies to the independent agent, but it also applies to the agent under contract, as well. Perhaps there is something awry with the company if the agent finds it impossible to reconcile his duties to the company and to his clients.

A few days ago, one of my students said that his company wouldn’t allow him to perform an action he believed was in the best interest of the client. I told him to go to his company’s website and look up their mission statement. I have never heard a financial services company state that shareholder wealth creation is its first mission or goal. If profit is mentioned, it is always subordinate to the overriding goal of serving the client to the best of their ability. When agents question me about the conflict in their duties to their clients and to the company, I tell them that if their company was behaving in the way that it should be, they, as agents, would not be in this predicament. That company is putting quarterly earnings or some sales incentive ahead of their mission statement.

How do you handle that conflict between the demand of profit and the fulfillment of the mission statement? In other words, how do you breathe life into the company’s mission statement?

Smith said, “I think there is a different question that you should be asking, which is ‘are all companies out to make money—period. I don’t know of any companies that are trying to lose money. Taking that as a given, we should question the situation in which a company is ‘trying to make money’ in a way that its own agents and employees do not think is ethical.”

Griswell commented, “We all know that there are companies in the industry who have products that are less competitive than those of other companies. If you are a CLU, which suggests you should do for your customer that which you would do for yourself, then you have to ask yourself, ‘If I were in the free



market, would I buy my own company's products? If the answer to that is "No," the people who sell for those companies may have decided that they are willing to compromise their own values. But they might also have a rationale that says, 'This company's products are slightly less competitive, but they provide better benefits for me, give me more housing and other things that allow me to do my job, and if I can do my job, I can help more people.' To bring it down to my having to sell the most competitive products to do the right thing by my client is an artificial argument, I think. If everybody followed that, they would all be working for the same company. Every company has a value proposition that is a bundled package that includes needs analysis, quality service, products and the like. You can't just get it down to a single product or a single rate—you've got to ask, 'Does my company provide a package of products and services that is good for the customer, and can I be proud to work for that company?' Of course, if the answer is, 'No,' then you have to get out."

Duska added, "I think there is a systematic problem in the industry. In one sense, products are just that—products that can be sold on the Internet or wherever else. On the other hand, these products are sold by a sales force that wants to look at themselves as professionals. So if I tell you that I am a professional, looking out for your best interest, and I am telling you that this product is the best product for you and the most suitable to your needs, then I am a hypocrite if I do not believe in my products."

Dennis Moberg heard a different question. "It seems to me you are also asking, 'Isn't there difficulty in encouraging ethical behavior when all the emphasis is on the metrics?'"

Duska responded, "The question is, 'How do you keep your company from falling into these traps?' Because these traps seem to be natural traps with reward systems, and these are the situations that the producers I am talking to are complaining about."

Jim Mitchell offered a solution. "We established a system in which we agreed that, for each of our products, we would show how we stacked up competitively against the leading sales companies. If we were not reasonably competitive, we would either change our product or stop selling it and broker a more competitive product." ■

"It seems to me you are also asking, 'Isn't there difficulty in encouraging ethical behavior when all the emphasis is on the metrics?'"

Dennis Moberg



Don Robin talks to Gene Choate at the opening receptions.

“We can read pieces in *Fortune* and *Business Week* that cover some of the same things that you folks have touched on. But to hear it in a heartfelt way is much more meaningful. You helped me be a better professor.”

Dennis Moberg

CONCLUSIONS

The end of the Forum featured the participants identifying what benefits they received from the day’s experience and what they would take away or reflect upon afterwards.

Catherine Smith felt that it had been “a fascinating conversation. It has been valuable to hear the discussion from a more academic angle. I will certainly think more about the conversation about compensation and the changes in our culture. I thank all of you for lots of candor and a great openness and willingness to share.”

Don Robin received “great things” from the day. “Today, I heard some good stories about good companies. So much of the stuff you read in the paper harps on the bad side. Here we have companies doing good stuff, good stuff ethically as well as profitably. That’s the song of my business ethics class—you can be ethical and run a good, successful, maybe even more profitable, company.”

“Besides the stories,” said Dennis Moberg, “I think it really helps to look somebody in the eye. I looked Catherine in the eye, Gene in the eye, and Barry in the eye as I talked to them. There is something about that authenticity that’s really behind this day. We can read pieces in *Fortune* and *Business Week* that cover some of the same things that you folks have touched on. But to hear it in a heartfelt way is much more meaningful. You helped me be a better professor.”

As a result of the day’s discussion, Al Gini was reminded that “it is not me against them. I think the notion of the ‘other’ always isolates us.”

Linda Treviño said that she was reminded that industries really do have very specific issues. “I think that’s really important to recognize. I also heard wonderful, positive stories that I can use in my class. I, too, emphasize the positive in my class, but I go in with the assumption that everyone already knows about Enron and Adelphia and all those horrible stories. And these good sorts of stories help me to balance the discussion.” For tomorrow, she went on, she expects to continue her pursuit of her bottom line question—“I’m trying to understand what makes for good ethical leaders, and then trying to help develop this when I teach.”



Linda and Dan Treviño at the opening reception.



Gene Choate appreciated the opportunity “to meet a lot of great people. I got an awful lot of things from a lot of different sides. Tomorrow I will reflect upon things I can change, suggestions I heard from other people that could make things better in my company.”

Barry Griswell found the day very enjoyable. “I love debate, I love these kinds of concepts, I love to talk about them, and I love to try to put them into real life practice. I think the thing that I will reflect on is how industries can have things going on in them that are common practice but that are not necessarily appropriate.

Ron Duska thanked everyone and remarked, “I’ve gotten lots and lots of stuff. I want to underline the value of these good stories. I’m also intrigued by the debate on moral development. I just had a wonderful time.”

Jim Mitchell noted, “I, too, learned that there was such a thing as cognitive moral development. And, because I truly think that notion of how you identify senior executives who are going to lead in an ethical way is a big deal, I have to get smarter about that. The other thing I will reflect on is how our Center for Ethics can be most influential and helpful.” He concluded by thanking all the participants. “I love to rub minds with intelligent, well-meaning people, and that’s what today has been. Thank you. I have enjoyed it enormously.” ■

“I love to rub minds with intelligent, well-meaning people, and that’s what today has been.”

Jim Mitchell

THE AMERICAN COLLEGE CENTER FOR ETHICS IN FINANCIAL SERVICES

The American College Center for Ethics in Financial Services is the only ethics center focused on the financial services industry. Under the leadership of Director Ron Duska, the Center aims to serve as a catalyst for professional and responsible behavior by providing information to multiple stakeholders, moderating dialogue among various constituencies, and influencing decision-making through a diverse array of programs.

The Center brings together industry leaders, accomplished producers, and prominent business ethicists to reinforce the interconnectedness between values and good business practices.



Co-hosts Jim and Linda Mitchell.

The Mitchell Forum has become a defining event for the Center. It underscores the Center's emphasis on collaboration and conversation among academics and practitioners. This one-of-a-kind event is an annual, day-long, invitation-only forum that brings together a select group of chief executives from financial services companies and esteemed business ethicists from academia in a meaningful conversation about the state of business ethics in the financial services industry.



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