

2 0 0 3 P R O C E E D I N G S

THIRD ANNUAL  
FORUM ON  
ETHICAL LEADERSHIP



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





The third annual James A. and Linda R. Mitchell/American College Forum on Ethical Leadership in Financial Services took place January 11–12, 2003, in Boca Raton, Florida. At the event, seven financial services executives and six business ethicists from academe met to discuss issues, challenges, and developments in the practice of business ethics. The participants included:

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## The practitioners

**James A. Mitchell**, Chairman and CEO (retired), IDS Life Insurance Company, Longboat Key, Florida (host)

**Lawrence J. Arth**, Chairman of the Board and Chief Executive Officer, Ameritas Acacia Mutual Holding Company, Lincoln, Nebraska

**Roger K. Brooks**, President, Chief Executive Officer, and Chairman of the Board, AmerUS Group, Des Moines, Iowa

**Robert W. Clark**, President and Chief Executive Officer, Shenandoah Life Insurance Company, Roanoke, Virginia

**Kenneth C. Mlekush**, Vice Chairman, Jefferson-Pilot Corporation, Greensboro, North Carolina

**Donald J. Shepard**, Chairman of the Executive Committee and Chief Executive Officer, AEGON NV, Inc., Baltimore, Maryland

**Edward J. Zore**, President and Chief Executive Officer, The Northwestern Mutual Life Insurance Company, Milwaukee, Wisconsin

## The business ethicists

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

**Thomas Dunfee**, Kolodny Professor of Social Responsibility/Vice Dean and Director, The Wharton School, University of Pennsylvania, Philadelphia, Pennsylvania

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

**Kenneth Goodpaster**, The David and Barbara Koch Chair in Business Ethics, University of St. Thomas, Minneapolis, Minnesota

**Edwin Hartman**, Professor, Department of Business Environment, and Director, The Prudential Center for Business Ethics, Rutgers University, Newark, New Jersey

**Linda Klebe Trevino**, Professor of Organizational Behavior, Franklin H. Cook Fellow in Business Ethics, Smeal College of Business Administration, The Pennsylvania State University, University Park, Pennsylvania

# FORUM ON ETHICAL LEADERSHIP

## Executive Summary

In recent years, with the increasing complexity of financial products and services, the challenge of ethical decision making in this industry has become more important than ever. The James A. and Linda R. Mitchell Center for Ethical Leadership in Financial Services at The American College sponsors the annual Forum on Ethical Leadership to encourage a dialogue on ethical issues facing financial services professionals.

The third annual forum, conducted in January 2003 in Boca Raton, Florida, brought together thirteen representatives from two sides of the dialogue: “the practitioners,” executives from some of the nation’s largest financial services and insurance companies, and “the philosophers,” the business ethicists, professors and chairs of ethics and management at prestigious educational institutions across the United States.

Co-hosts James A. Mitchell, retired chairman and chief executive officer of IDS Life Insurance Company, and Ronald Duska, holder of the Charles Lamont Post Chair of Ethics and the Professions at The American College, welcomed participants for the two-day program. The executives expressed curiosity in the frameworks that academic experts recommend for addressing complex ethical issues. They were interested in developing a better understanding and interpretation of how people define and interpret ethics, particularly when companies have operations that cross borders into different cultures. They also wanted to engage in a self-examination of their own ethical choices, as well as bring back ideas that would encourage their employees to adhere to high standards of practice. The ethicists expressed curiosity and interest in the day-to-day challenges the practitioners face, how they manage their “corporate cultures” to promote ethical behavior, and what leadership tools and structures they employ to ensure that ethical decision making permeates an organization.

The first day of the program was devoted to discussing the ethical quandaries presented by a major case recently in the news—litigation involving Wal-Mart regarding company-owned life insurance (COLI) on which it incurred losses it claimed exceeded \$135 million due to tax-law changes—as well as a series of ethical “dilemmas” that addressed such issues as firing a relative for embezzling, fraudulently obtaining life insurance applications from senior citizens, and finding out about the murderous past of an otherwise long-trusted employee.

In the COLI case, the participants debated the ethics of this product, including some of the issues raised by the Wal-Mart lawsuits: proper

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*The executives wanted to engage in a self-examination of ethical choices, and bring back ideas that encourage employees to adhere to high standards....*

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disclosure to the insureds, their families, and Wal-Mart shareholders; sufficient disclosure to Wal-Mart of the tax laws' potential impact on its bottom line; and whether Wal-Mart had the right to take out insurance on all employees, regardless of their levels in the organization.

Some in the group could see the value and legality of the product so long as all interested parties were completely informed. However, others questioned whether its use to generate tax benefits or fund benefit plans—versus primarily to insure the lives of indispensable management employees—was fully justified. All felt that the financial services industry and its players need to take a more assertive leadership stand in encouraging their managers to question potential ethical time bombs, such as this one at Wal-Mart, before they explode.

On the forum's second day, the academics asked the practitioners a number of questions about the practical implementation of ethics in companies. Issues such as compensation and hiring standards, how management can encourage board members to challenge them appropriately, and how best to encourage ethical behavior were discussed.

The virtues of a “front-end-loaded” commission structure versus a “levelized” commission structure were debated, with participants noting that the latter is more likely to discourage unethical replacement of policies. Several of the executives noted the importance of having monitoring mechanisms that track the suitability of products by customer as well as customer complaints, down to the agent level, to ensure accountability.

The ethicists questioned whether there is too much emphasis today on near-term “shareholder value” by executives and boards of directors, to the detriment of critical thinking and questioning about company operations. The practitioners emphasized the importance of full disclosure to board members and ongoing communication, perhaps through board retreats and an environment that fosters questioning.

The group also pondered some of the internal structures in place that ensure against the possibility of loss of reputation and integrity. Items such as “indexes of corporate responsibility” might be helpful, but more importantly are the signals that come from both the internal and external environments—internal and external surveys, complaints, litigation, the decision-making process, and a shared corporate philosophy about ethical behavior.

In closing, participants expressed appreciation for having the opportunity to engage in a candid dialogue about ethics in the financial

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*Tom Dunfee (center), The Wharton School, University of Pennsylvania, makes a point to Roger Brooks (left), AmerUS Group, and Larry Arth, Ameritas Acacia Mutual.*

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industry. The practitioners said they benefited from assessing their companies' own practices by comparing notes with their peers, and at the same time from the broader perspectives brought by the ethicists who study these issues for a living. The ethicists learned more about the practical challenges faced by the practitioners and the methods they use to deal with them—valuable information about corporate practices that the ethicists could bring back to the classrooms at business school programs across the country.

## The Proceedings

### Introduction

Host Jim Mitchell, retired president and chief executive officer of IDS Life Insurance Company, and co-host Ron Duska, holder of the Lamont Post Chair of Ethics and the Professions at The American College, welcomed the participants of the third annual Mitchell Forum on Ethical Leadership in Financial Services. By way of introduction, Mitchell asked the members to briefly comment on what ethics means to them, as well as on their expectations of the day.

Ken Goodpaster, who holds the David and Barbara Koch Chair in Business Ethics at the University of St. Thomas, recalled obtaining his PhD degree (in philosophy with a special interest in moral philosophy). "I came out of my doctorate with a tremendous amount of high-level understanding of ethical theory, but not a great deal of understanding about how to apply it to practical circumstances.... And over the years I got myself involved progressively in applications of ethics...in business ethics and environmental ethics, and started coming down off of that theoretical pedestal. I started to realize that I had to learn about the decision-making environments of practitioners to understand applied ethics."

He was interested in learning from the practitioners in the group how they manage their corporate cultures to promote ethical values, and what leadership tools they use to ensure that their organizations' consciences are healthy.

Unlike Goodpaster, Roger Brooks, chairman of AmerUS Group, has no experience in theoretical ethics. "Ethics is a very disquieting and difficult topic to work with.... I find it very difficult to define exactly what it is. Certainly I have been faced with ethical decisions in my career...even when I made what I'm sure was the most ethical decision." During the forum, he wanted to take a closer look at traditional academic frameworks for addressing ethical issues, as well as engage in a closer self-examination when it comes to his own behavior.

Ken Mlekush, vice chairman of the board of Jefferson-Pilot Financial, said that he has always believed in the concept that good ethics is good business. "Following the appropriate ethical principles has been good for my career, and has also created a very positive and fulfilling environment in which to work."

He also noted that decision-making processes in business often don't pay enough attention to ethics. "Discussing ethics involves more of an 'ad hoc' approach as opposed to something that is purposefully a part of one's culture." He hoped the forum would provide a process—a point of view of good ethical practices within an organization.

Linda Klebe Trevino, professor of organizational behavior and Cook Fellow in Business Ethics at Penn State's College of Business, noted that unlike the other academics present she has a PhD in management rather than in philosophy. She has spent 20 years studying ethical behavior in an organizational context. "It is the management of ethics in organizations that's really of interest to me." Her focus has been on issues such as ethical culture, climate, ethical leadership, reward systems, increasing moral awareness, and the use of discipline, and how those actually influence ethical behavior. She is particularly interested in ethical leadership in business, with a focus on the senior executive perspective, as well as in ethical issues in the academic realm—academic integrity, academic dishonesty, and the ethics of research.

The forum offers "challenging" opportunities to gain access to talk to business leaders. "To have the opportunity to sit around for most of the day and just talk with you will be wonderful for me and very educational."

Ed Zore, CEO of The Northwestern Mutual Life Insurance Company, noted that ethics is part of the "genetic code" of that company. The company tries to hire people with an ethical code that is "imprinted genetically," by which the company operates.

As for his expectations of the day, he said, "I'm always intrigued by the ability of people to operate in an ethical manner in a variety of circumstances, amidst competing demands. Of course, sometimes ethics seems to be in the eye of the beholder—you know it when you see it—but it can be hard to define up front, especially when you have different points of view."

Don Shepard, chairman of the Executive Committee and CEO of AEGON NV, Inc., said that his experience of ethics has been influenced by dealing with foreign countries, with their different points of view of what is or is not "ethical." When one company takes over others in countries with different cultures, often there are "real hornets' nests" inside that must be dealt with after the fact.

As for his goals for the day, he said, "Our business is one of selling promises; and yet the agents in our industry aren't given the highest marks in the integrity field, which is very much a concern to me. It would be very helpful if I can take something out of the forum to help our different distribution systems and our management do a better job of raising the bar in terms of the view of our industry."

Co-host Ron Duska, professor of ethics and holder of the Lamont Post Chair of Ethics in the Professions at The American College, noted that his ethics chair is unique because his institution, The American College, was specifically created to produce ethical agents. "The College was founded by Solomon Huebner, who wanted to raise the marketing of insurance to a profession. Huebner's main point was that insurance sales had to be ethical. The mandate of the ethics chair is to have some sort of ethical impact on the financial services industry."

One result has been the establishment of the Mitchell Forum, now in its third year. For Duska, ideas have consequences for behavior, so his simple aim for the day is to have "good thought." "If anything else comes out of that, so much the better."

Larry Arth, chairman and CEO of Ameritas Acacia Mutual Holding Company, noted that while he probably had never taken an ethics course in college, in his mind ethics and integrity are pretty much synonymous. His goal for the day would be to learn what others are doing to address ethical issues. "I don't know how an industry that deals with products that you sell today, but that you don't have to honor your side of the bargain for 70, 80 years, in some instances—could be successful as

an industry unless the companies operate with the highest level of integrity. I hope that's what others are trying to do. I know it is something that we try to do."

Ed Hartman, professor and director of the Prudential Center for Business Ethics at Rutgers University, said that most of his time since earning a degree in ancient philosophy, and then an MBA at The Wharton School of The University of Pennsylvania, has been spent in a consulting organization and at Rutgers. "The striking thing about them is that ethics was in the air in both places. It is just that the language is different."

In setting his objectives for the day, Hartman said that he believed that anyone who teaches ought to know something about business. "I just have a feeling that the business representatives here know a few things that I don't know, and I would like to hear what some of them are. . . . I harbor the hope that our center, the Prudential Center, may be able to find ways of partnering with business that can teach us something about ethics."



*Ken Mlekush (left), Jefferson-Pilot, joins ethicists Linda Klebe Trevino, Penn State, and Ken Goodpaster, University of St. Thomas, at the Mitchell Forum.*

Tom Dunfee, Kolodny Professor of Social Responsibility/Vice Dean and Director at the Wharton School of the University of Pennsylvania, noted that, in addition to his duties at Wharton, he recently served as the ethics advisor to the Independence Standards Board. “I came to have a much richer understanding of the issues,” he said. “Sometimes some of the people in the field of business ethics give snap judgments. . .when they really don’t understand some of the complex issues faced by executives.”

Ed Freeman, Olsson Professor of Business Administration and director of the Olsson Center for Applied Ethics at the Darden School of the University of Virginia, recounted how after getting his PhD in philosophy in the 1970s, he went to Wharton, where he helped start a research center that gave him initial exposure to business. “I have spent the last 25 years banging around the business world talking to people about business issues, strategy, leadership, and ethics—not ethics per se, because it was a mistake to separate that out from what makes a business successful.”

It is important to consider business issues and ethical issues together, rather than just focusing on ethical ones, Freeman said. “I like talking to people about these issues. I would hope that we talk about how the business issues and the ethics issues—if we can separate them out—how those things go together. I’m distrustful of somebody who says, ‘Well, it makes sense for the business but it is wrong.’ I think that sentence in itself is what is wrong with our idea of business.”

Bob Clark, CEO of Shenandoah Life, noted how when he first started with his company nine years ago, he focused on developing a vision and corporate values. “The first corporate value that we put down on paper was integrity, which is firm adherence to legal and ethical principles in the conduct of business. We have standards of conduct, just like many companies do.”

He said he was interested in participating in the forum for several reasons. “One, I was really angry over what was happening in general to business, and I hoped this forum would help me focus on what I could do about it. The second reason is that it’s very important to me personally, as well as to our company and the industry, to set the highest possible standards.”

He also noted that he would like to explore additional techniques to be a better leader—to communicate, implement, and influence, and to continue to build a business culture and company where people are proud to work, because the goal is not to take money out of the customers’ pockets, but to give them “a true value product.”

Jim Mitchell, retired CEO of IDS Life Insurance Company (American Express’s insurance subsidiary) said that one of his goals since retirement has been to raise the level of conversation about ethical issues in business. “One of my beliefs is that good ethical behavior is actually good business. I wanted to talk about this and try to help

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*Duska:*

*“Huebner’s main point was that insurance sales had to be ethical.”*

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people think about it and try to help organizations be as good as they could be." The Enron, WorldCom, and other scandals have made this discussion of ethical issues in business even more important and timely.

"I'm hopeful that what we can do here is to have some really good dialogue. I hope the academic folks come away with a better sense of the kinds of ethical issues that CEOs face."

He also added that the forum gives his executive colleagues the chance to stop and reflect on ethical approaches in business—something most of them may not do very often in a structured or formal way. "I think it is useful to step back and reflect on what's the right thing to do. That clarity helps people have the courage to do what's right."

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*The forum was divided into two segments. On the first day, the group discussed a major case in the news involving Wal-Mart Corporation and its practice of buying life insurance on its employees, and then analyzed several "mini-cases"—dilemmas that could confront companies and their executives. On the second day, the ethicists from academia asked the corporate participants a number of questions about how they promulgate ethical standards in their organizations.*

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**Mitchell:**

*"One of my beliefs is that good ethical behavior is actually good business."*

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## Case: Corporate-owned life insurance (COLI)

A series of lawsuits involving Wal-Mart offer a valuable lesson for accountants who sell tax planning ideas or investment products whose success depends on a specific interpretation of the tax laws.

As a "low-risk means of gathering annual positive cash flow" Wal-Mart purchased over \$1.3 billion of life insurance on over 350,000 employees' lives between December 1993 and July 1995. However, promised benefits to the corporation didn't work out, and the scheme produced nothing but headaches for everyone involved.

Wal-Mart's lawsuit against AIG and Hartford alleges that Wal-Mart lost more than \$150 million due to negligence, misrepresentation, and breach of fiduciary duty related to its purchase of corporate-owned life insurance (COLI) policies. The charges include failure to disclose:

- (1) The full range and magnitude of tax-related risks and insurable interest risks associated with COLI plans, and
- (2) That some state insurance regulators would not approve COLI plans similar to those sold to Wal-Mart based on concerns relating to tax treatment, insurable interest, and deviations from accepted accounting principles in the life insurance industry.

Wal-Mart also alleged the insurers “affirmatively misrepresented” the COLI plans as being designed and administered in a manner that would minimize or eliminate adverse financial consequences to Wal-Mart if the tax law changed. [Wal-Mart Stores, Inc. v. AIG Life Insurance Company, et al., C.A. No. 19875 (Del. Ct. of Chancery), filed 9/03/02]

—from *“Tax Investments Can be Risky: Wal-Mart’s Tax Dodge Disappears In Litigation,”* by E. Lynn Nichols, CPA, in *AccountantsWorld*; [www.accountantsworld.com](http://www.accountantsworld.com), 12/12/02 (copyright © 1999-2002, AccountantsWorld LLC; reprinted with permission)

In the early 1990s, as the company dealt with changes in funding of health and death benefits, it purchased the life insurance as a “commonplace, low-risk means” of enhancing cash flow, primarily through favorable tax treatment of life insurance.

Wal-Mart said it had sought specific assurances that—because favorable tax treatment was essential to the viability of the plans—provisions would be implemented to minimize or eliminate any negative consequences of a tax law change. Wal-Mart also asserted that an agent for one of the companies assured it that any future tax law changes would have a relatively minor impact and that the insurer would provide a full refund if the tax law changed in the early years of the plan. The agent assured Wal-Mart that, in a “worst case scenario,” Wal-Mart would lose no more than \$280,000. Wal-Mart alleged that the representative for the other company also assured it that the arrangement was structured in a way “to minimize or eliminate the risk of a program un-wind in the event of adverse tax legislation.”

Although Wal-Mart purchased the insurance based on these recommendations and assurances, the policies “failed in their fundamental purpose,” the company said. HIPAA, the Health Insurance Portability and Accountability Act of 1996, effectively eliminated many of the benefits of COLI policies. HIPAA was especially harmful since its changes retroactively applied to policies issued after June 20, 1986. As a result, Wal-Mart settled what it considered to be a substantial, unanticipated tax liability out of court with the IRS. Not counting the disallowed income tax deduction, Wal-Mart estimated that its losses due to the failure of the COLI plans were in excess of \$135 million.

In addition, the estates of several deceased Wal-Mart employees challenged the company’s decision to take COLI insurance out on their lives, claiming Wal-Mart never had an “insurable interest” and that any death benefits the company expected to receive should be given to these estates.

As a guideline for discussion a number of questions about the case were raised.

- What exactly is the ethical problem here, and is it different from the legal one?
- If products like COLI are consistent with the mission of a financial services company, can we explain them and defend them? Do they violate the spirit of tax laws?
- Are these products generated not so much for their insurance value as for their tax advantages?
- What are the ethics of promoting such a product?
- If you don't have an insurable interest in the life of a particular employee, why are you taking out a policy on that life?

For participants not familiar with the operation of life insurance and annuity contracts, Mitchell explained that money that accumulates within such a contract generally is not subject to current federal income taxation; normally it is only taxed at some point in the future, when it initially comes “out of the pot” in one form or another. He also noted that in this case, the company had leveraged the policies—that is, Wal-Mart borrowed to buy the policies (taking the money out of the contract) and deducted the interest as a business expense.

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*Shepard:*

*“When we put a product out it has to pass the ‘smell’ test.”*

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### ***Selling for good reasons***

Ken Mlekush identified four ethical issues: 1) improper disclosure to the insureds and their families, as well as to shareholders (in the case of a public company that might face financial impacts because of the practice); 2) insufficient disclosure of the tax laws involved; 3) improper representations by the broker regarding the impact of a change in the tax laws; and 4) the issue of insurable interest—whether Wal-Mart had the right to take out insurance on all types of employees.

“The fact that it serves a useful business purpose if done properly—I don’t have a problem with it if done properly,” he continued. “But my sense is that, based on the information here, none of these four issues was addressed.”

Don Shepard noted that his company writes a significant amount of corporate-owned and bank-owned life insurance, but not any leveraged business. “When we put a product out it has to pass the ‘smell’ test. We made the decision not to sell leveraged cases because we thought it was dangerous. Secondly, we have a sign off from every employee. So when we sell a corporate-owned or bank-owned life insurance (BOLI) policy we send out a release statement to every employee and ask for a signature.”

Like any employer, Wal-Mart has an investment in its employees that could justify an “insurable interest,” Shepard said. He also noted that COLI and BOLI policies often are used to fund post-retirement benefits. At the same time, he understood how one employee, who questioned the practice when she found out about it, felt it was “terrible” that Wal-Mart had bought a policy on her life.

Ed Zore said that the question that needs to be asked is whether a company that buys insurance on its employees is doing so for a reason other than mere financial gain. “There are good reasons why a corporation might want to buy insurance on its employees—it wants to fund benefits, it wants to use the insurance policies to fund deferred compensation plans that it might have in place. Insurance is an effective way to do that. But the employee has to have an understanding that the corporation is doing this.”

In the Wal-Mart case, the company took advantage of changes in the law in the state of Georgia that made it easier for companies to buy life insurance on its employees without them knowing about it. However, in most states and jurisdictions the employee has to agree to it. Zore said, “In our company we require a signoff by the employee. We also require that the employee legitimately has high strategic value.”

There is a legitimate purpose for insuring those who are high up in the organization, he continued. However, if you insure those who need little or no training, it is done for a pure financial gain.

Tom Dunfee saw a disconnect in the question of insurable interest. “It basically comes to this: A company is insuring the life of somebody, and there is not a direct connection to benefit that individual.” He said that while it might sound outrageous, should an employee be killed in an accident due to a safety issue, a trial lawyer could raise the issue that a company did not implement safety precautions because it hoped to benefit from the death.

Dunfee related how two of his colleagues, partners in a law firm and a major accounting firm, respectively, both reacted negatively to the idea of “janitor’s insurance” if it did not involve a direct connection to benefit that person.

“The head of corporate practice said, ‘You know, there is some conflict of interest here; I just don’t like the idea that somebody else would have insurance on me.’ You have to think about how these employees think, the kinds of stories that are told, and the idea that the company is somehow going to benefit from their deaths.”



*Ed Freeman (left) of the University of Virginia meets with Ken Mlekush, Jefferson-Pilot, and his wife, Paula, at the reception during the Forum.*

Ron Duska said he has been studying the abuse of tax codes, and the standard criterion of abuse is to ask whether the move is made because it makes business sense or because it gets a tax write off. It makes sense to take out a life insurance policy on someone if his or her loss would cost the company money. Thus it makes sense for a company to insure upper-level managers and executives because there is a cost of replacing them. But life insurance can be sold purely as a tax dodge. "Because of competitive pressures some companies got caught listening to some broker-dealers say, 'We can buy this insurance and it has all these tax advantages.' But they were not selling life insurance any more, they were selling tax dodges. That fails the 'smell' test. This is not what those selling insurance are supposed to be doing. If they are selling insurance as tax dodges to keep up with the competition, it strikes me there is something wrong with that."

Roger Brooks said, "The fact is that this is really a tax efficient way to accumulate funds for a purpose, that's what it is. Does it end up being aggressive vis à vis the tax code? Probably. Is that illegal? Certainly not."

While the participants were critical of how Wal-Mart handled the matter, they understood the CEO's decision to save the company money. "There is nothing unethical about not paying taxes that you don't have to pay," Shepard said. "The problem is they went beyond this and used this

'leverage' practice. And I think most of us in the industry knew the leverage stuff was dangerous....They were deducting the interest on borrowed funds to fund a tax deferral....I think it carries it too far to say that a benefit that was created for the individual cannot ever be used to fund post-retirement benefits for employees in an economical way."

Ed Freeman recognized the company's need to make efficient use of cash. "The point of efficient financial instruments is to raise cash; this is just one more. We can all tell a good story...we are going to use this money to fund benefits. But the truth is...we have dug a hole in the backyard, we have put the money from this in it, and whenever we have a need for it we are going to take that money out."

Zore argued that there is an important difference here. "Most corporations have a much more efficient use of their money. If they are just looking at leveraging, insurance is not the best vehicle. This is



*Penn's Tom Dunfee (left) and his wife, Dottie, share some social time with Dan Trevino, husband of Penn State's Linda Klebe Trevino.*

actuarial. Sure, there is tax leverage. But for a company such as Wal-Mart to think this is a godsend—a great way to make money—no.”

Zore defended the concept of corporate-owned life insurance when used appropriately. “The plans that we put together typically have a direct link between insurable interest and benefits. Employees sign off on it, you understand, as part of a program. I am confident that we can look at the business that we do, and we see that it makes sense for the employer, it makes sense for us, it makes sense for the employees. I can defend it because there is knowledge and consent from the employees and the plan benefits the employees. It’s a legitimate use of insurance.”

Jim Mitchell challenged his colleagues on how they looked at the Wal-Mart case. “I think you executives are too close to this stuff. I mean it’s your business and it is a financial thing, it’s leverage and so on... If I’m the Wal-Mart CEO, though, and see this article from the *Boston Globe* that says, ‘It is absolutely reprehensible for a giant like Wal-Mart to be gambling on the lives of its employees,’ that is the last thing I want to read. There needs to be some process inside of Wal-Mart that encourages people to ask, ‘What’s the worst thing that could happen?’ Well, gee, the worst thing that could happen is somebody could write a story like this, and maybe we should not be in that situation. Wal-Mart can’t possibly have made enough money on this thing to be worth this kind of damage to its reputation.”

Linda Klebe Trevino pointed out, “I think it’s difficult for a person in the position of CEO to easily put himself in the position of the janitor or the checkout clerk. I think it’s a real challenge to the CEO to try to figure out ways to perceive the world from a very different perspective.”

Freeman added that most likely someone lower in management decided the practice would be useful, but failed to ask, ‘What is the worst thing that can happen here?’ And they made a mistake.

## **Slippery slopes**

Bob Clark raised a new concern: how a company could take what could be a viable way of funding retirement benefits—the use of life insurance on its employees—and get itself into ethically questionable circumstances. “There is usually a thread that has a viable, ethical purpose. Then somehow down the path, it gets mutated. So, while you think what you are doing is ethical, when you step back, you can see that it is no longer pure.”

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*Mitchell:*

*“There needs to be some process... that encourages people to ask, ‘What’s the worst thing that could happen?’”*

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On this point, Ed Hartman noted that companies sometimes have a problem with “drawing lines.” “What started out as a reasonable way to protect key employees turned into a way to use the tax benefit meant for individual families to shelter corporate earnings. . . . What is required here is for people to have a good sense of ‘smell,’ and people who will say, ‘Whoa, wait a minute, I think we are getting too far from what is reasonable.’”



Mlekush challenged the group to assess how far a company can go before it goes “way beyond reason,” citing examples of other companies with similar company-owned life insurance programs that contributed significantly to earnings. “What is missing there is that you are asking a question that says, ‘How can I make the most money?’ rather than, ‘How can I do something good for the business?’ And instead of just saying ‘good for the business’ you better say, ‘What effect is it going to have on customers, what effect is it going to have on employees, and how much money am I going to make?’ But when you don’t ask those questions, it seems to me, you just let the financial thing run,

and that’s the rule of the road.”

Hartman also reminded the group that it was important to consider how such programs look to employees. “It speaks a rather cold attitude toward one’s employees, and maybe something like that is wrong. . . . It helps to account for how Dunfee’s friends felt about it, and for how the *Boston Globe* felt about it. I don’t think that’s nothing. I think that needs to be explored and thought about.”

*Linda Mitchell (left) co-founder with her husband, Jim Mitchell, of The American College’s Mitchell Center for Ethical Leadership, joins Cheryl Clark (center) and Diane Zore, spouses (respectively) of Bob Clark, Shenandoah Life, and Ed Zore, Northwestern Mutual Life.*

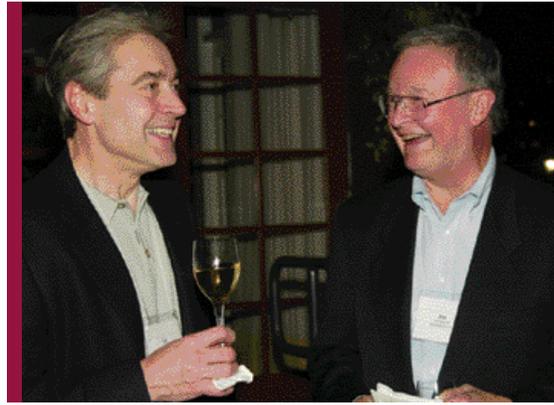
He suggested that, while internal advisers might present the benefits of the practice to a busy CEO, that person still has responsibility for assessing the risks, and for creating an environment where employees can question the proposed course of action. "The CEO is supposed to have created a climate in which everybody knows that before you even take this to the CEO that you 'smell' it and you do all kinds of other stuff with it, and you think about what would happen if the *Boston Globe* reported on it. It is not only the CEO who should be thinking about that."

### ***Informed consent***

Another question that arose repeatedly was that of the consent of the employees. Brooks said his company has bought life insurance on its employees, asking for their permission to do so, and giving them the opportunity to "opt out" if they choose to do so.

Trevino raised the issue as to whether a nonmanagement employee, such as a checkout clerk or janitor, has any real freedom to decline the company's practice of taking out insurance on his or her life. "I don't think they are in any position to say, 'No, I don't like what you are doing here.'"

"What is the negative effect on them with the company doing this?" Shepard countered. "It doesn't cost them, they are not worried about the company knocking them off to get the \$15,000 or the \$50,000, and if they stay until they retire they are going to be more certain that their post-retirement benefits are going to be funded. So I don't understand what the negative is to the individual."



*Jim Mitchell (right), host  
of the Forum, welcomes  
Ed Zore of Northwestern  
Mutual Life.*

# FORUM ON ETHICAL LEADERSHIP

## *Industry leadership in exposing questionable practices*

Trevino raised a different concern—“why ‘the good guys’ in the industry don’t disclose what’s going on. Isn’t it in their interests to do it?”

Zore replied, “A lot of times it’s in the eye of the beholder. We might not have all the facts. And we probably have a little different perspective than some other people. And you don’t want to go out there and just start a battle that’s going to tarnish everybody. So I think that often we lead by example. We work a little differently... through an industry group, bring stuff up at meetings, prod people, challenge people to do what is right.”

Goodpaster also emphasized the importance of having a company culture that encourages employees to bring attention to questionable practices. “There needs to be an environment in the company that allows people to raise a flag, some kind of internal flag waving—I won’t say whistleblowing but... a kind of free spirit when it comes to raising moral issues and not a fear that you are going to be branded as disloyal or as a weirdo.

“If one can create an environment within a company where certain kinds of concerns are allowed to surface and then be subjected to significant critical discussion, that seems healthy to me,” he continued. “And by the same token, if you can create an environment in a *whole industry* that provides a forum for critical assessment, that would be healthy across many companies.”

## *Leadership stand*

Freeman noted that it was important for companies to take a leadership stand on ethical issues, regardless of what other players in the industry might think. “The truth is that one of the reasons visions work and values work is because they do set expectations for us. We don’t know how to live up to them, we have to invent how to do it. I think about industries that have gotten themselves into enormous amounts of trouble by not having people speak out.”

Mitchell wondered why more honest executives are not taking a more public stand on matters of ethics. “I believe that most executives are honest. So why is it so that so few of those honest executives are speaking up and saying that Enron and WorldCom are not the way that business is generally done, that most business people behave ethically. Why aren’t people saying that?”

Several of the participants noted examples of how the industry is stepping up to the plate to address ethical problems head on. Shepard

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*Goodpaster emphasized the importance of having a company culture that encourages employees to bring attention to questionable practices.*

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said that professional groups like the U.S. Chamber of Commerce and the American Council of Life Insurers have pointed out that the cases of bad behavior are in the minority, but that maybe their stand is not strong enough; he also noted that the LIFE Program was established to educate the press about what is going on in the insurance industry. Goodpaster noted that Minneapolis-area businesses recently came together to produce a “manifesto” on their indignation about recent ethical lapses, with areas for potential improvement.

Zore noted that companies may be reluctant to expose ethical failures in the industry because of concerns about reputation and potential litigation. “We have a reputation to nurture and protect and build. And for us just to go out there and say, ‘We are good guys,’ would just be to put a target on ourselves.”

At the same time, Brooks expressed skepticism about organizations talking too much about how ethical financial services professionals may be, and Shepard noted that some companies that have talked most about ethics in the past were, in fact, among the biggest offenders when it came to ethical problems.

Trevino noted it is important for CEOs to come into both undergraduate- and graduate-level classrooms to discuss the importance of ethical choices in business, and to reach out in the community to “get the word out” to the public. “Students need to hear it from the horse’s mouth, whether it is you or other people in your organization. You need to send out some sort of army, bearing the news that this is how we do business everyday, and we have pride in ourselves, in our work, in our organization, in our careers, that we feel very comfortable going home telling our families what we did today. They need to hear it. And they believe you when you tell them.”

Clark noted that the industry could be much more proactive in emphasizing the importance of ethical decision making. He noted that insurance companies had a lot to be proud of by their commitment to policyholders after the devastation of 9/11, and Goodpaster, Zore, and Freeman agreed with Trevino on the importance of having both CEOs and academics share these stories with students who are preparing for careers in business. As Goodpaster said, “It’s not just that business leaders have to take initiative here. Educational leaders have to take initiative as well.”

Clark added a sentiment shared by all the participants, particularly the executives: “Our challenge is to move forward on an industry basis where people understand that we make positive, good decisions day in and day out.”

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*Clark noted that the industry could be much more proactive in emphasizing the importance of ethical decision making.*

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# FORUM ON ETHICAL LEADERSHIP

## The mini-cases—ethical dilemmas

The second part of the program involved considering ethical dilemmas. As defined by Jim Mitchell, a dilemma is “a situation where there is conflict between obligations, benefits, and loyalties.” In grappling with a dilemma, he said, one faces a situation where there are good reasons both for and against a particular course of action.

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### Dilemma 1: Money and family

John has just taken a job as the chief accountant at an insurance company. His subordinate Tom, the professional accountant in the accounting management department—and brother of his fiancée, Mary—was responsible for preparing both the accounts receivable and accounts payable and had access to cash held by the company.

Tom experienced a major personal financial problem. Shortly thereafter, John reviewed the company's financial statements, and much to his surprise, discovered that Tom had manipulated the accounting records and had been involved in “teaming and lading”—a practice that involved delaying the recording of receipts from debtors and accelerating the recording of payments to creditors. This was to conceal the fact that he had withdrawn a substantial amount of money from the company without approval. When John discussed this with Tom, Tom asked that John keep his transgression a secret, as the disclosure would ruin his career. When Mary became aware of the case, she strongly urged John to help her brother and promised she would repay all the amounts owed to the company immediately.

Should John disclose the misconduct?

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Mlekush said he felt that the first problem was the fact that John had a close relative of his future wife as a key subordinate. “This is an issue that, especially in a sensitive area such as this, should have been avoided up front. . . . I might not have hired John in the first place for that reason, for example, since he was a new employee. And/or if I would have hired John, I would have suggested that perhaps Tom go into another area within the company because of a potential conflict of interest.”

Secondly, if Mary were aware of her brother's financial problem, perhaps John might have been as well, and hence should have exercised a special oversight of Tom throughout the process, Mlekush continued. “Clearly a conflict of interest exists because of the personal relationship. Personal interests interfere with your ability to exercise judgment objectively, and one needs to avoid that at all costs. The bottom line is this misconduct must be reported.”

Mary's offer to return the funds would not make a difference, he added. "That doesn't make the problem go away...Let's create this scenario. She returns the funds, and it is later discovered that this occurred. And if that were to happen, if it were my company, John would have a problem."

Mitchell asked whether Tom should be terminated. While Mlekush said he should be fired, Hartman asked whether, at his hiring, Tom had been clearly the best-qualified candidate and the company really needed him in that job. "Would it be unfair to the company and to Tom for John not to hire him just because he was the brother of a woman you might end up not marrying?"

Mlekush repeated that he would have considered putting Tom in a different role in the company so that John wouldn't have that potential conflict of interest.

Larry Arth reiterated the importance of moving Tom to another area to prevent the conflict of interest in the first place. Hartman pursued the issue. "So, you would move Tom? Suppose you have a case in which John is exactly where he ought to be, and Tom is exactly where he ought to be; and you would be incurring some kind of cost if you moved them and raising questions about fairness. Are anti-nepotism rules, which by the way probably don't apply here, are they not perhaps unfair? They certainly have been used unfairly in the past."

Arth questioned, "How could Tom have been qualified for that job if he was willing to steal money?"

Duska and Trevino both asked whether reporting Tom to the law was in order. "Don't most companies have a policy that deals with this that says if we catch anybody stealing money, we do report them?" Arth asked.

Freeman raised the issue about whether cultural differences would affect how this situation would be handled. For example, in Indonesia, John would not be expected to put the company's interests before those of his family. "There is no question that stealing is wrong. I think the students I have would agree that Tom had done something wrong. The question is, what do you do? There is a family relationship that's very strong. If I can keep the family whole here, and I'm going to have a hammer over Tom's head that he better not ever do this again, all right. Certainly Indonesians would see this as a much bigger dilemma than we see it. I don't think that's true just in Indonesia."

Hartman questioned further how cultures with a stronger emphasis on family ties deal with such a situation. "It's tempting to say that blood is thicker than money or something like that. But as far as I'm concerned their intuition on this attitude is very problematic."

If the business were a family business, not a publicly traded company, would the response to Tom's theft be different? Dunfee said that if there are no shareholders, then it could be treated as a private matter. "And if you found that somebody had stolen from you privately, you might decide to prosecute, you might not. But we don't know how long this has been going on. There may be cooked books already."

Dunfee also noted a study of Chinese businesses that questions whether an approach that emphasizes maintaining family ties is as fully accepted as one might expect in that culture. "This survey indicates that the Chinese find this harmful to the broader Chinese community. Why? This is one of the reasons that you really can't trust the financial statements out of China. To the extent that the Chinese get more integrated into the world economy, there are pressures to follow international accounting standards and to reject this family-based justification that we can manipulate the books to some extent.... So I think the pressure is against that."

Dunfee said that academics deal with cheating students in a way that is analogous to the nepotistic solution to this case. "Cheating is a very serious thing, and the faculty decide they will take care of it themselves. They will flunk the student for the assignment or they may flunk him in the class, but they won't prosecute him internally throughout the university. The failure is the thing that gets on the student's transcript."

Zore noted that a comparable issue comes up with giving references in cases where an employee has been fired. "If you fire anybody today for anything and you don't want to get sued, you have to agree to give kind of an innocuous referral. In other words, you will not mention anything about it to the prospective employer. Now, I would ask the group this: What is the ethics of that?"

"What you have done is taken the whole institution of giving references and rendered it obsolete, so they're worthless," Duska asserted.

Mitchell noted how the conversation on ethics invariably leads to concern about protecting the company from legal consequences. "That's very sad, I mean that's a huge indictment of our system," he said. "Our national response to the Enron case has been a lot more law, a lot more regulation, and very little more conversation about ethics. Ethics ought to be the superordinate thing, and the law and regulation ought to be some codification of the ethical practice; instead, it seems like the ethics part has disappeared from the conversation."

Mlekush agreed. "I find it interesting that the law, which is theoretically designed to protect the folks in our country, is actually promoting the challenge with respect to ethical behavior."



*Ron Duska (co-host) of The American College joins Cheryl Clark (center), wife of Bob Clark, Shenandoah Life, and Linda Mitchell, co-founder of the Mitchell Center for Ethical Leadership, which sponsors the Forum with The American College.*

“It’s a real paradox, because a lot of people like to say, well, ethics begins with the law and then it goes beyond the law,” Goodpaster added. “But sometimes it doesn’t begin with the law, sometimes the law is unethical or causes unethical behavior.”

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### Dilemma 2: Defrauding the elderly

XYZ Insurance became aware of a situation involving one of its new top producing agents from three sources: customer complaints, which are routinely taken to the company’s legal department and circulated among senior management, including the CEO; an external third party, a vendor; and the company’s chief marketing officer, who noticed extremely high face amounts on policies and then significant annual premium coming in through this new agent.

The company investigated and found out that the new agent, working with more experienced agents who were not contracted with the company, was using existing insurance relationships with senior citizens to fraudulently obtain life insurance applications from them. Several stories were used to convince the seniors to write their checks out for their Medicare supplement policies with another insurer’s name on the check. The agent would fill out a life insurance application, have the seniors sign it, and then submit the policy.

If the situation constituted fraud, XYZ Insurance would have to report it to the state insurance department. The company had several other courses of action: address the issue only when a specific customer complaint came in and try to solve it at that time; immediately investigate the agent, and if warranted, terminate the agent’s contract; and/or investigate all policies written by the agent and contact every policyholder to determine which, if any, of the applications were fraudulent.

The company chose the last course, and upon determining that the agent and several other individuals were misleading and taking advantage of consumers, terminated for cause the agent’s contract and appointment with the company. After investigating each application, the company engaged a private investigator to talk to every policyholder, some forty people—not an inexpensive remedy. All premiums were returned to policyholders. A full fraud report was made to the state insurance department. The insurance department reported that it had long been aware of the situation with these agents, but said that previously no company would cooperate so fully because they did not want to lose so much premium.

Litigation proceeded against other companies that were involved in similar arrangements with these agents, but the company handled the matters on a task-by-task basis only. The litigation created another dilemma for XYZ Insurance—whether or not to be deposed. The company agreed to the deposition, and focused on discussing its own actions only.

When all was complete, the CEO was especially proud of how XYZ Insurance had handled the situation, e-mailing his staff: “My thanks to everyone involved in this unfortunate matter. It took teamwork and a strong desire to place our value system in front of short-term production gains and a potential risk of alienating our largest production source. In the end everyone benefited except the guilty parties. This type of action never gets publicized, but you should be very proud of your actions, and I am.”

The bottom line was that XYZ Insurance avoided a large settlement, but more importantly, the CEO noted that the company’s actions demonstrated what it means to be on the front lines of ethical behavior.

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Clark noted that in this situation, XYZ Insurance is challenged to do the right thing. “We are all faced with this in terms of a very small portion of producers out there who can get on the wrong side of an ethical dilemma,” he said. “Once you start down a certain path you run the risk not only of litigation with policyholders, but also problems with agents—because of contracts—and insurance departments. Then there is the plaintiff’s attorney sitting out there. So, why is it hard to do the right thing? It’s because you have to have everybody geared up to do the right thing in the system.”

As to deciding to investigate each insurance application written by a certain agent, legal departments may pursue that. “You’ve got to do that,” Zore said. “You’ve got a smoking gun out there—you better find out who has been shot.”

Clark noted that for companies, handling the situation transaction by transaction, it could be an expensive course of action. “An unethical agent gets into you very deep and very quick. . . . If a mistake is made in the way the situation is handled, it can be very costly.”

Perhaps the success in how XYZ Insurance dealt with the problem lay in how well management communicated—what Clark referred to as an “early warning system.” Between the CEO, the legal department, and the marketing department, it didn’t pass the “smell” test. “In other words, the marketing people couldn’t just drop it, the underwriting people couldn’t drop it, and the legal people certainly wouldn’t drop it once they got hold of it,” Clark said.

Mlekush noted that the CEO of XYZ Insurance also sent a very powerful message to his organization in handling it as he did, which would be a benefit to the company in the long term. Clark said that the best prevention for situations such as XYZ Insurance faced is “right out there in the front line—that underwriter, that salesperson or marketing person who understands the ramifications of it, they are going to do what you want them to do.”

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*Goodpaster:*

*“Part of the moral of this story is: Stick to your guns. But also, be prepared for a lot more than you might have bargained for.”*

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Goodpaster noted that the company took the initiative in pursuing the right course of action, however potentially litigious and expensive it might have been. “Part of the moral of this story is: Stick to your guns. But also, be prepared for a lot more than you might have bargained for.”

The importance of communicating a culture that fosters these types of ethical choices also was emphasized. Freeman recalled how a friend of his, a CEO, had a problem with how one of his departments was managed, and set up a conference room with pertinent paperwork used to “work the problem” of resolving these issues. “My friend is one of the most ethical people that I know. An employee said, ‘I assume we’re putting all of these documents together here because we are going to shred them, right?’”

The comment made the CEO believe that he had failed in communicating what was happening—how the company was “working the problem” from an ethical perspective—to his organization. From then on, the CEO made a point of communicating what he was trying to do with the project, and turned the outcome into a success story. “The way they handled this turned out to be a model for other companies. But it was a subtle issue of seeing that little signal that’s there, and seeing that as the CEO’s problem.”

Mitchell asked the group to identify what procedures should be in place to ensure that, when an ethical issue arises, someone can bring it to management’s attention for review without risking legal exposure. Trevino noted that many companies have reporting systems—call-in hotlines for people who have ethical concerns, though these communications may not be “privileged” to avoid being part of a lawsuit. Shepard noted that his company has a tipster hotline run by an outside firm, with reports eventually prepared for review by the company’s general counsel that are probably not privileged, per se.

Trevino said that the system should make it easy for employees with concerns to bring up real problems. “People in the organization need to know that when they call or take it to whatever person or place they are supposed to take the issue, that the issue is going to be taken seriously, that it is going to be addressed, and that they can find out what happened.”

However, Trevino continued, people sometimes don’t bother for a couple of reasons. “One is they are afraid that they will be retaliated against for raising such an issue; and the other is that they don’t think it makes any difference. So the worst thing that can happen is that an individual raises an issue, either with their manager or through one of these formal systems, and they never hear about it again or they are told, ‘Don’t worry about it, we are taking care of it.’ It happens all the time.”

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*Trevino:*

*“People in the organization need to know that...the issue is going to be taken seriously, that it is going to be addressed, and that they can find out what happened.”*

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*Enjoying themselves at the reception that took place at the Forum are (from left) Roger Brooks, AmerUS Group, and his wife, Sunnie Richer; Don Shepard, AEGON NV; and Ken Goodpaster, University of St. Thomas.*

In cases of these “early warning systems,” Shepard noted that it was important for the manager either to give a full explanation about why the issue was not dealt with, or to tell the employee how it was resolved.

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### Dilemma 3: The employee with a history...

One afternoon, employee John Jones, who had worked for his company about 10 years, came to the CEO’s office with a problem. John made rapid progress in the company over the past decade, and continued to do good work in every job did. He had many promotions, was heading a major unit for the company, had an exemplary work record, and was very well liked and respected by his subordinates, peers, and bosses.

In his visit with the CEO, he said there was going to be an item from his past coming to the surface in the next few days—that 15 years before, while wrestling with major mental illness, he had murdered his wife and all of his children. He had been sentenced to a rehabilitation institute and received thorough treatment, which resulted in a “clean bill of health.” When he was hired, he had not disclosed this history, and now he desperately wanted to remain with the company with which he had a great record. Two questions arise: Should the CEO fire the employee? How should the CEO handle the issue with his other employees?

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While some in the group questioned the employee’s failure to list either the crime or the rehabilitation period on his resume, Dunfee took a different tack, noting that the employee had gone through the process established by society for someone who is mentally ill who has committed a serious crime. If the application for the job had requested information about what crimes the employee had committed, and if he had in fact made “an affirmative misrepresentation,” that would make a difference in how the CEO should handle the situation. “But if you assume that he didn’t, and we also assume that he has been cured, there is something to be said for standing up for your person who has contributed so much to your company.”

Mlekush and Shepard questioned this approach. “How do you explain that to your employees when it comes out in the press?” Mlekush asked, while Shepard raised the issue of liability in terms of the company’s responsibility to protect its other employees.

Duska raised more commercial concerns. “Even if you want to keep him on out of compassion, what is this going to do to your business? What is your responsibility to that business? I can’t imagine if this becomes public people would want to do business with you.”

The seriousness of the offense, versus a less serious one, also was discussed. Freeman recalled a case where a psychiatric patient in a hospital was raped in the psychiatric ward by an employee. The media

found out that the employee was a convicted felon. The hospital checked the backgrounds of all employees, found several who were convicted of felonies (including lesser offenses, like writing a bad check), and fired them. Since many of those fired were African-Americans, the issue was doubly problematic. "It was a huge thing that blew up. But they didn't kill someone. Let's suppose, in John's case, that what is going to come to light is not that he killed his wife and children, but that he passed some bad checks and did some jail time for that.

Arth felt that the violence of the crime was a factor to consider. "There is no risk to the other employees within the organization from somebody who wrote a bad check," he said.

While Shepard felt that would not garner the same type of publicity, he asked, "Doesn't it get back to the same thing about ethics, that the reason you hire people to be managers is you expect them to have judgment, and you want them to look at the specific instances and make a judgment?"

An alternative for the CEO would be to call in all of Jones' coworkers, tell them the facts, and ask if any of them have a problem working with him, Hartman said.

What really happened was that the CEO told his employees about Jones' past history, told them that Jones was "cured," and reiterated that the company had known him for 10 years. The CEO indicated he planned to keep Jones on the job, and offered to transfer any employee who was not comfortable with that situation. Of the six employees who reported to Jones, only one asked for a transfer.

Brooks disagreed with what the CEO had done, indicating he would have terminated Jones because he could not expect his "stakeholders" to accept that risk.

Goodpaster questioned Jones' lack of responsibility for not divulging this information sooner. "This is explosive enough that a rational person could anticipate that there could be a problem someday." On the other hand, Trevino noted that Jones would never have been hired if he had divulged the information about his past.

Clark noted other risks involved in assessing the situation. If the CEO does not terminate Jones, one of the other employees may continue to have problems with the decision—for example, opting to be on disability, rather than accepting a transfer to another location. Hence, assessing the possible impacts on the other employees in the group may go beyond just offering a transfer. "When you are trying to make an ethical decision in this matter, you are always trying to weigh the interests of the entire group," he said.

Clark also noted that the company policy for job applications—perhaps, that falsification may mean termination—would govern the decision as well.

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*Clark:*

*"When you are trying to make an ethical decision in this matter, you are always trying to weigh the interests of the entire group."*

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Zore said he would have fired Jones. “I would have tried to assist that person in landing on his feet, but I would not have been able to justify keeping him in that position within the organization. The downside actual and potential risk was too, too great.”

Duska questioned the assumption that since the employee was treated, he was “cured.” “What if you found out that this employee that you knew for the last 10 years was a child molester; and he said, ‘You know what’s going to come out next week, Boss, that I attacked this kid—for which I am sorry. It’s going to come out and everyone will say that I am a child molester.’ Now, you don’t have any children in your company. If it was a job where you work with children, that’s one thing. You really like the guy. How does that change—several people dead, versus one molested—which is the bigger problem?”

Dunfee replied that the chances of a molester repeating the offense were greater than the chance of Jones committing murder again, and the risk to reputation actually may be greater in the case of a child molester.



*Visiting the reception were guests Barbara Bey and L. Charles Fitzgerald, staff members of the American Council of Life Insurers (ACLI), which met prior to the Mitchell Ethics Forum.*

Freeman challenged the group further, noting that offenses like a drug-related conviction, being expelled from school for cheating, or falsifying academic credentials, all require case-by-case assessment rather than a blanket application of an ethical “line.”

As for the case of the employee who had murdered his family, Trevino noted there are legitimate concerns about the comfort level of the other employees. “As a CEO you would have to take it into account, because people living in fear are not productive people. Is it rational fear? If it is irrational fear, can it be dealt with? Should you deal with it? Do you have any obligation to this person?”

Zore replied that he felt the interaction among the employees would change when the information came out. “If I know you murdered four people, I’m going to stand a little bit farther away from you, and I’m not going to go out with you for a drink at night.”

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#### **Dilemma 4: The new hire needs an operation**

Recently, a CEO received a letter from a member of his field force who had joined the company ten months before. The employee had asked the CEO to intervene on his behalf with the administrator of the company’s self-insured health plan, who had denied coverage of a costly medical procedure without which, he was told, he would die. The employee, who had known about his medical condition before being hired, had gone on disability only ten days after starting with the company.

The health plan specified what procedures it covered, but left some decisions up to the plan administrator. In the following days, the CEO received letters sent by the employee to members of the company's board and to the local Congressman, as well as a letter from the employee's public relations firm suggesting the employee's story would be worthy of national news coverage. The company's benefit committee met and determined the company should cover the procedure because the plan document was itself deficient, and should have contained language that better disclosed which procedures were covered or not.

Several in the group felt that, given the circumstances, the employee was not entitled to the coverage. However, a couple of the ethicists asked whether an employee with longer tenure who had done a good job for the company should receive the coverage, even if the plan documentation was not clear as to what is covered. One corporate participant noted that his company plan had turned down requests for coverage in two cases where there was no question about the person's motivations, but because the plan simply did not cover those procedures. Others in the group felt that an employee's long history of good service might make them consider a request for coverage more favorably than a request from an employee of only ten days.

Freeman noted that the issue of health-care decisions would only become more difficult as time goes on. "Everybody looks at the health-insurance companies as kind of 'Doctor No' to turn them out. The companies obviously have to manage the financial part. But they are going to be regulated out of existence if they don't do a better job of trying to figure that stuff out."

Another of the corporate participants asked to what degree a company is responsible for keeping up with experimental medical developments, to determine whether or not they should be included in the company health plan. While a CEO can outsource the decision about what is or is not included, he said, he or she can't outsource the ultimate liability to the employee.

Some in the meeting questioned whether situations such as the short-term employee's made the insurance on this group of employees not cost effective. Dunfee said, "If you allow these things to happen, it then affects the other employee benefits, so the only right thing to have done under this argument would have been to have said, 'No.'"

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*To what degree is a company responsible for keeping up with experimental medical developments, to determine whether they should be included in a health plan?*

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*Planners of the Forum included (from left) Ron Duska of The American College and Linda and Jim Mitchell, founders of the Mitchell Center for Ethical Leadership in Financial Services at The American College.*

# FORUM ON ETHICAL LEADERSHIP

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## Dilemma 5: The error-prone trader

An insurance company employed a young professional on its money-market desk managing daily cash investments, buying commercial paper and certificates of deposit. The trader happened to be a member of a minority group, the first in its investment operation. His supervisor noticed that the professional made frequent mistakes in processing transactions, giving the incorrect instructions to the bank or dealer from whom he purchased the instrument. The result was that the company was experiencing costly transaction failures, being unable to take delivery of the instrument purchased on a timely basis. After giving the trader many opportunities to improve his performance, his supervisor finally suggested that he find another place to work. The trader took a job with one of the dealers that had been a vendor to the insurance company. The dealer never asked the insurance company for any information on the trader's past performance.

One day, when the markets were especially volatile, the trader, now employed with the dealer, made an agreement with his former employer to sell the company a bank CD for \$50 million at 12 percent. Later that morning, interest rates decreased to 11 percent. The company instructed its back office to take delivery of the \$50-million CD at 12 percent. At delivery time, the bank delivered a \$100-million CD (twice the amount ordered) at 12 percent, and the company took delivery. Should the company have drawn attention to the error?

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A number of the participants felt that, given the long history of errors by the trader that benefited this dealer in the past, and their impact on the company's business over time, accepting delivery of the \$100 million CD was justified. However, the company's relationship with the bank should be considered, and in any other situation, the company normally would have drawn attention to the error.

Freeman asked whether the insurance company had given the trader the right feedback on his performance while he was employed there. Was his minority status a factor in how the company dealt with the errors? That is, could the company have supervised him better, to help minimize the errors while he was employed there?

Others asked whether the company could be sure the dealer had benefited from the trader's errors in the past. Was it right to overlook the error, to make up for past errors by the trader? Several asked whether the company would have behaved differently if the trader in question had not been the one who had made so many costly errors

when he was with the company originally. Duska challenged whether such a situation was truly “poetic justice” for failures from which the dealer had benefited in the past, and asked whether it was ethical for companies to behave the same way, “rationalizing” a situation where the company benefits to make up for past errors.

*The participants closed the day with a reception and dinner, and looked forward to Day Two, when the corporate participants would consider questions from the academics regarding ethical challenges and remedies in the financial services industry today.*

## The academics' questions

The ethicists posed a number of questions to the practitioners, addressing topics such as assessing and establishing compensation and hiring standards, getting board members to challenge management constructively, and developing and implementing processes for encouraging ethical behavior.

### Compensation

Trevino began the first topic by asking what a company needs to do to establish a compensation system for its sales force that promotes ethical conduct and discourages unethical acts. Does a front-end-loaded commission structure promote unethical behavior?

Arth responded that the larger companies in particular ought to go to a “levelized” commission structure. “Instead of receiving a full commission for the sale of a product up front, you receive a full commission, but spread the payment out over a five-year period or some such number to make it less lucrative, at least up front, to replace policies.”

Some in the group noted that a few companies, but none of the larger ones, had successfully established such a system, due to the costs involved. Zore said a company could do it but only with experienced agents who have established blocks of business. Deferring payment for five years for young agents just starting out makes it a financial hardship for them.

Mitchell explained further. “Somebody successful in the business for a long time probably generates half or less of their income from their first-year sales. They have enough renewal compensation coming in that they can make a handsome living, so they are not nearly as pressured to write a lot of new business.”

Young agents just starting out are in a different situation. Trevino noted, “It’s those inexperienced people where you have the most risk, because they need to sell to make money, and they don’t have that much experience. They would be the most inclined and motivated to deceive a client or to sell them an inappropriate product.”

Zore emphasized that young agents are encouraged to identify the issues that customers have to deal with and then try to sell them the appropriate product. “That’s the process. It is a fact-finding process. They can’t do that unless they meet people. It’s the most difficult part of the business. If you pay them not to do it, they are not going to do it. So the only thing you’ve got to do is say, ‘If you want to eat, you’ve got to meet.’ If they meet, then they go through the process, so they will have ten fact-finders, and they will have three proposals, and they will get one sale. That’s just the math, that’s the way it works.”

Mlekush noted that more and more distributors—but still only a small percentage of all distribution companies—are going to a fee-based system, where clients pay a fee for professional advice. He noted that, in his company, “We have a two-approach system—we have traditional compensation, which is high first-year, low renewal. But then we have more of a ‘levelized’ compensation system available to agents that rewards persistency of the business. So if you are writing high-quality business that stays in force for a longer period of time, you will actually make a lot more money than you would under the traditional system.”

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*Brooks:*

*“The people that don’t look for insurance are the people that you want. It is a hard sell, it really is, it’s a difficult sale.”*

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## **Hiring standards**

The discussion of compensation systems led to a discussion of hiring standards, and what companies look for in a new agent. Arth noted the attrition rate. “The industry statistic is that 14 percent make it for five years. So you are losing 86 percent of the people that you hire over a five-year period.”

Brooks added that it takes an unusual person to be successful in the insurance business. “The people that don’t look for insurance are the people that you want. It is a hard sell, it really is, it’s a difficult sale.”

Mitchell reminded his colleagues that the failure rate in hiring in the industry is high. “We go out and spend a lot of money trying to identify people to sell for us, people we hope will become successful. And for every hundred of them we hire, we’re wrong eighty-six times. As an industry, we are causing a lot of pain for those eighty-six people and their families.”

Brooks and Zore noted that other professions, such as teaching, face the same challenges, but perhaps not to the same degree, while Duska acknowledged that selling insurance is more difficult than teaching.

“We look for people who have, first of all, the capability of being entrepreneurial because they are not on salary,” Zore continued. “They

have to be entrepreneurial. There is no security blanket. They are not going to get a paycheck every week that they show up at the office. They have to hustle, and they have to go through the routine. We try to make sure that people have the intelligence, and we try to make sure that they have the drive because they want to do it. And we want to make sure they have the integrity.”

Shepard added, “They have to continually get themselves up and go out and do something when there is nobody cracking the whip. And you would hope that your agency does a little whip-cracking, but you can’t make them get out and do it.”

### ***How do you manage ethical behavior?***

Trevino asked, “What’s the main mechanism for making sure that they are not out there lying and selling inappropriate products? How do you manage that?”

Arth and Shepard noted that companies manage their agents by using “suitability analysis”—which takes the form of customer surveys once a sale is complete, as well as ongoing oversight by a supervisor.

Zore said he thought that new representatives were not the only ones who might make bad ethical choices. “It can be the people who have been in the business for awhile. They understand how all this stuff works, and they are very persuasive and good at what they do.”

Duska asked why many companies still want to hire these producers. While Shepard noted that most of his companies prefer to hire new agents, Zore recognized that some of these producers continue to be hired. “It is pretty hard to figure this out. But the answer to your question is that it is incredibly costly to go out and attract new representatives. It is easier and cheaper for some companies to go out there and attract a big producer rather than to go through grinding it out by developing new people.”

Clark noted that his company outsources its recruitment. “We will find a marketing organization which is basically a stand-alone agent group. And our compensation structure is that we will pay that marketing organization to penetrate the market, to recruit. We will go in there, and we will train them on our products and company culture.”

He said that when agents come on board, the monitoring system has to be a lot different—very intensive—because the company’s control is removed an entire level. “We built a lot of automated systems that track all the way up the levels—persistence, death claims, underwriting statistics. So if we get a complaint on an agent or a red flag turns up in underwriting, we can go down to the marketing organization, down to any one level all the way down to the agent.”

Clark also noted that this system looks at “rolling persistence,” business netted, the agent’s debit balance, and other items. “So in building our particular system we essentially would be out of business

if we had to try to compete and train... You can recruit a questionable marketing organization, but you will find that really quickly, and you can terminate them. You can recruit questionable agents, because some of these organizations are high-volume recruiting machines."

As for responsibility in the case of ethical missteps, Clark noted the parameters. "If it is my product and they sold it and I licensed them, contracted them with my company, then I have the responsibility to deal with it. Any chargeback on a problem like that gets charged all the way back, commission all the way up through the hierarchy.... So those are the monitoring systems that we use to protect ourselves."

Clark said that the company has to watch for ethical pitfalls on two fronts. "We are in the business of trying to protect ourselves against that small percentage of people who are going to take advantage of consumers. Because of the tremendous risks for the company, not just economic risks, but reputation risks, you have to have early and swift intervention, but go about it in the correct legal way."

Zore commented that the erosion in agent retention, from 30 percent to 20 percent, and now to 14 percent has occurred because of the increasing competitiveness in the marketplace. Many agents can no longer afford to serve other than the top end of the market, for example, and still make a living. "You can buy \$500,000 of life insurance now if you are a 35-year-old person for a few hundred bucks, and the rep can't afford to make that sale. If you go through the numbers, the people you have to see, the amount of time it takes, you are working for five bucks an hour. People can't do that. It's an economic fact of life."

Zore also noted that with the commission-based structure, even high-end agents still must invest a lot of time in the sale. "If they are doing their job, the average is four visits over a period of time—sometimes it is six or seven. An agent talks to a client about twice a year and does fact-finding. He is spending a lot of time, and periodically the client will purchase a product. But the agent is in the business of worrying about the client and figuring out what he can do for the client. That's not the instantaneous sale. So when the agent makes a sale, he is getting paid for a lot of time that has been invested."

### ***Getting the board to "push back"***

Beginning a new discussion, Freeman asked how the CEOs work to get people to "push back"—that is, to encourage board members in particular to question management when it comes to ethical issues. "There is what I have come to call the 'BamBam Bigelow Problem.' BamBam Bigelow is a professional wrestler. He has his head shaved and tattooed. I asked my son, 'How wasted do you think you have to be so that getting your head tattooed seems like a good idea?'.... So what I'm wondering is: How wasted do you have to be if you are on the board of Enron so that you give Andy Fastow two exceptions to the ethics policy, the conflict of interest policy?"

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*What process should be in place to foster an emphasis on good management—along with criticism and skepticism—on company boards?*

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Freeman suggested that the board in that case and in many other cases “didn’t probe, didn’t challenge, wasn’t critical.” He also suggested that the financial services industry suffers from an overemphasis on enhancement and maintenance of “shareholder value,” a concept with such a “stranglehold” on the industry that it prevents board members from probing. “What happened is that the idea that one can manage shareholder value, and focus just on that, prevents a person from asking questions—What does it do for customers? What does it do for employees? What does it do for suppliers? When the board sees themselves as fiduciary shareholders, but sees that as a way of trading off the interests of all of these others, I think they make a lot of bad decisions and give a lot of bad advice to CEOs, and they don’t challenge.”

So the question becomes: What process should be in place to foster an emphasis on good management—along with criticism and skepticism—on company boards?

Brooks replied that 20 years ago his company designed a “best practices” board, composed of individuals who are skilled and knowledgeable in key areas as well as totally independent. “We hired a recruiting firm, went out and interviewed three or four people at a time, and then issued invitations. That solves some of the ‘push-back’ problem. These people are all very tough. I selected people—several of whom you almost can’t like because they are just tough.”

At the same time, Brooks said, the board composition does not solve what he calls “the various staples.” “They are basically shareholder people at this point. To the extent that treating customers right helps the shareholders, which it does, this works, but I can’t tell you that my board understands the sales process, the product needs.”

Arth noted that in his experience boards typically ask tough questions. “One of the things I think we have to do is make many members of management available to the board for them to question. I think it is a big mistake if the CEO presents the only face of the company to the board. During our board meeting we have the CFO and the general counsel, and the head of each of the businesses. They will make presentations, and the board will ask them questions and try to assess how the organization is doing.”

Mlekush emphasized the importance of disclosure to boards. “I think it’s very important for management to disclose fully and completely the operations of the business to your board members so that there is a trust between you and them that nobody is holding anything back. Next it is important to develop open communication, in the sense that we make an effort to have a board retreat once a year where we really



*Also at the reception were Linda Klebe Trevino, Penn State, and her husband, Dan Trevino (right), and Bob Clark, Shenandoah Life.*

'peel the onion back' with respect to the strategy and the strategic plan we have for that year. And then I think a third key element is just the whole area of creating a format or a process where the company has an open environment to ask questions."

Mitchell said that over the past ten to fifteen years, the concept of shareholder value has become "perverted." "I would ask what group of shareholders should you really care very much about—the short-term ones who are probably speculating in your stock anyway, or the ones that invest with you for a three- to five-year period? Which ones are the shareholders that you as a board or as an executive ought to care about?"

Freeman said that even for shareholders who are holding on to the stock, the world is uncertain. "There is uncertainty when you focus on criteria like shareholder value, EVA, and all those tools—it gives you a false sense of security. You've made some tradeoffs that are really precise and are not world changes. We don't know everything."

The goal of good management has been "hijacked" by the concept of shareholder value, Freeman said. "What is good management? You've got to do something for customers. You've got to have employees who want to show up, who want to be there. You have to have suppliers who want to make your business better. You better be good citizens or suffer the loss."

But Mitchell pointed out that attorneys routinely advise board members that the board's obligation is to take care of shareholder value. So what boards need to do is to encourage management to build shareholder value over the longer term, rather than trying to maximize the near-term stock price.

Shepard noted that, in the Netherlands, board members are all outsiders. Besides that, twice a year the CEO and the chairman of the supervisory board meet with a workers' council, a nonunion organization elected by the employees. "We don't have to ask their permission, but we inform them what we are doing, and we ask for their advice. Even when we are appointing them they have the right actually to give advice that way. It is actually something that works pretty well."

He added that it is not typical for supervisory board members to be shareholders, and if they do have shares, it is only a limited number. "What is most important is that if the company for which they are a board member does poorly, they really get trashed in the press. It is their image that keeps them tough."

Zore commented on his experience on both for-profit and nonprofit boards. "You want good people. They are going to pay attention to the important things, not micromanage, but pay attention to the important things, and give their input when it's appropriate." What an organization needs, Zore continued, is a board that is not afraid to ask

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*Mlekush:*

*"It's very important for management to disclose fully and completely the operations of the business to your board members."*

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questions, either directly in committee meetings, or even offline, outside of a formal meeting.

He said that in addition to a board, his company has a policyowner examining committee, consisting of individuals from various professions, that is invited annually to examine any aspect of the company.

“Beforehand, I as CEO will get together with the chairman of the group and say, ‘Look, these are the things that I’m really concerned about, that you might want to examine in-depth and to challenge management. Then senior management spends five days with these people, just interacting. Every year we get good ideas out of this.’” Some of the valuable input comes through a formal report, but much of it is offered offline.

Clark said that he shares extensive financial information with the members of his company’s board. Every month he gives them a complete financial package, with a report on all the activities in the company. “At the very beginning of the report there is a very simple section that says ‘green flags’ and ‘red flags.’ My chief financial officer takes us through the financials, including the red flags and the green flags, and you can ask questions. Then we bring in our chief actuary on a quarterly basis to talk about persistency and mortality.”

Clark emphasized the importance of keeping the board informed. “One of the rules I have always had with any board I have ever dealt with was *Never surprise your board*; that means try to give them all the information, both the positive and the negative.”

He thought that most CEOs spend more time informing the board about negative developments than about positive ones, and that is an important part of the entire process. He added, “You have to have talented board members, and you’ve got to have a willingness to share information. Then you have to have a format in which you promote the basic discussion on those really tough, painful issues so that the conversation is going across the table. You don’t know where it is going to end up, but when you have good board members it is going to end up in the right spot.”

Cases such as the Enron scandal arise in part because board members did not play the necessary critical role in overseeing key decisions, asking such a simple question as, “Why do we have all these partnerships?” In these cases, Hartman said, “You don’t need wisdom. You need stupidity. You need somebody saying, ‘I’m sorry, I don’t understand it, you’ve got to explain it to me, you have to keep explaining it until I get it because I’m not too smart.’”

Goodpaster suggested that the “push back” that CEOs need to expect from their boards might be enhanced by separating the CEO role from that of the Chairman of the Board. Brooks differed, noting, “If you can

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*Freeman:*  
*The goal of good management has been “hijacked” by the concept of shareholder value.*

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put in place mechanisms to make sure the board gets on the agenda what they want on the agenda, that's the key. . . . And if you have a really formal board meeting every time, and there is no give and take, and it is a case of 'Resolution 7 is up' and you make a presentation, and then vote—then you don't have a board, in a way."

Shepard said that in Europe, the two-tier board system—consisting of a supervisory board of all outsiders and an executive board that runs the company—is popular. Whatever the structure, however, how well a company behaves depends on the people involved. "Bad management is going to do bad things," Brooks said, and Shepard noted that whether one structure works better than another depends basically on the people.

### ***A matter of "bias": auditor independence and executive compensation***

Dunfee said he has noticed that some corporate leaders have a "cognitive bias"—in some cases, it might be a "familiarity bias," which causes them to trust the auditors who have examined their companies for years. In cases such as executive compensation, it consists of a "self-serving fairness bias," which leads CEOs to justify their high compensation. He wondered how executives

guard against this bias, and also asked whether they were confident they were being compensated appropriately for their jobs as CEOs.

Zore replied, "People are going to be paid basically what they have to be paid to get them to do the job. Now, whether that's sufficient or whether that's fair, I don't know. All I know is that, if the going rate for a CEO is \$5 million, you better be paying \$5 million because you are not going to get a really good one for a million."

He commented on the use of stock options as compensation, "I think most organizations mistakenly felt that the money was free and it did not really cost them, but it was incentive driven. If the person produced the results, and the market rewarded it, the CEO and the rest of the management got paid. How we got from being at 'market-level' salaries to somebody making a couple hundred million dollars for doing a mediocre job is an accident of history."

Freeman noted that there is no evidence that such incentives are connected to performance. The use of stock options encourages the emphasis on immediate "shareholder value" that can lead companies into ethical problems. Several in the group agreed that the excessive reliance on options has led to absurdly high CEO salaries. Mitchell said that he believed that compensation committees and boards are going



*Don Shepard (center), AEGON NV, presents his perspectives to Bob Clark (left), Shenandoah Life, and Ed Zore, Northwestern Mutual Life.*

to place a greater emphasis on long-term performance in the future. “If you actually create continuing shareholder value, not just momentary shareholder value with a blip in a stock price, you deserve to be compensated.” Shepard felt this would not necessarily be successful—longer-term stock options have been used for this purpose, and had not worked very well.

Trevino asked the corporate participants if they were motivated by aspects of the compensation plans at their companies. Zore said that it was more important that he be paid “appropriately.”

“The Human Resources Committee asks me, ‘Do you have any feelings that you want to talk about relative to you? I said ‘Look, you guys have to reward me appropriately. . . . Whether you pay me more doesn’t make any difference at all, it won’t make any difference in my lifestyle. . . . But what you have to do is just make sure that it lines up so that the people who are around me feel it’s the right thing.’”

Goodpaster returned to the question of the role of the market in determining CEO salaries, particularly in recruiting outside candidates for CEO positions. “It is a market system and therefore there is a kind of a ratcheting up that goes on over time, and the decade of the ‘90s was extraordinary in this regard,” he said. “We’re assuming that the market is out there in the world of CEO attraction and loss, and we’re not assuming that the market is internal to the corporation—that is, CEO candidates coming up from the ranks where presumably there wouldn’t be as much market inflation.”

Shepard noted that it was important to remember that quality of life, not just financial compensation, is a factor in determining whether a senior executive takes a particular position or not. Noting his company’s locations—Louisville, Kansas City, and Cedar Rapids, he said, “We are in communities where people live because they want to live there. And it is much more difficult to recruit them away because they want that kind of lifestyle.”

Mitchell said that, as part of the role of “perpetuating the company,” the CEO is responsible for paying employees fairly, especially those that contribute the most value. “Those employees are the ones that are most likely to get wooed away. And you want to be able to look them in the eye and say, ‘Look, we are paying you what we believe is fair compensation, you can go to work in New York and make twice as much, we know that, we think a lot of you, you are making a great contribution, and you have a great future here; if you have to leave, you have to leave. We don’t counteroffer, you know, we are paying you fairly.’”

Zore agreed. “If we don’t pay them fairly and we continually have to replace them, we are continually bidding them up because we have to hire somebody from someplace else. So then you are automatically jacking that compensation up, perhaps by 25 percent, because that’s what you need to get somebody to move.”

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*Zore:*

*What an organization needs is a board that is not afraid to ask questions. . . .*

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## **“The Brits don’t want a woman....”**

Rather than posing a question, Hartman presented another dilemma, a real-life situation, to highlight issues of equal employment opportunity in the face of cultural differences, wondering how the executives would react.

In the late 1970s, Ron was a young consultant in the U.S. office of a consulting firm. His bosses told him, “We are going to send you to England to meet there with our consultants and a few of their clients and help them learn how to do business research. You will be there for six weeks.” It sounded like a great assignment. However, at the same time Ron couldn’t help thinking about his colleague, Anne, who had been with the firm longer than he had been, and had a background in research. While she had an MBA from a less prestigious institution than that where Ron had earned his MBA, he thought she probably was at least as well-qualified to do the job. On the other hand, Ron knew a little about research—he had done a PhD thesis and had written a book. Because it still struck Ron that Anne might be a little bit better qualified than he was, he asked his bosses, “Why aren’t you sending Anne?” Their response: “The Brits don’t want a woman, they don’t want to work with a woman.” On further thought, Ron realized that in any consulting engagement it is important for the professional to work effectively with the client, so perhaps not sending Anne was the right choice. Still, he did not feel very comfortable about it. It wasn’t his decision.

Hartman polled the group, asking how many of them would have sent Ron to England, and how many would have sent Anne. Most of the group indicated they would have sent Ron.

Clark said it would be important to ascertain the client’s true preferences on this issue. The company should understand whether, if the client did not want Anne to go, it was because of her qualifications or just because she is a female. “I would also like to understand if there was an opportunity at that point in time whether the firm would be willing to send both Ron and Anne.”

Shepard said it was important to satisfy the client’s needs—with the decision often based on the time and place of the situation, noting that the time (the 1970s) and the place (perhaps a more traditional, European culture) might dictate how much flexibility the company had in dealing with the client. “I would send the kind of person the customer asked for. To me that’s what we are there for—to satisfy the needs of the customer.”

Hartman continued with a similar scenario.

The head of a consulting practice was talking to a client one day. The client said, "Hey, are you guys trying to make some sort of liberal point?" The chief consultant replied, "What do you mean?" He said, "This guy that you have got coming in to do the job." The head of the consulting group asked, "Well, what about him?" He said, "His name is John Jones." The consulting head said, "Yeah, what about him?" And the client replied, "Well, you are trying to show how liberal you are." Finally the head of the practice understood that the problem was that John Jones was African-American, and asked, "So, what's the problem? And the answer was, "Well, the person who is in charge of our liability company is very conservative. I don't think John is going to be acceptable."

Hartman asked the group how many of them would remove John Jones from the assignment. Brooks noted that one should do "what works generally"—that is, if the client or some other business contact works better with one person in the company more than another, that individual should handle the relationship. Describing how staff-client relationships work in his company, he said, "This person is going to like you better than they like me, so you handle it. Or conversely I will say, 'I will do that because I know I can be more effective with that person.' You still have got to deal with the other side of the equation. It is not always, 'We will jam this down your throat....'"

Zore shared a similar opinion. "If John wasn't going to get the job done because somebody had a bias against him, I guess I wouldn't send him. What are you going to do, what's the point? You are not going to be doing John a favor, the customer a favor, or yourself a favor. So who wins?"

Hartman said that many of his students would send only John, and Mitchell agreed. "The point is that in the first case—the choice between Ron and Anne—you could chose beforehand, and nobody is really going to be harmed. Anne is going to be perfectly fine if she doesn't go to the U.K. In the second case, the assignment has been made....The customer has been told that John is coming. John is going to show up with the client and that decision is made. At that point if you don't support John going in there, you have lost John and probably half of your staff too, and you are way better off losing that client than you are losing John."

While he would opt not to send John on the assignment, Shepard said he would find a way to explain the situation to him diplomatically. "If John is a smart guy, you tell him what the circumstances are, and if he wants the company to do well, I think he will understand it." If John still would like to go, he said he would support him.

Zore expressed a similar sentiment. “The scenario was that it’s not good for the company, it’s not good for John, it’s not good for the customer, but if John thinks he can overcome the customer’s concerns and he doesn’t care if it is going to tarnish him or be tough or something, send him in, fine.”

Freeman questioned leaving the decision up to the employee. Why do anything other than support him, why make him choose? He reminded the group, “John knows there is discrimination. Women know there is discrimination. People of color know there is discrimination.”

However, Shepard disagreed, holding that the employee can make his own decision. “I think a consultant, a guy that is a good solid guy, I think he can make that decision on his own if he wants to handle it.”

Hartman said that although the client may prefer to work with one person, or type of person, over another, there is another important point. “Sometimes there may be opportunities to oppose bigotry, and this might be such an opportunity. The question is, do we have a moral responsibility to take such an opportunity? It has to do in part with what you guys call risk. You might set out to do something good in the world and end up angering the client, embarrassing John, creating a failure, so you do have to think about the risk of that.”

While the head of the consulting practice should consider his employee’s comfort level, at the same time there are other things to consider, Hartman continued. “Are we really going to give in not only to the personal preferences of our clients, but their sexism, their racism?”

Shepard raised the question of what impact the client’s share of business would have on the decision—that is, if the client represented 75 percent of the company’s billings, would that affect the decision to send or not send John?

“The question of whether it is actually going to be a problem is a big one,” Hartman replied. “You have to calculate whether it is going to work.” Determining the client’s real needs and issues—in particular, why the client would have a problem with a woman or a minority—is very important.

In the real-life case of the British client not wanting to deal with a female consultant, one of the partners of the consulting firm felt strongly about sending Anne anyway, and that is what the practice did. It turned out that the British client had never said they did not want a female consultant. Anne went on the assignment and was so successful she was asked to stay another six weeks.

In the case of John and the bigoted client, Hartman said that the head of the practice decided to send John on the job anyway. “At the end of the assignment the client says, ‘John, it’s been a pleasure to work with you, and if we ever have anything like this again I’m going to demand that John Jones be the consultant.’”

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*Hartman:*

*“Sometimes there may be opportunities to oppose bigotry, and this might be such an opportunity.... Do we have a moral responsibility to take such an opportunity?”*

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Hartman wryly called the positive outcomes in these cases the “one-at-a-time phenomena”—when the client works with the person in question, they believe that person must be the “only” woman or African-American who can do the work. At the same time, he acknowledged Shepard’s concern that if the client represented 75 percent of the company’s business, it might make more sense to “back off” and not force the situation.

## Encouraging ethical behavior

Goodpaster asked about insuring against what he called “moral hazards,” noting that companies insure against other types of hazards, such as death, bad health, and so on. “Is there such a thing as a moral hazard? Not just reputation—although that’s a factor clearly—but just the hazard of loss of integrity, whether someone knows about it or not? What systems are available to us for insuring against moral hazard?”

He explained how, for the values of a leader to become effective in an organization, the leader must not only have those values, but also have the right information to apply them to get results. “What is the information system available, whether it be for the board or for rank and file?” he asked, directing this question specifically to the CEOs. “Is there such an information system in your companies?”

In the wake of some of the latest corporate scandals, Goodpaster continued, won’t the public now demand that more companies conduct an “ethics audit” or be expected to disclose “ethically relevant information” from across the company—including both the board and senior management? Is there a way of getting ethics data that’s relevant to leadership?

Shepard noted that there are “indices of corporate responsibility” that might provide some of this information. “If you don’t meet the standards on corporate responsibility you are not on the index, and a lot of the institutional buyers—I think more in Europe than in the U.S.—they won’t buy your shares.” One way his company monitors this in its European operation is to have a “corporate social responsibility officer” who keeps abreast of developments in the countries there.

Goodpaster questioned the use of some ratings indices, particularly if issued by the media, and Trevino followed up with further skepticism, noting that data from some large companies suggest that the higher the position one holds in a company, the “rosier” the perception of the ethical climate in the company. Brooks said that his company does use consumer opinion surveys to monitor its business practices, and recently changed its processes, in response to recent corporate



*Ed Hartman of Rutgers University chats with Mary Arth, wife of Larry Arth, Ameritas Acacia Mutual, at the reception during the Forum.*

accounting scandals, to require him, as the CEO, to sign the annual financial report and attest to its accuracy. The change in process led him to work more closely with his financial people and others in management in assessing the financial statements, evaluating their qualifications, asking more questions, and exacting the same level of scrutiny from them as well. "People take it seriously when they have to sign their name," he said.

Zore said his company uses what he calls "vectoring in," which involves assessing signals from many different directions. "You have the external attitudes and opinions of people, you have internal surveys, you take a look at complaints, you take a look at litigation, and you take a look at how the decisions are made—the number of surprises that shouldn't be surprises. You put this all together, and you should be able to get an idea—Are we operating correctly, or are we not operating correctly?" While requiring a code of ethics from employees is important, more day-to-day scrutiny is involved.

Arth and Shepard said their companies use similar approaches, from simply walking around and asking questions to solicit feedback to sharing the company "consumer complaint log" internally. At the same time, Mlekush said he could see value in a more formalized process—an "ethics checklist," perhaps.

Several in the group felt that formal tools like "ethics audits" and mission statements are not worth much if the philosophy behind them does not permeate the organization. "It's got to be demonstrated by leadership at all levels," Zore said. "In other words, you can't say one thing and have actions that are in opposition. You have got to walk the talk. And that's the job of a CEO."

Clark thought that formal statements of ethical principles are necessary, but excessive written documentation that is never used is of no value either. "I think companies don't do enough on stressing and communicating that," he said.

Clark said his company developed a three-page document that talks about its values and guidelines of ethical conduct. "In orientation, as part of our ongoing training with our employees, we use these documents that say, 'This is how you are expected to behave at Shenandoah Life in terms of quality, sales, services, performance, workplace conditions, compliance, conflict of interest, and privacy.' Are they going to read it and understand all of it? No. But we are going to do our very best to make sure that they get an opportunity to see it." When questions arise about a particular issue, the company uses its set of guidelines as a reference point, to ask whether it is operating according to these standards.

Clark said he has learned the importance of using tools such as mission statements because they provide the necessary "gut check" a company can use to assess its behavior.

Hartman recalled how important the Johnson & Johnson (J&J) credo was. It emphasizes service to customers—including families and health care professionals—and high quality, accuracy, and reasonable pricing in its products—and it was applied in the days after the Tylenol poisoning scare of 1982, when seven people took capsules that had been laced with cyanide by a stranger. “J&J really hammered the credo into people,” he said. “When the Tylenol thing came up I was told that one of the first things they said was, ‘Well, you know, if we take the credo seriously we recall the whole thing.’” Johnson & Johnson voluntarily recalled the product, took a \$100 million charge against earnings, and subsequently reformulated it in caplet form.

Shepard said his company has a very simple mission statement—“Respect people, make money, and have fun.” “Respecting people really does take your customers, your clients, your colleagues and your employees, and your vendors and everybody into it,” he said. “We have seminars and we go out into the field—all employees go through it. We keep pushing that kind of a theme rather than having a long set of values because we think that covers it.”

Zore’s company mission statement is “We are not in the business to be the biggest, we are in the business to be the best.” Executing the mission statement is not necessarily easy, and involves training employees at the front end and periodically surveying them about the company mission and any special concerns about activities in the company.

Mitchell said he felt the best single information system is the employee survey. “Employees know what is going on before the customers and everybody else. If they actually think that you want to know, they will tell you.” Mitchell noted that American Express has asked essentially the same seventy questions of its employees every year for twenty years. “It is serious stuff. American Express has core values. Many of the questions dealt with—What sort of behavior do employees see going on, and is the company acting consistently with ‘Clients come first’? Is American Express acting consistently with the concept that each employee is a valued employee? And so forth.”

In the survey process, employees were given an opportunity to report on matters that appeared to be inconsistent with the values of the company, and to do so anonymously. Mitchell said he followed up on every concern, reporting results back to the employees.

Freeman said that demonstrating practical commitment to ethical values—perhaps through asking employees pertinent questions about what they think about the company on a regular basis—is necessary. “My experience is you can have a set of values in an organization that are laminated, and you can have a set of values where there is a live conversation about it.”

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Freeman:

*“My experience is you can have a set of values in an organization that are laminated, and you can have a set of values where there is a live conversation about it.”*

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# FORUM ON ETHICAL LEADERSHIP

Goodpaster related how he serves as a consultant to a major corporation, guiding its senior management in a similar process of ethical analysis, conducted in a retreat-type format. “We go through an afternoon of what I call hypocrisy exercises.... And the underlying message is that every human being falls short of walking his or her talk; it is part of being human. Similarly for organizations. If the definition of hypocrisy is the gap between the talk and the walk, we need to monitor that gap on a regular basis—personally and organizationally. The question is not whether we have a hypocrisy problem. The question is: How are we managing our hypocrisy? Are we managing it downward, toward convergences between walk and talk, or are we just letting it go?”

Goodpaster said that, during these retreats, “People are given permission to look for gaps between the spirit of the place and the pushes and pulls of business life. Once problems surface we start looking for solutions to them.”

Goodpaster further said that this commitment to ongoing analysis is now part of the life of the company because the CEO has encouraged it. “If it didn’t have the CEO’s sanction, it would never work because people would be wondering to themselves, ‘Is this a promotion interview or what?’ It isn’t. The CEO had to send that signal.” The result has been policy changes designed to correct problems that are identified in the sessions—and a renewed sense of authenticity among the executives of the company.

Mitchell recalled how his company periodically would conduct a program called *When Values Collide*, in which senior company leaders took questions from audiences. “We would sometimes have differing opinions about how to resolve conflicts. That was actually fine. As long as we all used the values as a framework for making the decisions, we could talk about the decision that we favored in terms of those values.”

## Closing thoughts

At this point, the participants were asked to summarize what they gained from the forum, and how the process could be improved in the future.

Hartman replied that while he knew what his academic colleagues would bring to the table, he was impressed by several traits in the CEOs who attended—from their “moral seriousness” to their alternative points of view. “What I’m going to reflect on in the next few days is what that divide means. Does it have something to do with self-serving fairness, bias? Does it have something to do with the fact that you know a lot more than we do and understand things we don’t? Can we be of service to you by challenging preconceptions and ‘spins’ that you share and don’t think about very much?”

Clark said he felt comfortable with how his peers “operate and think,” adding that, “I get some comfort from thinking that we do things the right way. I also feel really good with an honest and open dialogue. There are differences of thinking in terms of opinions and views. But it’s very helpful because that dialogue is something that prompts more thought on my part.”

CEOs, he noted, are always in the spotlight. “You always have to walk the talk, you always have to try to get out there and set the best example. And I think that these kinds of conversations help you do that.” The forum could be improved by discussing techniques and guidance on how to make ethics “more alive” within his company.

Shepard said the forum stirred his concern about what appears to be a greater acceptance of cheating, and a concurrent belief among young people that business people are “crooks.” “Those two things together frighten me a little bit about what I can expect with the people we recruit going forward. I’m wondering if there isn’t something more that industry should be doing.”

He expressed interest in finding a way to apply the philosophical approach of the ethicists to the pragmatic operations of a business. He noted the importance of including people in the business world in educational programs, to ensure that practical applications are emphasized.

Zore said he appreciated the openness of the forum participants. “I’m struck by basically the similarities in the thought processes between the theorists—the academics—and the CEOs. I expected to see maybe more of a polarization, and it’s obviously not there.”

As for what is right and what is wrong in business, in some cases there is no right answer, he said. “I expected when I came into this thing that you thought you had the right answers, and it is obvious that that is not the case. So I think having dialogue like this is really productive.”

As for future reflection, he said he would focus on this question: “How do we know that the process of what we are doing as a company meets the standards that we think it does? I have to give some thought to that, to figure out if there is some way we can maybe get it better defined, better articulated. How could this process be improved?”

Goodpaster expressed satisfaction with having had the opportunity to talk not only to his fellow ethicists but also to the practitioners—“people who are on the firing line who understand the complexity of decision making and are held accountable for it.” Their perspectives enable him as an educator to present to students a more realistic view of the subject matter than otherwise would have been possible.

He also found the process, with a focus on a case study, and the structure—several ethicists and several practitioners—to be useful. The small group minimized the temptation to stereotype. “You can’t box them, you treat them as individuals, and that’s enormously valuable. Because you hear better when you don’t ‘filter.’” Additional discussion devices, such as an essay or an editorial for discussion, might have improved the process.

Trevino said she was impressed from the beginning that the CEOs would take the time to talk about ethics issues. “The time we spent together reinforced some ‘hunches’ that I probably was already aware of. . . . Some of those are the extent to which the CEOs are very much influenced by the legal and regulatory environment.” She also noted she was surprised by how many of the issues raised by the CEOs were really human resources issues.

She also said that the cases discussed that involved incorrectly prejudging a client’s motivations—the cases of the British client who supposedly would not work with a woman, or the company that did not initially want to work with an African-American—were “incredibly effective.” “I think we don’t give people enough credit for being willing to learn or change,” she said.

Brooks said that the forum would encourage him to wrestle with understanding the ethical process in his organization—“whether I have a hold of only ‘one part of the elephant,’ because there were some divergences.” Exposure to alternate points of view challenges him to think differently. “So I will probably wake up and think through some of these and say, where am I deficient in terms of my looking at the world, where do I not see multiple views? As least I will do some self-examination as a result.”

He suggested that future programs might involve discussing how companies and CEOs have dealt with bad publicity on matters of corporate behavior.

Mlekush felt that the meeting increased his awareness of ethical matters, and he was impressed more by the consensus than by the differences in perspectives. “The program sharpened my awareness of some of the tough ethical issues that we deal with on a day-to-day basis—that’s a good thing. Even though there were differences between the academics and business practitioners, I was impressed with the number of agreements there were between the two constituencies.” The forum encouraged him to set aside time for reflection on these issues in the future.



*Participants at the Third Annual Mitchell Forum on Ethical Leadership in Financial Services included (from left) Ed Hartman of Rutgers University, Bob Clark of Shenandoah Life, and Don Shepard of AEGON NV.*

As for improvements, he said he would like to see more time spent on discussing a methodology that can help corporate leaders drive practices and principles into their organizations.

Freeman said he brought stereotypes about his academic colleagues and the financial services CEOs to the meeting, and they were dispelled. He learned from his colleagues, and also was impressed that the CEOs have a much broader view of the business world than he expected. "It is not surprising that there was a dialogue, because I think the academics were able to try to put themselves as near as we can to you, even though we know we would be bad at it in the places where you sit." Such a dialogue is necessary because it helps build our models of business and how they work.

Dunfee said he found the insurance-specific discussions, such as the COLI case, and the discussion of commissions and compensation particularly interesting. "We basically talked about two types of issues. On those that apply to conditions generally, there we had clearly some diversity among the group. There was less diversity in views I think around some of the industry-specific issues."

He continued that he is going to reflect more on the areas of consensus. "I think one can maybe look at the auditing profession and what happened with them in the last few years, and say there were certain norms that came to be accepted, and that really didn't get challenged that much. In a sense, maybe we resolved these issues. The issue as to the extent to which consulting accountants somehow maybe compromised auditor independence—we have worked that out. We kind of all understand what the answer is. I will reflect on those issues."

As for format and process, he said the forum worked well, noting that the discussion of the case and the dilemmas was especially helpful. An improvement would be to find a way to foster discussion of specific questions, perhaps during informal times like meals or breaks, on matters like executive compensation reform and surveys of stakeholders. "I'm very interested to get the sense of how these are done and the perspective of that."

Arth said he was struck by how there was less divergence of opinions than he anticipated. "I haven't spent a lot of time with a lot of college professors or university professors since going to college. I was surprised that we came down on the same side as some of some of these questions, with some exceptions, as often as we did."

He also said that the forum is particularly timely now during these times of corporate scandals. "It would be too bad if somehow somebody, and I don't know who that is, can't come up with a way to change the environment as it exists out there today. There is clearly a lot of suspicion and dislike and concern about corporate America, which impacts each and every one of us. Whether or not we are operating like some of these people have operated, we are all painted with the same brush."

Businesses have to find a way to deal with this perception of their practices, he continued. “I think this would be a great effort for the ACLI to somehow become involved with. It is timely, and it is critical. When you are a fiduciary organization, you can’t survive if your customers don’t have trust in you. So one of the things I’m going to be reflecting on as we go forward—What, if anything, could we do to make results different?” He also said he would reflect on some of the processes his colleagues are using in their own organization, to see if they could be appropriate for his company.

Duska expressed what he called the “joy” of sitting around and talking about ethical issues, learning from his colleagues and reinforcing his belief that there is a lot of ethical behavior, and ethical leaders, in business. He expressed appreciation for everyone’s participation in the forum.

Mitchell echoed his sentiments. “You are very generous to give us a day out of your lives. You are all busy people, and we appreciate it very much. I had a wonderful time. You have given me a gift, and I thank you for that.” He noted that the structure of the program—several ethicists and several practitioners—fosters “enough differences that we can have a productive discussion and learn something, but not so big that we can’t come together and have a useful dialogue.”

One thing he noted is that, since his retirement three years ago, the concern about legal compliance has increased. “It pervades everything executives are thinking about. And it bothers me because it gets in the way of doing the right thing. We ought to be asking ourselves, ‘What’s the right thing to do?’ Instead the first question executives are asking is, ‘How do we minimize our legal exposure?’ I think that’s sad.”

As Mitchell and the others found during the forum, perhaps that shouldn’t be the first question. He shared their commitment to reflection on how both the practitioners and the ethicists might turn this tide around. “It seems to me that we need to get back to the place where the first question is: ‘What’s the right thing to do?’”

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*Mitchell:*

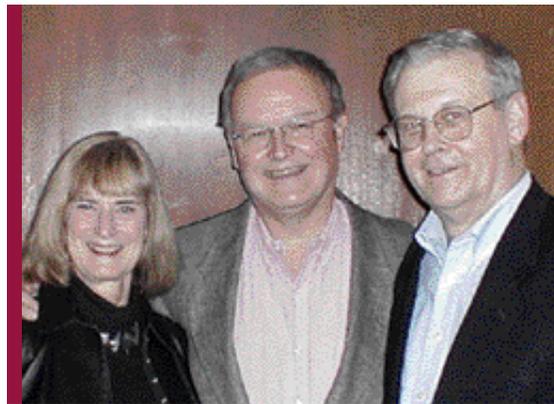
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## The James A. and Linda R. Mitchell Center for Ethical Leadership in Financial Services

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

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



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

*Jim Mitchell (center) and his wife, Linda, are sponsors of the Mitchell Center for Ethical Leadership in Financial Services. Ron Duska of The American College is the Center director.*



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