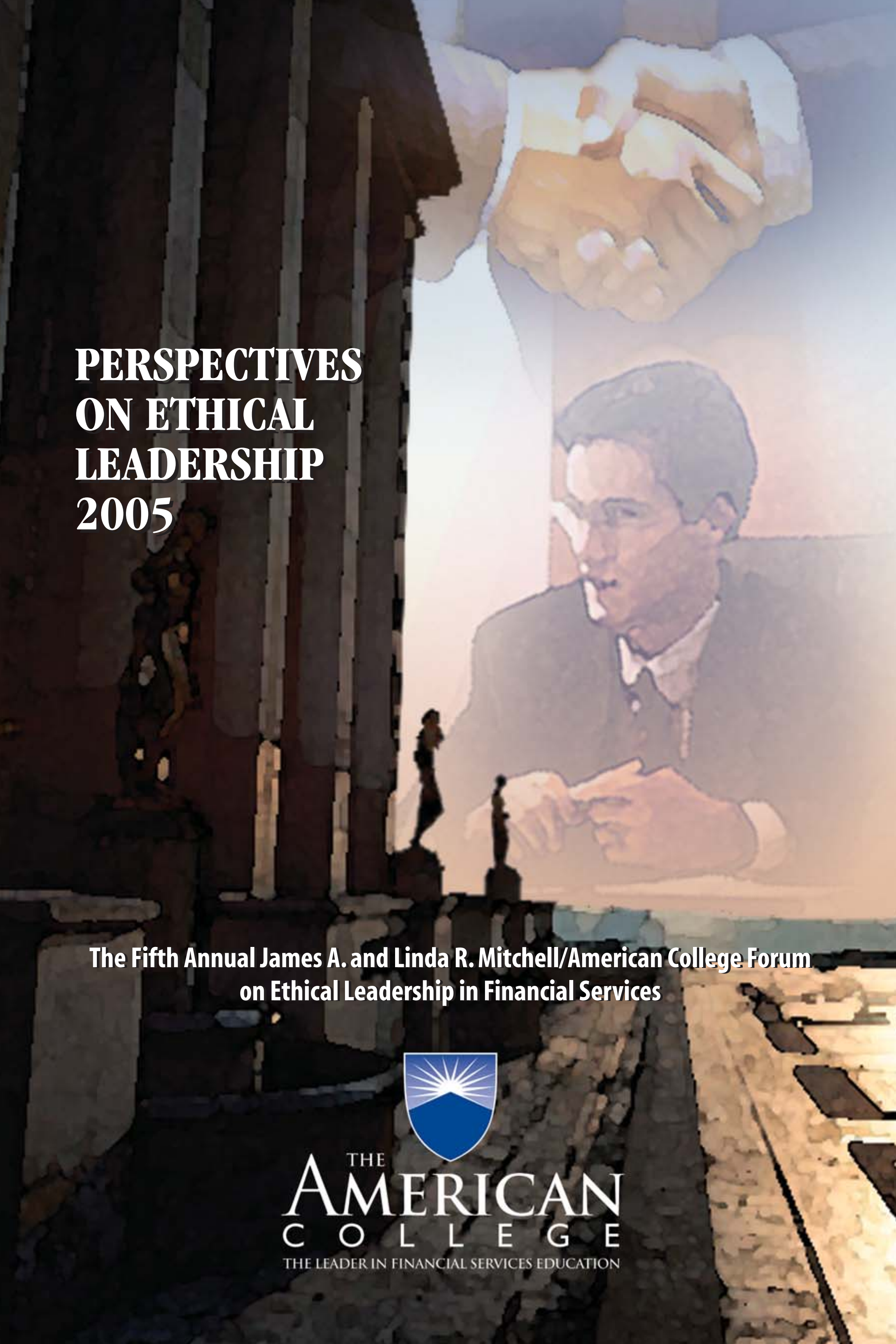

PERSPECTIVES ON ETHICAL LEADERSHIP 2005

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

THE AMERICAN COLLEGE

THE LEADER IN FINANCIAL SERVICES EDUCATION

fifth annual

PERSPECTIVES ON ETHICAL LEADERSHIP

The fifth annual James A. and Linda R. Mitchell/American College Forum on Ethical Leadership in Financial Services took place January 8, 2005, in Boca Raton, Florida. The event featured roundtable discussions of a major case in the news, practical ethical dilemmas faced by the executives during their careers, and questions raised by business ethicists from major colleges and universities around the country.

THE AMERICAN COLLEGE

ADER IN FINANCIAL SERVICES EDUCATION

THE PRACTITIONERS

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

William M. Cameron, Chairman and Chief Executive Officer, American Fidelity Assurance, Oklahoma City, Oklahoma

John O. Gilbert, Chairman of the Board, Thrivent Financial for Lutherans, Minneapolis, Minnesota

Phillip Hildebrand, Executive Vice President and Co-head of Life & Annuities, New York Life Insurance Company, New York, New York

John D. Johns, President and Chief Executive Officer, Protective Life Insurance Company, Birmingham, Alabama

Mark E. Schwarzmann, Senior Vice President, Insurance and Annuities, American Express Financial Advisors, Minneapolis, Minnesota

THE PHILOSOPHERS

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

Norman E. Bowie, The Elmer L. Andersen Chair in Corporate Responsibility and Professor of Strategic Management and Organization, Carlson School of Management, University of Minnesota, Minneapolis, Minnesota

George G. Brenkert, Professor, School of Business, Georgetown University, Washington, DC

Joanne B. Ciulla, Coston Family Chair in Leadership and Ethics and Professor, Jepson School of Leadership Studies, University of Richmond, Richmond, Virginia

David M. Messick, Morris and Alice Kaplan Professor of Ethics and Decision in Management, Director of the Ford Motor Company Center for Global Citizenship, and Professor of Psychology, Northwestern University, Kellogg Graduate School of Management, Organizational Behavior Department, Evanston, Illinois

Laura L. Nash, Senior Research Fellow of Entrepreneurship and Service Management, Harvard Business School, Harvard University, Cambridge, Massachusetts

EXECUTIVE SUMMARY

The fifth annual James A. and Linda R. Mitchell/American College Forum on Ethical Leadership in Financial Services, conducted January 8, 2005, in Boca Raton, Florida, brought together six executives ("the practitioners") from several of the nation's well-known financial services companies and six ethicists ("the philosophers"), professors in philosophy, ethics, and psychology in business programs from among the country's most prestigious colleges and universities.

Objectives and Expectations

The objectives of this annual event, established in 2001 by Mr. Mitchell (retired chairman and chief executive officer of IDS Life Insurance Company) and Mrs. Mitchell, are twofold:

- to give the executives an opportunity to reflect on the ethical dilemmas they face on a regular basis, challenging them with questions posed by the academics, and
- to give the academics the opportunity to better understand the practical day-to-day ethical dilemmas faced by leaders in American business today and how they grapple with them, so they can bring these lessons back to the classrooms at their respective educational institutions.

By way of introduction, the participants shared their expectations for the day and the meaning of ethics in their organizations. The philosophers looked forward to the engagement and dialogue with the executives, expressing hope that it would shed light on leadership and management issues that they could share with their students. The practitioners were eager to reflect on the ethical dimensions of their roles, and expressed their companies' fundamental commitment to trust and integrity in dealing with the various stakeholders—customers, distributors, employees, stockholders, and community—to which they are responsible.

The format for the day involved discussion of a recent major case, New York versus insurance broker Marsh & McLennan Companies, Inc.; analyses of mini-cases—real-life ethical issues brought by the practitioners; and a question-and-answer session in which the academics asked the executives about issues of leadership, management, and responsibility.

The Marsh Case: Disclosure of Contingent Commissions

In the Marsh case, as noted in the indictment, Marsh had designed a plan under which insurance companies agreed to pay Marsh more than a billion dollars in "contingent commissions" to steer business to it and shield it from competition. The plaintiffs also asserted that Marsh solicited and obtained fictitious high quotes from insurance companies to deceive clients into believing that true competition had taken place.

The case set off discussion of a variety of issues. Practitioners and philosophers concurred that insurance agents need to make it clear whose interests they represent—whether clients or carriers. Marsh's motto was that it represented the clients' interests, but in reality it represented the insurance carriers who received favorable treatment and its own interests, several in the group said. Making these lines of accountability clear to the consumer is becoming increasingly necessary, particularly as advisors now often sell both planning services and products.

There is a danger in overloading the consumer with too much disclosure—too much detailed information that may scare the customer from purchasing what is a necessary and worthwhile product.

Participants also agreed that more disclosure of compensation arrangements is needed, particularly in the area of life insurance sales. However, the complexities of these sales—addressing the systems of how producers are compensated initially and throughout the life of a contract and how companies in this field make a legitimate profit from these products—need to be considered. There is a danger in overloading the consumer with too much disclosure—too much detailed information that may scare the customer from purchasing what is a necessary and worthwhile product.

Ethical Dilemmas

In this segment of the program, the executives brought forth personal experiences in which they and their companies had to grapple with ethical choices. The cases included lively discussions of how American business values translate into foreign cultures, and whether walking away from a lucrative deal may be preferable to playing by the values in another culture; the challenge of avoiding "unsuitable" replacements of insurance policies that may occur when agents leave one company for another, bringing along their "book of business"; and the "mini-truth-and-reconciliation" system used in one organization when a unit leader was fired after extorting bonus payments he'd awarded to members of his unit.

Another participant outlined how his company underwent what it called a "Tylenol Cure," pulling products from availability due to compliance problems in its sales literature, and the resulting challenges in enforcing new requirements with its large advisor force. A fifth case dealt with whether one of the firms should develop its own company-developed financial services certification programs, and whether such programs would have legitimate customer credibility.

Philosophers' Questions

The academics' questions spanned both conceptual and practical issues.

When asked about whether ethical behavior and successful leadership can exist in the same person, the executives concurred that they can, and that "sustainability" of the business over time is one

A more systematic approach to executive compensation is needed—for example, limiting the exercise of stock options used as compensation.

prime way to measure this—though at times even the best leaders, however ethical, may face failures in business. When philosophers expressed concern about an increasing emphasis on short-term financial results, the practitioners emphasized that financial services, and life insurance in particular, continues to maintain its focus on long-term performance and its ethical counterparts—trust and integrity. As to what drives the executives to stay the ethical course, many attributed this to core values, often inculcated by their parents and families.

The practitioners also answered queries about their industry's responsibility for the condition of health care—or lack thereof for millions of people—in the United States, and about how executive compensation systems in U.S. companies have gotten "out of line" with those in the rest of the world. In the area of health care and related insurance, some noted that exorbitant costs, arising from exorbitant demand, for these services have driven some insurers from the field, and that the challenge lies in finding a plan to which all parties, including doctors, lawyers, pharmaceutical companies, and consumers, can agree. The executives concurred that a more systematic approach to executive compensation is needed—for example, limiting the exercise of stock options used as compensation.

Concluding Thoughts

In conclusion, both practitioners and philosophers were grateful for the opportunity to experience a day of dialogue, sharing perspectives about some of the ethical dilemmas facing the financial services industry today and looking forward to educating the next generation of business leaders on these issues. ■

Laura Nash from Harvard Business School with Linda Mitchell, co-sponsor of the Mitchell Forum.

THE PROCEEDINGS

INTRODUCTIONS AND GOALS FOR THE DAY

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

The Ethicists:

Ron Duska of The American College, co-host of the Forum, hoped that bringing executives and ethicists together would generate an engaging dialogue from which both parties would benefit.

"It is absolutely essential that you have these dialogues to understand the kinds of challenges that people in real leadership positions face."

Ciulla

Joanne Ciulla of the University of Richmond said dialogues between academics and practitioners are "absolutely essential to understand the kinds of challenges that people in real leadership positions face."

David Messick of Northwestern University said he hoped he might bring a psychological perspective on why people make errors in risk judgments, typified by the Enron debacle.

Laura Nash of Harvard University said she sought insights on the future of managing, particularly in light of the short-term, "winner-take-all" mentality she sees increasingly in students. "How do people think about success, how do they begin to model their visions of success for themselves and for their companies?"

Norman Bowie of the University of Minnesota hoped to explore issues arising from economic partnerships between colleges and the private sector. "Relationships with corporations and with businesses create issues about what professionalism means . . . who the client is, who controls the research, how objective the research is. . . . It creates conflicts of interest, agency problems, and problems of asymmetrical information. The universities are full of that now."

George Brenkert of Georgetown University said, "Many academic institutions are more challenged in terms of ethics than are the businesses they end up studying." He noted that MBA students often prefer taking an additional technical course—to enhance their job prospects—instead of a course in ethics, which may serve them better in the long run. He's also interested in hearing how the executives see their businesses "relating to society with regard to poverty, particularly with regard to the individuals who are not able to afford insurance."

The Practitioners:

John Gilbert said his company—Thrivent Financial, a nonprofit fraternal benefit society which resulted from the merger of Lutheran Brotherhood and Association for Lutherans—emphasized the importance of trust. "Our research shows the thing [our members] value about us—and the expectation we have to hold ourselves to—is they have a great deal of trust in us . . . so the manner in which we have to operate needs to be at the highest order."

Johnny Johns of Protective Life Insurance Company said his company's survival strategy relies on balancing the interests of a "triangle" (the symbol in his company's logo): the customer, the employee, and the stockholder. "Our culture revolves around attracting people with a servant's heart . . . we are called to make life better for the people we serve. We believe that doing the right thing is smart business. . . . It is why we survived over companies that have had a pure profit orientation."

Phil Hildebrand of New York Life stated, "We try to live by our core values, and one of those is integrity." Hildebrand said that, with its vast agent force, the company has special ethical challenges requiring education of the agents, particularly as regulations change. He looked forward to discussing issues like suitability of products and disclosure of agent compensation.

Mark Schwarzmann of American Express Financial Advisors noted that the company's largest shareholder, Warren Buffett, pointed out that consumers have an "emotional attachment" to the American Express brand, which he attributed to integrity. "He said that integrity is the moat around [the company's] castle, and to never violate that." Schwarzmann looked forward to gaining insights on how to deal with the "murky regulatory environment" and the independence of some financial advisors.

> ***"The manner in which we have to operate needs to be at the highest order."***
>
> **Gilbert**

Bill Cameron, who heads his family-owned life insurance company, American Fidelity, noted that a core value of his company is fairness. "It has got to be fair to the customers, it has got to be fair to the colleagues, it has got to be fair to the shareholders. . . . A critical part of how we manage our business is to make it a place where employees want to come to work." Given his company's growing involvement in foreign ventures, he was anxious to hear more about how American ethical values translate into other cultures.

Jim Mitchell closed the introductions by proposing that a company can maximize value over time in three ways—finding the right balance among the interests of all stakeholders (customers, employees, owners, and the community) over the long term, providing effective leadership, and "baking" values into the core processes of an organization. "Organizations that do this find that they do in fact outperform over time." From Mitchell's point of view, the primary goal of the Forum is to give busy executives time to reflect on how best to meet those objectives. ■

THE MARSH CASE

THE MARSH & MCLENNAN CASE

The participants turned their attention to a discussion of the recent indictment of Marsh & McLennan submitted by Eliot Spitzer to the New York State Supreme Court. What follows are excerpts from the indictment.

Supreme Court of the State of New York, County of New York; The People of the State of New York, by Eliot Spitzer, Attorney General of the State of New York, Plaintiff; Complaint against Marsh & McLennan Companies, Inc., and Marsh Inc.

Marsh is the largest provider of insurance brokerage and consulting services in the world. It holds itself out to its clients as a trusted expert in the analysis and placement of insurance policies. Businesses and individuals who need insurance retain Marsh to help them design an insurance plan and negotiate with insurance companies to get the best mix of coverage, service, financial security and price.

According to Marsh, "Our guiding principle is to consider our client's best interest in all placements." It boasts, "We are our clients' advocates, and we represent them in negotiations. We don't represent the [insurance companies]." [Marsh-NY 32815]

The facts show otherwise. Since at least the late 1990s, Marsh has designed and executed a business plan under which insurance companies have agreed to pay Marsh more than a billion dollars in so-called "contingent commissions" to steer them business and shield them from competition. Styled as payments for nebulous "services," the agreements to pay these commissions were called "placement service agreements" (PSAs) and, most recently, "market services agreements" (MSAs) by Marsh.

Whatever the agreements were named, they created an improper incentive for Marsh. As one Marsh executive told his subordinates, the size of the contingent commission payments to Marsh determines "who [we] are steering business to and whom we are steering business from." [Marsh-NY 17870]

"We try to live by our core values, and one of those is integrity."

Hildebrand

John Gilbert, Chairman of the Board of Thrivent Financial for Lutherans and his wife, Marilyn, at the opening reception.

"What gets sticky is that they may not always make clear to the customer that they are legally the agent of the carrier…their fiduciary duty is really to the carrier."

Johns

In another instance, during discussions with an insurance company president seeking to expand her firm's sales, a Marsh executive did not advise her to provide a better product to Marsh's clients; instead, he told her that she would need to enter into a contingent commission agreement paying Marsh an amount that was "above market."

At times, Marsh's plans to maximize the profits it received from contingent commission agreements went even further: it designated winners. Marsh solicited—and obtained—fictitious high quotes from insurance companies in order to deceive its clients into believing that true competition had taken place. It promised to protect insurance companies from competition, and did so. And it threatened to hurt the business of those who thought of truly competing for particular pieces of business.

This business plan was phenomenally profitable. For example, it has been reported that in 2003 alone, approximately $800 million of Marsh's earnings were attributable to contingent commission payments. That year, Marsh overall reported approximately $1.5 billion in net income. Marsh, however, has never disclosed to its shareholders how contingent commissions constitute the lifeblood of its business. Jeffrey Greenberg, the Chief Executive Officer of Marsh, has stated: "We don't break out contingent commissions. That is not separately enumerated because it is part of our business mode…." [July 28, 2004, Analyst Conference Call Transcript]

George Brenkert from Georgetown University chats with William Cameron from American Fidelity Assurance at the closing reception.

The losers in all of this, of course, are Marsh's clients and the marketplace for insurance, which Marsh has corrupted by distorting and elevating the price of insurance for every policyholder. Other victims here are Marsh's own shareholders, who have never been told that hundreds of millions of dollars of Marsh's profits derive from illegal activities.

Who Represents Whom?

Ron Duska began the discussion by asking some leading questions. "What exactly is going wrong here? Aside from bid rigging, what is different from what Marsh is doing and what Wal-Mart is doing? Wal-Mart buys in bulk to get better prices, and that's business, that's the marketplace. What has Marsh done that's so bad?"

Several executives noted that Marsh as a broker had a responsibility to its clients.

Johnny Johns pointed out that depending on the model a company uses, the agent may represent the carrier or the customer. With some life insurance companies, it often is the former. "What gets sticky is that they may not always make clear to the customer the fact that they are legally the agent of the carrier, they are paid by the carrier . . . their fiduciary duty is really to the carrier."

Marsh represented itself differently, Johns said. "The legal and fiduciary relationship that existed between Marsh & McLennan and its client, as I understand it, [was such that] its motto was, 'We always do the right thing for the client, not the carrier.'"

Mark Schwarzmann noted how advisors increasingly provide financial planning services in addition to selling products. "If an advisor truly develops an advisory relationship with a consumer and is then paid for implementing the financial plan," this puts the advisor in possibly conflicting roles. In such situations, requirements for legal disclosure become more challenging.

Phil Hildebrand agreed that the lines have become increasingly "blurry" as agents represent multiple carriers, and as agents provide advisory services. "That calls for more and more disclosure of what that really means. What Marsh did was present themselves to the public as the agent for the client. They are going to represent the client in their best interests, and they have the universe here to select products from. And in reality what they did is represent only themselves and their pocketbook."

Hildebrand characterized Marsh's lack of disclosure and manipulation of bids as "destructive" to the industry. "I personally believe they have taken it way beyond the limit."

Legitimate Role of Contingent Commissions—and Challenges of Disclosure

Leaving the questions of manipulation of bids aside, the question of the acceptability of contingent commissions was discussed. Jim Mitchell shared his experiences as a former chief financial officer of a property/casualty company, which used contingent commissions as a legitimate way to lower prices for insureds, build profitability, and share revenues with the agent. "If you as an agent bring me profitable business that is persistent, as an

"Marsh was able to basically monopolize all the different carriers that would take on that risk. So there was not competition at the retailer level and for the consumer."

Cameron

insurance company I'm going to do a better job for that customer over time... I will be better able to do better loss prevention work with them, their premiums will come down, and my profits will be attractive. I'm willing to share some of the profits with that agent.... That's a win-win-win situation. Is that unethical?"

Bill Cameron added that for property/casualty policies, contingent commissions are really payment for field underwriting to screen out properties with a poor claims history. He echoed Hildebrand's view that Marsh misrepresented itself as looking after the customer, when it was not. There was "a failure of competition" in the Marsh case. "Marsh can reserve all the different companies where you can place the risk so it controls all the markets that will write it. This effectively limits the competition from other agents."

Wendy Hildebrand and her husband, Phillip, EVP, and Co-Head of Life and Annuities of New York Life Insurance Company, talk with Norman Bowie of the University of Minnesota at the opening reception.

In contrast, Wal-Mart still has competition from other retailers who have access to similar products. "The difference is that Marsh was able to basically monopolize all the different carriers that would take on that risk. So there was not competition at the retailer level and for the consumer." The practice may have started to give Marsh more control over its pricing structure, but it ultimately hampered competition.

Mitchell proposed that the legitimate purpose behind contingent commissions—to reward agents for bringing profitable business to the company so that the customer would benefit—was lost in the Marsh case, because the company emphasized only volume and did not share the benefits with its customers.

How Did It Happen?

John Gilbert raised a new point—a consideration of how Marsh's practices arose. "I bet you would find [if there were a paper trail] something that started out to be pretty innocent.... But what you see is a process that has evolved as incentives were innocently put in place for more volume, for more profitability... but over time you get an unintended consequence."

Cameron said he could see how a practice such as bid rigging might evolve. For example, in the months after 9/11, some insurance companies were struggling with how to find the capital to keep writing new business."I could see a broker saying,'We are concerned we are not going to be able to get coverage for this large company's business. We need to have someone else bid on it. They are not going to want to bid on it in case the existing carrier does not have the capacity to write it. They may not want to bid on it because of their capital issues right now. So we are going to have to go to someone else to get a backup bid to make sure the customer is not left without coverage. They might ask a carrier to bid even if they do not think they will be competitive. The first carrier may decide they don't want to bid on this business anymore and the broker needs a backup bid so their customer is not left without coverage.'. . . I can see how that sort of benign approach could end up getting into blatantly bad stuff."

"Unless I know something about the incentive structure…I'm just completely at sea as to whether [my agent] is recommending one policy as opposed to another because it is more profitable for him or because it really is a better fit for my needs."

Messick

Norm Bowie remarked that the Marsh case has made him raise questions about insurance issues in his own life. He now wonders if he is really getting a better deal when he goes to an independent agent and the agent sells him auto and home policies from two separate companies. "Until I read about Marsh I believed the agent, and now I don't know anymore. I don't know now whether he really gave me the best deal, or whether he got a bigger payoff from [one company or another]. I don't know anymore, so I don't trust him, and I used to trust him."

Should There Be Full Disclosure?

The question then turned to the importance of disclosing the commission structures. Is it necessary to disclose? It was suggested, for example, that clothing salespersons in department stores don't disclose commissions. Bowie asserted, however, that insurance agents are supposed to be different, that disclosure of some kind is critical. "I always thought insurance guys were professionals—that's the difference."

Hildebrand concurred and carried the analogy further, noting that disclosure requirements differ vastly in the two types of sales. Consumers can readily compare the prices of hammers in Wal-Mart and the local hardware store. "In the insurance business you don't know how to measure what you're paying for, and you don't know how the quotes are being developed. To laymen there is no way they could do that as a comparison."

"One of our ethical tasks is to come up with not just ideal perfect solutions for ideal people with perfect information, but feasible realistic solutions…

Nash

David Messick pointed out that this was the problem of asymmetry of information. "I know a good bit about hammers, and I have a good idea of the price distribution for them.... Unless I know something about the incentive structure that my broker has, then I'm just completely at sea as to whether he is recommending one policy as opposed to another because it is more profitable for him or because it really is a better fit for my needs.... The asymmetric information is huge.... My agent generally knows much more about the structure of the insurance policy of mine than I do. I probably know as much about a hammer as the guy at Wal-Mart who is selling it to me."

Johns raised the issue of whether there should be differences in disclosure practices among different financial products. "Why should we have different systems of disclosure for products that are sort of alike? Our products do not require telling the consumer how much money you charge for placement of that product so long as only the carrier is paying you. If you are being paid something by the client, you have to disclose commission. If you are paid by the carrier, I don't know anybody in our industry who is pushing for agent commission disclosure."

Laura Nash from Harvard University with Mark Schwarzmann, the Senior Vice-President of Insurance and Annuities at American Express Financial Advisors

Mitchell agreed on the need for comparable disclosure practices. "From the layperson's point of view, why are you quite willing to tell me about the two percent commission when you sell a mutual fund, but yet you are not willing to tell me about the two-plus percent commission when you put those same dollars in an annuity contract?"

Laura Nash wondered, however, whether the insistence on full disclosure might be unrealistic. "One of our ethical tasks is to come up with not just ideal perfect solutions for ideal people with perfect information, but feasible realistic solutions....It would be so easy from an insurance standpoint to say, 'Well, just give the consumer more information, just disclose everything, disclose commissions.' A, I couldn't process it. And, B, I might turn into a Wal-Mart consumer where I will buy socks for 50 cents until the whole system falls apart and the socks aren't worth taking out of the store because we have gouged the sock producer's profit so badly."

She commented that the emphasis on low-cost consumption leads to an emphasis on volume. "The more you can make money on volume, the more you are getting into these commission incentives and corner-cutting, so that in commodity markets we may see the worst happening—collusion in setting prices."

"One of our ethical tasks is to come up with not just ideal perfect solutions for ideal people with perfect information, but feasible realistic solutions…"

Nash

Johns noted that there are several arguments for not disclosing commissions on life insurance sales. One is complexity. "You can have a career agent whose office is provided by the company—that's part of his compensation; he would get paid less transactionally but he gets more benefit overall maybe. Or you get an agent who is working purely on commission; maybe with a contingent commission; he sells more, he gets more. So it is very confusing. It is hard to make a meaningful disclosure." Customers also may be overwhelmed by too much information that is difficult to understand. Sales will plummet, and the family who really needs the product will not have it.

Schwarzmann also talked about the risk in providing too much information. His company tries to be on the "leading edge" of disclosure requirements and found that even lengthy documents seem inadequate. "You read it and you go, 'That's great, it tells you everything that you could possibly believe is bad about the industry.' There was absolutely zero balance in this document . . . nothing that said, 'By the way, I have a fiduciary responsibility to you, these things are extraordinarily complex, and part of the reason I get paid more to sell a VUL [variable universal life] product than a mutual fund is because I have to understand it to sell it to you and you get more value from the products and its features than simpler investment products."'

Joanne Ciulla of The University of Richmond with Nancy Johns and her husband, Johnny Johns, President and CEO of Protective Life Insurance Company, at the opening reception.

Hildebrand noted that disclosing compensation on a life insurance policy sale presents many challenges. The initial sale, which may involve a huge percentage in compensation, does not reflect the costs of agent training and client development, or the fact the compensation is not paid evenly over the 30-year life of the contract. "Do you show compensation over the break-even period of what that contract is priced for—what is the net compensation? That's where it becomes very difficult."

"It certainly is an emotional-type thing. I talk to a number of people, and they say this person seems to have done well by me, and this is the best I can do."

Johns

He also said that disclosing commission structures gets complicated when financial planners have marketing arrangements with related professional services firms—such as law or accounting firms—that provide products. "They [the financial planners] are covering their advertising, overhead, and marketing agreements with them. In essence, they are splitting commissions. But they are looking for a way to technically avoid it."

Factors in Selecting an Agent and an Insurance Company; Avoiding Conflicts of Interest in Professionalism

In assessing how much "disclosure" a consumer really needs in buying insurance or other financial products or services, the group analyzed some of the factors consumers consider when they select an agent, a financial services company, or a particular product or service.

Bowie noted that media reports suggest that consumers not seek financial advice from a professional who also sells a financial product due to a potential conflict of interest. He asked the practitioners how they address this challenge.

Schwarzmann said his company and other "career companies" are erecting "Chinese walls" within the companies, separating the broker/dealer and asset management interests. He also said that the data, at least at American Express, do not support the media contention that advisors steer consumers to the company's products.

Mark Schwarzmann of American Express Financial Advisors and Laura Nash of Harvard listen to a point made by David Messick from Northwestern University.

The financial services industry is leaning toward the concept of a "buyer's agent," Schwarzmann continued, saying, "Perhaps as a consumer of financial services, what my bias would be is to gravitate to a buyer's agent in the financial services arena as well."

Johns said that his company seeks to provide "great consumer values" in its products, but that this—or the wealth or lack of specific product information—is not necessarily why a customer stays with a particular agent or company. They stay because of an agent. "It certainly is an emotional-type thing. I talk to a number of people, and they say this person seems to have done well by me, and this is the best I can do."

George Brenkert pointed out that, with buying insurance, personal relationships are as important as how much information he receives about a particular purchase. "I have asked what kinds of fees [my agent] is getting for things. But I don't know other types of products that he might have available to him. . . . It is not 100 percent transparency or no transparency. I hear from other people who have dealt with him this is the person to go with, so I go with this person and then hope."

Gilbert noted that his company's research indicates that different consumers have different sets of experiences with the same agent. Schwarzmann said, "Customer satisfaction data will tell you that the primary driver of customer satisfaction is contact. We focus a lot of energy on contacting the customer, and that level of consumer engagement at the broker/advisor/agent level is a primary measure for people."

Cameron concurred that referrals based on trusted performance ultimately determine your own level of trust. "Basically you trust your agent because your agent has been trustworthy for your friends. I think if agents have got a good reputation with other people, you can feel reasonably comfortable they are probably getting you the best deal while also covering their cost of living." However, it is important to remember that the agent has to earn a living.

Cameron likened the situation to knowing about how his clothing salesperson gets compensated. "I'm comfortable going into the retailer I go to and the person who sells me the clothes because my value proposition works out. I'm not sure part of my value proposition needs to be to find out how much money that retailer makes."

Joanne Ciulla noted a difference, though. Selling clothing in a department store is not a profession, but selling insurance and other financial services is, so the answer may not lie in just providing more information. "The question of how well technical excellence meets with moral excellence or ethical excellence is a bigger industry issue than figuring out how much information a consumer needs."

Mitchell continued, "People in the financial services industry *do* have a fiduciary obligation. We are talking about people's life savings here, something that affects the whole quality of life. . . . So we have got a higher obligation." It seems clear that the system of disclosure needs to be improved.

"People in the financial services industry do have a fiduciary obligation. We are talking about people's life savings here, something that affects the whole quality of life. . . . So we have a higher obligation."

Mitchell

"If I'm your agent and you're my principal, then when I act on behalf of my client or on behalf of you, I have got to do what my company says—look out for the benefit of the customer."

Duska

Distinctions between Broker and Agent

Duska raised the question whether a problem in the Marsh case might not lie in the legal distinction between broker and agent. Brokers are supposed to act on behalf of the client and agents on behalf of the company. But most company mission statements claim that the primary concern of the company is providing benefit for the client. Thus, an agent of a company in acting on behalf of the client is also acting on behalf of the company because to act on behalf of a company is to do what the company says it exists for—look out for the benefit of the customer.

If an agent is acting on behalf of the company, and if the company is not providing products in the best interests of its clients, the agent has a responsibility to go back to the company and have it get its priorities in order, he said. If its commission structure keeps the company and agent from serving the best interests of the clients, the company needs to reform its commission structure.

Ciulla summarized the challenges in disclosing agent compensation. "The issues are very complex, and we have to work very hard to come up with ways to communicate this complex information in a way that's more helpful than counterproductive to the consumer." Providing information not only about commission structures but also about how the industry is doing in general, she added "would begin to reestablish the notion of being professionals."

"It is going to take a lot of hard work to reach a consensus to serve the ultimate best interests," said Johns. The challenge lies in continuing to maintain the professionalism of financial services.

Sharing conversation at the closing dinner, along with others, were (from left) William Cameron of American Fidelity Assurance, David Messick from Northwestern University and Mark Schwarzmann from American Express Financial Advisors.

ETHICAL ISSUES

THE PRACTITIONERS' ETHICAL ISSUES

The next segment of the Forum was devoted to a discussion of practical ethical issues that each of the executives faced during their careers.

ISSUE 1: Culture Clash: The Evasive Thai Bankers

In 1994, we decided to enter life insurance markets in Asia. The first step was to form a joint-venture company in Hong Kong, which was organized and managed successfully. One of the next markets was Thailand, where the life insurance business was starting to catch on. We were introduced to the senior manager of a mid-size local bank. The bank was successful in the open market, and its executives, several of them Americans, enjoyed a good local reputation. Our due-diligence and background checks were all favorable. We reached an agreement on material business issues and proceeded to apply jointly for a local insurance license. During one meeting we offhandedly said, "You can assure us, can't you, that it will not be necessary for anyone to accept any payments or bribes or anything like that as part of this process for obtaining the local license?" Their answer was evasive, indicating we would not be asked to engage in any questionable activity, and assuring us that our money would not be used for any illegal purpose. . . . They weren't going to lie to us but wouldn't tell us straight up.

We sat for a short period of time incredibly entranced by the business opportunity. . . . We had a meeting one day and said, "No, we can't do this," and we passed on the opportunity. A couple of people in the company said, "Come on, be a big boy, that's the way everybody plays in Asia." We said, "No, it is just not our style." In so deciding, we talked extensively inside the company about integrity and values. You may have a big opportunity, you can make money, but you have to compromise just a little bit. . . . Legally you are okay, but it just didn't feel right, so we passed.

Jim Mitchell emphasized that when a company asserts that it puts the client first, the chief executive must "walk that talk," as the CEO and his colleagues did with this case.

That message filters down to employees, Johns stated. "The employees who come to a company become cynical with this notion that cheaters win. . . .

. . .when a company asserts that it puts the client first, the chief executive must "walk that talk"

Mitchell

"Different cultures have different values. As you try to do business in other places, how do you avoid being an 'ugly American' by imposing American cultural ethics on other people's?"

Cameron

I don't think they believe you are serious about your internal values until you show them that you are willing to lose money or a profit opportunity in defense of those values."

Joanne Ciulla asked if this was really so much an ethical issue. Isn't it more practical? "With special payments, bribes—whatever you want to call them—you have a very unreliable environment to work in." Johns replied that whatever the answer to Ciulla's question, the objective was to deliver a valuable, American-style product, and to run the business very ethically.

Bill Cameron highlighted the fact that in Asian cultures, values are different and raised the issue of dealing with cultures that have different standards. "Different cultures have different values. As you try to do business in other places, how do you avoid being an 'ugly American' by imposing American cultural ethics on other people's?"

Cameron asked whether American companies are trying to impose American values on cultures with legitimately different values.

Mitchell did not see it that way. "It is not that their system is terrible—it is simply who we are. If they want to operate with somebody else and play a different game, they can do that. That's just not who we are."

John Gilbert of Thrivent Financial for Lutherans, John Johns of Protective Life Insurance Company and Joanne Ciulla of The University of Richmond, listen to a point being made in the working session.

Phil Hildebrand said that New York Life, with its presence in nine Asian countries, faces this cultural conflict all the time. "I've learned that part of business [in India] is built on kickbacks and rebating, and it is a common way of doing business. Entering that country we learned that, and we have clearly communicated throughout the organization that we're not going to participate. If, in fact, we catch our agents paying any kind of a kickback . . . we will terminate; the same thing goes within management. Maybe we would have had three times the success, but we are using the same core values we have here."

George Brenkert concurred, noting also that if companies were simply "chameleons" and acted differently in different cultures, their integrity would be questionable. He added, "I wonder, are we too quick to jump to the conclusion that they have totally different values…? Maybe you are a leader there in helping them get in touch with certain values they have rather than simply imposing your values on them."

According to Mark Schwarzmann, this may not be a values issue. "In many cases, these practices develop as a means to circumvent some onerous tax system, for example, or an extraordinarily complicated bureaucracy in the country. The reality may be they do these things because it is a way to get business done."

He contrasted that sort of accommodating approach with those of his former employer, GE. "The GE rule was very clear: We do the same thing everywhere…. Everybody had to sign off that they would comply with this set of policies. It became a booklet…the spirit and the letter…. And every employee had to sign every year that he agreed." An employee who failed to live up to the standards would be terminated, regardless of the operating standards in any given country.

"I wonder, are we too quick to jump to the conclusion that they have totally different values…? Maybe you are a leader there in helping them get in touch with certain values they [also] have…."

Brenkert

ISSUE 2: "Bring Your Book of Business with You" – or The Replacement Problem

When our company merged with another company, we brought together 3,000 agents in the field and had to put them under one contract and one system of compensation. Agents from both sides had to swallow some differences, and some people chose not to stay with the new company. Other companies were seeking to build their distribution capability. They wanted our agent, but right behind it they wanted the agent's business to move to them. These people were offered significant financial incentives to go to another company. The troubling part was the offer was presented in various ways to "bring your book of business with you." Because our products have front-end loads and surrender charges, I was troubled by this kind of offer.

We chose not to make a counteroffer to those leaving by saying we would match dollars or do this or that. But the loss of agents impacted our top-line performance in the short term…. Whether to match the offers or not was a dilemma for us, but not a very difficult one. However, offering a new job to agents if they bring their books of business with them is a dilemma for the industry in terms of trust and integrity.

"There is probably some expectation that the broker is going to bring his book of business and his customers with him to the other bank…

Schwarzmann

In some cases, agents who move to another company are replacing policies. Policyholders typically don't complain—they trust their advisor when he or she says, "I sold you this product 3 years ago, but now I have an opportunity to sell you one that's even better." When clients would bring this up with us, we would follow up, saying, "Did you know that you are going to pay a $1,500 surrender charge?" They would answer, "Yes, George [my agent] told me that." But since they have this tremendous confidence and trust that what George was telling them was right, they would replace anyway.

Our company did everything we could to warn our policyholders, but we ran into the question of whose clients they really are. This issue gets into the fiduciary role of the agent. It becomes difficult because some producers will provide a better service—they are not all equal.

Schwarzmann said that the situation becomes more complex when the company is selling through an intermediary—as when a broker for a bank sells variable annuities to consumers and then the broker decides to move to another bank. "There is probably some expectation that the broker is going to bring his book of business and his customers with him to the other bank.... The insurance company is probably going to get ripping mad because it paid the commissions, but it is in a situation where if it goes directly to the consumer, the initial bank will claim, 'That's our customer.'" The broker, the bank, and the carrier can all claim this, and no one really knows who is right, because, over time, product features change, a new policy might be suitable for the client, but the situation is "chock full of gray areas."

Hildebrand noted that to avoid such problems, the state of New York now requires disclosure of all policy replacements. "Since that law was put in place, we have sent business back, saying, 'This is not a suitable sale, we are not accepting it, we are not allowing you to do this.' Since the regulation was instituted, policy replacement dropped considerably, particularly since it is not easy to prove that one product is more suitable for the customer than another. That's a tremendous benefit to the consumer. Where the business is now being replaced, it's being fully disclosed."

Schwarzmann added that, in the case of variable or registered products with a variable component—annuities or life insurance policies—the National Association of Securities Dealers (NASD) requires a supervisory review.

"There is a whole other layer of issues about how that process works.... There are checks and balances in the process beyond just the insurance company or the broker/dealer."

Johnny Johns said that companies do not like the practice of "churning" replacement. "These commissions are so heavy on the front end, we need to hold the policy for 8 or 10 years before we start making any money."

That's why the industry is seeing more "trail" commissions over time, Schwarzmann said. "But if you can get more and more of an alignment between the consumer interest, the broker/agent interest, and the company interest, then these things also tend to go away."

"If you can get more and more of an alignment between the consumer interest, the broker/agent interest, and the company interest, then these things also tend to go away."

Schwarzmann

Mitchell noted that, while younger producers might have a problem with commissions paid over time, the senior ones are more amenable to them. However, he said, "A new person can't make a living on flat commissions, which means that companies have got to subsidize even more than they already are doing to get new people to start in the business."

The various companies represented by the executives have differing models of how they recruit and train agents, with "career" companies like New York Life and Thrivent investing considerable training dollars in brand-new agents, and others, like Protective Life, recruiting experienced agents from career companies. A few key companies can't do all the recruiting and training for the rest of the industry, particularly when the growth rate in agent population has dropped dramatically over the past decade, John Gilbert said.

Norm Bowie, the Elmer Andersen Chair of Business Ethics at the University of Minnesota, chats with Nancy Johns and her husband, Johnny Johns, President and CEO of Protective Life Insurance Company, at the opening reception.

Johns offered his company's counterperspective. "At some point in their career, [experienced agents] decide they want to move on.... They probably feel they can make more money working as an independent instead of as part of the captive system. Some would say they don't like being tied down to just offering in-house products." The result, for his company, is that the money they don't spend on training can be devoted to commissions.

David Messick asked whether companies can ask new agents to sign contracts for 5 to 10 years to ensure that the training investment is not wasted. Mitchell replied that most agents are not successful enough initially

"It is not in the interests of companies to keep these training programs up, and there is less training taking place, so you are getting a less and less professional agent in the long run if this keeps going."

Duska

to make this economical. An alternative is to have the agent sign a noncompete agreement, whereby it is clear that the clients of the agent are the company's clients, although typically that is only for a short term.

Another ethical dilemma arises from the differences between independent and "captive" arrangements, Hildebrand said. "New York Life agents are career agents, but they also have a license to sell other companies' products . . . but, we want them to sell our product. It is a very difficult issue to manage. It creates some interesting dilemmas when just before you lose a sale you say, 'Oh, I have got this other product.'"

He added that life insurance products are priced to break even no sooner than 9 or 10 years later. "When we go out to hire and train an agent, we are not going to break even on that agent for 10 or 12 years, depending on the success rate of the retention period. So every time we lose an agent to the competitor, it raises our cost, which in turn gets passed down to the consumer."

Ron Duska questioned whether the decline of career companies is really best for the industry. "It is not in the interests of companies to keep these training programs up, so there is less training taking place. Consequently, in the long run, you will get a less and less professional agent if this keeps going. The consumer will end up losing because you will have a lot of transactional insurance salespeople instead of insurance professionals."

Ron Duska, Director of the American College Center for Ethics in Financial Services, and Jim Mitchell, sponsor of the Forum and co-host, listen with George Brenkert of Georgetown University to a point in the discussion.

Issue 3: The Bonus in the Boss's Pocket

In our company, a manager can use a "spot" bonus to reward people. A veteran leader of one of our business units misused the "spot." He would authorize that those bonuses be paid to members of his senior management team and then would tell these people—some who had worked for him for a long time—to give the money back to him. He was able to keep the secret for 3 or 4 years during which he collected about $250,000. We found out about it and fired the leader.

But if you fire the leader, what do you do with the senior management team of the business? You can't fire the whole senior management team without a lot of disruption. This was one of the largest divisions, and these people had most of the institutional knowledge.

On the other hand, here was a group of managers who, because of senior leadership, had not lived up to company ethics. What should be done with those people? Ultimately, the company decided to open a 3-week period during which time a manager could come forward and tell everything he or she knew about his or her involvement, without suffering any repercussions. The 3-week amnesty period was a chance to clean the slate. After that time, if improprieties were found that the company hadn't been told about, the person would be assumed guilty and punishment would be harsh.

Allowing people who were coerced into [the bonus arrangement] to come clean basically allowed them to rehabilitate themselves, not only in the organization but also to themselves.

Cameron observed that the objective of the amnesty process was justice and fairness. Bonuses should be paired with achieving sales and process goals, and the trust of that process was violated, so the corrective process had to be fair. "In essence [the unit leader] was robbing from his colleagues, and his senior management team was facilitating that."

Brenkert asked whether the company has instituted measures that encourage people to come forward when similar circumstances arise and wondered whether having a whistle-blower system in place would have changed things.

In fact, the company did respond by re-emphasizing its whistle-blower system, where employees can go to the internal audit department or human resources to raise complaints, and changed the policy on the bonus plan, requiring more approvals from higher levels.

Ciulla remarked on this "mini-truth-and-reconciliation" system. "One of the things that people don't often talk about in organizations is organizational forgiveness and what that process entails. It is what you have to do to really forgive somebody. Just saying, 'Okay, I forgive you, that's the end of it,' is not enough. There has to be a process." But she questioned the value of whistle-blowing systems as sometimes "artificial structures" that can backfire.

Laura Nash wondered why the leader fell from grace. She noted that the situation called to mind a pathology where people obey authority against

"It often starts out incrementally in terms of small steps—each step doesn't look all that bad or the consequences don't seem bad to people. It doesn't seem as if anybody is getting hurt."

Nash

Allowing people who were coerced into [the bonus arrangement] to come clean basically allowed them to rehabilitate themselves, not only in the organization but also to themselves.

their own consciences. "Such situations often start out incrementally in small steps—each step doesn't look all that bad or the consequences don't seem bad to people. It doesn't seem as if anybody is getting hurt."

"Perhaps this person realized he hit the ceiling with his career," Cameron said. "Maybe he started thinking, 'Well, I can get away with things.' Maybe he saw he was getting away with little things, and then he started getting into bigger things, and then he started feeling like, 'Well, I'm due things.'"

ISSUE 4: "The Tylenol Cure"

Our marketing materials and sales techniques had come under criticism in the early 1990s. We felt the best thing to do was just to stop everything, pull all our marketing materials off the shelf, and then refile them with each state, coming forth with what the states felt was proper disclosure—marketing material we felt was legitimate—and disclose everything they wanted. It took about two years. Sales went into the dumpster during that period of time.

As we started to rebuild, we set up a complaints department to take responsibility for supervising salespeople, by making sure that everyone adhered to the new rules. It was an incredible challenge because we had people in business 20 and 30 years, and all of a sudden they had to change the way they did business.

As regulations were challenged the states came back to us. . . . We were held guilty for years of actions of which they had no knowledge. We rebuilt this entire area. . . . Then came the suitability requirements. The states gave up on defining suitability because nobody could come to an agreement on what the criteria should be. So they passed the responsibility of defining suitability on to the insurance carrier. . . .

We learned through this whole process that you have to protect clients from themselves. Part of the "suitable sell" is to make sure you wouldn't let them do anything harmful to themselves, even if they have full knowledge and everything has been disclosed. . . . The degree of supervision and cost of this infrastructure have been enormous.

We have relationships with the broker/dealers and also have over 7,000 agents that are licensed. There are different standards under NASD for brokers than *there are for agents.... What is happening now is that the insurance companies have the same thorough supervision and oversight. This has made it really challenging.*

The tough times are behind us. First, we had to fire a number of people.... Second, we warned our agents that everything is fine until NASD or the insurance department shows up at your place of business and does an unannounced visit....Now inspections are being done and they have completely changed the marketplace for the agents. Our agents' feedback now is that they really appreciate what we have done in teaching them how to run their practice.

One concern, though, is that we end up holding onto people longer than we perhaps should until we have really strong evidence we can terminate them. Hopefully we demonstrate to the insurance department and the NASD that we can get their license revoked. If not, they are off with somebody else, and they are continuing to do what they are doing. It is very costly.

The result of this process was a brand-new procedures manual, defining the steps agents had to follow to get insurance illustrations and other marketing materials approved.

They really challenged the way we were illustrating the product, and there was not enough disclosure showing the dividends were not guaranteed.

It took several years before agents came back. But at the same time, the company has had to be careful about promoting some high-end producers. They will run harder for recognition than for compensation. What [one top agent] did was take people hitting retirement and advise them to roll all their funds into very aggressive investments, when in fact they had never been there themselves.... In an unannounced visit we found she was filling out all the suitability investments for her clients. It cost us millions because we disclosed as we learned more about it. We had to go back and take care of these people and refund their original investments.

Mitchell asked, "These people do make the client whole if one of their agents messes up, but would most of the company's competitors do the same?"

The reputable ones would, Johns said. "We had one situation—an independent broker/dealer whose life agent had a securities license through

"These people do make the client whole if one of their agents messes up, but would most of the company's competitors do the same?"

Mitchell

George Brenkert of Georgetown University and Norm Bowie of the University of Minnesota listen to a point during the dialogue.

"You detect it in commission—you detect it in seeing a spike in sales all of a sudden."

Nash

our broker/dealer. . . . He embezzled $2 or $3 million. . . . He would go take money from a 65-year old who had a 30-year-old Downs Syndrome kid and steal her money. He would say he was investing it, and he would steal it."

When the company found out, it sent its representatives to deliver six-figure checks to the cheated customers. "We made everybody whole without even being asked, and we didn't say to each, 'Give us a legal release,' but 'Here is your money. . . .' We had the lowest cost of any other company involved because nobody really wanted to sue us. . . .' We had already made them whole. It was a classic example of doing the right thing and smart business."

Johns said that working through independent agents, rather than through a captive sales force, presents its own challenges, and in his company there is no tolerance for problems with independent agents. "Our vigilance is extraordinary. When I find anybody pocketing money, forging a signature, falsifying an ad, I have zero tolerance. I don't care if you were the biggest producer last year, you are out of here."

Nash had a number of questions. First, she asked whether the company can implement effective detection systems. Hildebrand said that local management, which can detect a change in an agent/advisor's behavior faster than anyone, is key. "You detect it in commission—you detect it in seeing a spike in sales all of a sudden." Corporate-level also detects problems through unannounced audits, but not everything.

Nash next asked what causes some agents to resort to improper behavior. Gilbert noted that in some cases, recognition is sought more than compensation. "We had a number one agent and then one year he wasn't number one. I can remember him publicly saying it didn't really make any difference, but it made a whole lot of difference that he wasn't number one. Pretty soon. . . he started cutting corners. He started doing things that were inappropriate. When we terminated him that sent messages." At the same time, he said, management asked itself whether the company had set agents up for something they could not manage on their own. One remedy was to provide "positive counseling"—guidance on underwriting, required elements, and other items—to the top 25 salespersons.

Nash also wondered whether companies could track the "pressure points" in a salesperson's career that could lead to ethical missteps. Hildebrand said that a decline in recognition can be one pressure point, as well as personal financial problems. Johns concurred, noting, "You get these Greek tragedies—very talented, very smart people who get themselves in trouble. Their success is part of their failure."

"You get these Greek tragedies—very talented, very smart people who get themselves in trouble. Their success is part of their failure."

Nash

ISSUE 5: The Value of Internal Certification

Our company has the highest number of CFP®[1] certificants in the industry, so we have some level of independent certification today. What we want to do is begin to certify our own people on various skill sets. . . . Our thought is not to do it on a product basis, but rather on a practice-area basis—this person is an excellent estate planner, this person is an excellent whatever, and on down the list there would be levels of certification even within these specialties. For example, if you were worried about retirement, like most of us in the room should be, you would seek out not only a CFP® but also somebody who is a CFP® and is a Level Three retirement planner.

This certification makes me feel a lot better from the suitability and quality of the sale perspective. If a person is, say, a Level Three retirement planner, and the person makes the sale of an annuity inside of a qualified plan, the comfort level of our lawyers, and even the regulators' lawyers, should be higher because that person has met higher standards of expertise than most other agents.

Such a program is going to cost us an awful lot of money and time. What level of credibility would you as consumers apply to that sort of self-policing—"certified by our company"—what validity does that carry? I don't know whether cachet around the name has a halo effect here or not. Does that approach meet the ethical test as well? Are we moving in the right direction here as an organization? We already do lots of training. But there isn't yet this structure of certification—pass a test. Some component of it is going to be not only a more costly, but also a more onerous process for individuals. Experienced advisors may say, "Thanks a lot, I am going to go somewhere else."

[1] Certified Financial Planner Board of Standards Inc. owns the marks CFP®, CERTIFIED FINANCIAL PLANNER™ and CFP (with flame logo)®, which it awards to individuals who successfully complete initial and ongoing certification requirements.

"I think people are cynical that a company designates its own people something.... I don't think you are going to get a marketing benefit out of that."

Cameron

While a particular brand may mean a lot to the consumer, Johns replied, he wondered whether the establishment of "levels" of expertise might create disparities within the agent force.

Schwarzmann felt that in its name, American Express Financial Advisors had potentially already set an implicitly higher standard. Mitchell agreed. He indicated that in his years with that company, he had a similar experience: by calling its people "financial advisors," the company set a higher bar for what constituted ethical behavior.

Ciulla asked how a company could certify its own people as experts. "I don't understand why that would be credible. I could say, 'Gee, I read this great book on financial planning and now I consider myself a financial planner.'"

Cameron concurred. "I think people are cynical that a company designates its own people something. . . . I don't think you are going to get a marketing benefit out of that." Certifying professionals through an outside organization is preferable.

Gilbert also countered that a specialist in one area, such as retirement planning, may not be able to address all of the complexities of a particular case. "And so, even then, your 'Level 3' might not get to the particulars about this business setting."

To address complex cases with multiple financial services dimensions, a company might put together a multidisciplinary team that could work together and "cross-sell," Messick suggested. That would work well for a client with $10 million in assets, Schwarzmann replied, but for the client with $200,000 in assets, that model would not hold up.

Hildebrand suggested that the idea of internal certification can, at minimum, provide the company comfort that its agents know what they are doing professionally, although it may not change the image of agents in the marketplace, *per se*.

Finally, Mitchell suggested that third-party certification, such as through The American College's Chartered Advisor for Senior Living (CASL) designation program, would be more objective and more meaningful to consumers. ■

PHILOSOPHERS' QUERIES

THE PHILOSOPHERS QUERY THE PRACTITIONERS

At this point in the meeting, the "Philosophers" were asked what questions they had for the "Practitioners."

Why wouldn't a just person want to be a leader?

Plato

QUESTION 1: What does it take to be an ethical leader?

To deal with this issue Joanne Ciulla asked two questions.

The first question: *What is the relationship between being effective as a leader and being ethical as a leader?*

Some leaders are highly effective, and some leaders are highly ethical, and sometimes you can't get both in the same package. In our era, we have these two things effective and ethical as separate, and it causes all sorts of problems. . . . If you are thinking of hiring people or electing a president or a senator or anything else, you are constantly looking at these two aspects: This person seems very competent, he might come in and make a lot of money for the company, he might do some wonderful things for us, but I have a few questions about his character. If you read Plato and Aristotle, to be ethical, you will essentially have to be able to do both things well . . . be effective and be ethical.

Linda Mitchell (left) who co-sponsors the event with her husband, Jim, visits with Wendy Hildebrand and her husband, Phillip, EVP and Co-Head of Life and Annuities of New York Life Insurance Company, at a closing reception.

The second question is one Plato raised in The Republic about leaders: *Why wouldn't a just person want to be a leader?*

Plato's reason why just people do not want to be leaders is that for a just man, being a leader would not be in his self-interest. An ethical or just person realizes that true leadership will require sacrifice and it will take its toll on [him] and his family. The true role of the leader is to look out for the best interest of those he is leading. Is that the problem with leadership today? Is the cause of all of these corruption scandals the fact that just people don't want to be leaders?

Johnny Johns suggested that ethics and effectiveness are not so easily separated in leadership. "The problem, unfortunately, right now is we're focusing on the bottom 1 or 2 percent of the corporate headliners, but we are not focusing on the 98 or 99 percent who are effectively and ethically

An ethical leader is the one who does good things, creates good products, and does it in a fair and equitable way."

Schwarzmann

leading their companies. People I admire in the business community seem to display a very strong sense of right and wrong and very strong character. The good guys win; the good guys don't lose."

At the same time, he understood why someone might be reluctant to be a leader, given the difficult ethical dilemmas that arise. "It is not like, 'Oh, it is great.' You have to make judgments all the time in conditions of uncertainty."

Ciulla noted that some people might consider Hitler, Attila the Hun, and Saddam Hussein great leaders. So the question remains, "What makes a great leader and what makes a good leader in the moral sense?"

Ron Duska, co-organizer of the Forum, with the sponsors, Linda and Jim Mitchell.

Ciulla and Johns concurred that you can be a great, ethical, charismatic and strong leader and have bad business results. Several practitioners maintained that even some notable business leaders today who resigned in scandal or because of their companies' poor performance could still be considered good leaders.

Mark Schwarzmann said the answer lies in sustainability. "You don't see that over the long haul [with an unethical leader]. They [unethical leaders] may be charismatic, they may be transformational. They do the things that people say good leaders do or effective leaders do, but they are just patently unethical. So what makes the ethical leader? An ethical leader is the one who does good things, creates good products, and does it in a fair and equitable way."

Bill Cameron suggested that the impact of "doing the right thing" increases the ability of the organization to be successful over a longer period of time. "What it takes to really to be an effective leader is that you have got to be willing to make the hard decisions on an ethical basis. That's what builds a sustainable organization."

Jim Mitchell asserted that organizations need to work at ethical leadership all the time. "Businesses are cultures composed of human beings, and the cultures do change over time. Sustainability is a test of sort of a person or a group of leaders, but it is absolutely no guarantee that as leadership evolves over time, the same organization will continue to have people who keep on building the same kind of effective culture in the first place." Superb leaders should help foster the next generation of people to continue to maintain that culture, he added. "A lot of times that doesn't happen. Cultures are created and they grow and sometimes they wither. You have got to work at ethical leadership all the time.... If you don't care for and feed and water it, the culture is going to wither."

"You have got to work at ethical leadership all the time.... If you don't care for and feed and water it, the culture is going to wither."

Mitchell

The group examined other dimensions of leadership. David Messick said it is more realistic to discuss leadership in the context of practices, not in terms of living individuals. If one focuses on the latter, specific criteria—such as ethics and effectiveness versus how the person leads his personal life—should be established.

Mitchell disagreed about these criteria, however, suggesting that a person cannot be a good leader if he or she is "sleazy" in private life, particularly if you lead a company in a smaller community. "I think employees know a lot about you. If you are going to be credible, you better walk the talk in your private life as well."

Ciulla returned to the concept of sustainability as a benchmark for leadership. "Sustainability, which is really fundamental to ethics, is very hard when you have got quarterly numbers to meet, and so there are structural problems that make leaders perverse."

She closed the segment with Plato's explanation for why no ethical person would want to be a leader: "To understand the moral responsibilities of leadership, you should know it is not in your self-interest—not power and goodies for you—but late nights, lots of stress, lots of anxiety." She added that the only way ethical leaders are tempted to become leaders is a "fear of punishment"—the fear that someone worse than they would become the leader.

QUESTION 2: Why do so many Americans lack health insurance?

David Messick asked the participants to address the following issues:

It is an ethical injustice and a national disgrace that we have 45 million in this country who do not have health insurance. I wonder whether the insurance industry worries about that, and whether the leaders of the insurance industry—of which you are a subset—have strategies for coping with it.

"…We came to the conclusion this is not our core business. If it is not our core, we better exit or it would damage our core."

Hildebrand

Cameron responded that several groups are responsible for medical insurance costs in this country. "If you said to the health insurance industry, 'Could you come up with a plan that would solve the health care crisis?' they would have a reasonable shot at doing it. The problem is the doctors wouldn't like parts of it, the trial lawyers wouldn't like parts of it, pharmaceutical people wouldn't like parts of it."

John Gilbert said his company got out of the major medical insurance business because it was too costly—in part, because of what he called an "insatiable demand" for medical services. "In the time we were there, we lost $70 million trying to play in a business that we didn't belong in." He used his own 92-year-old mother's $85,000 hipsurgery operation as an example of a difficulty. "There is an extreme moral and ethical dilemma that confronts this society as we look at how much of the pie we devote to this kind of thing and the drug care and to have all the things that we have become accustomed to."

Phil Hildebrand responded to Laura Nash's question of whether New York Life's decision to get out of the disability income insurance business was the right one. Hildebrand replied, "We pulled out of health care a couple of years prior to that for all the same reasons—lack of scale. We couldn't figure out how to consistently develop a profit. We weren't sure we were managing all the risk properly. We came to the conclusion this is not our core business. If it is not our core, we better exit or it would damage our core."

Nash pressed further, asking, "Do we accept this? Here we have a major public problem, health care. We have a group of experts saying, 'Well, nobody else can solve it, we can't solve it either, and it threatens other things we do, so we are getting out.'"

Ciulla noted how, in the United Kingdom, Margaret Thatcher's government had considered revamping the country's health care system. "The kind of debate that went on had to do with the limitations of our thinking because of the market system. . . . The people at the Oxford medical college [where she worked at the time] were arguing that this simply should not be subject to the market system the same way other things are. But it is almost impossible to have that discussion in this country without people freaking out."

Mitchell responded that he thinks the problem with medical care in the United States is that it is not market driven; 90 percent of medical care in the United States is paid for by someone other than the consumer. "If you had a true market system, you might actually do a lot better." Messick asked if this situation creates a "free-rider" problem, to which Mitchell replied, "The lawyers and drug companies are along for the ride big time. The drug companies charge pretty much whatever they want, and the lawyers are suing everybody in sight. The doctors order lots of medical tests just to protect themselves. I think the system is massively inefficient. A more market-based system where patients were responsible for choosing the cost and quality of their care could be a lot better."

"We have gotten off on the wrong track somehow. We are the only major Western nation that doesn't have some kind of universal health care."

Messick

Cameron suggested that if the consumer had more information about what doctors charge, and how it relates to their effectiveness, it might help better control costs. "That's part of what America's Health Insurers Plans is hoping happens with HSAs [health spending accounts]—people will start having an incentive to pay attention. . . . But it is not going to be effective unless you start getting information out there to tell people how effective this doctor is and how much that doctor charges."

Chris Schwarzmann and her husband, Mark, the Senior Vice-President of Insurance and Annuities at American Express Financial Advisors chat with Jim Mitchell, host and sponsor of the Mitchell Forum, at a reception celebrating the close of the Forum.

Messick agreed, but insisted that more could be done. "We have gotten off on the wrong track somehow. We are the only major Western nation that doesn't have some kind of universal health care. Even if it is minimal, even if the treatment isn't as good as we would like it to be . . . some for the people that don't have any is better than none. We have to figure out some way to pay for it. Certainly, it is not the responsibility of any given company to risk bankruptcy to try to resolve the problem."

QUESTION 3: What Drives You to Be Ethical?

Laura Nash asked the participants if they could identify the factors that contribute to their concern for ethics in their companies.

What do you tell people who would say anyone who is loyal today to a business organization is a fool?

Bowie

What is it that gives you strength, stability, and vision to follow the ethical courses that you have been talking about? What is the satisfaction, moral satisfaction and professional satisfaction, that drives your sense of yourself and your responsibility? What sustains you personally, knowing you're doing the right thing? What prepares you for these hard dilemmas? What prepares you in terms of your idea, your model of success? How do you benchmark success?

Schwarzmann referred to the concept of sustainability he had mentioned earlier and emphasized that effective team building is key. "My guiding principle is that I'm going to leave the company better than I found it. . . . I could reconstitute any one of my teams over time in a heartbeat tomorrow if I wanted to, because the approach that I take to my job and the way we collectively do our jobs is one that breeds loyalty . . . you have to be confident enough in yourself to have a bunch of people around you who are smarter than you and then let them do their jobs. [This attitude] has served me well."

At the opening reception of the Mitchell Forum, Judy Messick (left) and her husband, David Messick, Professor of Business Ethics at Northwestern University, with Rene Kanter and his wife, Joanne Ciulla, from the Jepson School of Leadership at The University of Richmond.

Schwarzmann added that integrity—demonstrated by doing the right thing for the consumer—is a "baseline" for his company.

When Nash asked how that gets done in practice, Cameron noted the importance of following models. His is a family business, so his family name is connected with it. "I saw how my father and my grandfather went about their business. If the company doesn't pay a claim that it should pay, it reflects personally on you. . . . So it isn't about business, it's about family, it is about honoring my father's and grandfather's memories and my own reputation in the community. At the same time, it's building an environment that I hope my kids will want to be part of."

Cameron continued, "I'm a product of wonderful parents who taught me a set of values that I have lived by. . . . What gives me the confidence and the strength to deal with what is a tough job is the fact that at this time, at this place, I was the one who was called to step forward.... With good people, with a strong sense of values, with the sense that I have been called to be there, for me the pieces fit together."

So for him, too, there is the challenge to maintain the sustainability of the business—keeping that triangle [of stakeholders' interests] in place. "Part of my job is to not mess up the balance. If it gets a little bit out of whack, I try to help get it back on track."

In defining success, Johns emphasized the importance of core values, and how they sustain an executive even when business goes bad. "I have evolved over time a set of principles and views about how a business should be run that is good for the three constituencies.... Consistently applied, they should work.... In the next year if the market collapses, and we have some huge unexpected losses in the investment portfolio, I may be in the newspapers as a dog, but I won't feel that bad about it." Leaders who bring a long-term sustainability to the business will have a "generosity of soul," as opposed to those driven by "fear and greed and scarcity," he added.

"My father never made a lot of money, but it was his word that really represented who he was.... He always taught us that the moral values that you established for yourself...[is] the brand that you end up carrying."

Hildebrand

Hildebrand agreed with the concept of following models. "My father never made a lot of money, but it was his word that really represented who he was and what he stood for. He always taught us that the moral values that you established for yourself—the word that you give—[is what] you will live with for the rest of your life and the brand that you end up carrying." That translates into doing what is right for the customer, he added. "You have to define what you have for the public. You have to make sure that you honor what you promised, and if you want to be there for the next hundred years, you have to walk your talk. What's important is that we walk our talk."

Mitchell stressed the concept of internal values. "It comes down to who I am. As I was growing up, I saw people doing things I thought were wrong, but it didn't seem to bother them. Eventually, the answer I came to was—it doesn't matter why those actions don't bother them. If I did them, they would bother me, so I can't do those things."

"It is terrific to hear from five companies that are really actively working to create every day the kind of culture that encourages people to do the right things."

Mitchell

QUESTION 4: The Doomsday Question: Will the Financial Services Industry Survive? Is the "long-term" view that involves trust and loyalty passé?

Norm Bowie raised the question of whether the financial services industry—an industry that relies on the long term, trust, and loyalty—can survive in an age that emphasizes short-term results.

Your investment in your people is all long term. And yet we are a totally short-term society now; it gets worse and worse. Since Enron and WorldCom, it has been 4 years of unrelenting scandals across all of American business. Students say, "Why should we trust anybody?" And after the students have had enough finance, they look at employees simply as a cost. When things go south—what is the biggest cost? Employees. Fire them, downsize. What do you tell people who would say anyone who is loyal today to a business organization is a fool? You need long term, trust, loyalty—and those are exactly the three values that American capitalism most devalues now.

The executives agreed that there is a dichotomy between long-term and short-term results in financial services today, with some companies having capital structures that favor the long term, while others less so. Gilbert noted, "I remind our people that we are going to be competing in the marketplace against organizations doing things on a short-term basis, and that instills discipline in what we do. But we do have an advantage of being able to take a long-term perspective without getting caught up in the quarterly thing—we can't lose that perspective."

The industry still "vigilantly" guards the importance of trust, Gilbert added, noting that with recent "defaults" in ethics, it still has an enviable record of taking care of customers. Although employee loyalty is desirable, he understands the necessity for, and problems with, downsizing a company. "I have seen people who all of a sudden find themselves without a job. That is not a pleasant place to be. . . . Loyalty is nice, and we will do as good a job as we can. But the reality is we cannot guarantee someone lifetime employment in our organization. But that doesn't mean that we don't honor the service that they give to us when they are with us. It doesn't mean that we can't help them grow and develop."

Hildebrand said the industry has "exciting" opportunities ahead, noting that the population as a whole is underinsured. "We will have to reinvent ourselves in some ways. We are positioned for the long term.... Our differentiator as a company is that we have been able to maintain a brand. We have been able to stay out of the paper in a lot of these scandals, and we have a field force that is very loyal to the life insurance business, to New York Life."

"...It is very seldom you have loyal customers that you have high employee turnover, because the employee touches the customer."

Johns

Johns said investors are more interested in the long term than one would expect. "Our shareholders are surprisingly interested not in what we are doing today but where we are going. Most are investing their money over a long period of time. We have the big mutual fund companies. They want to find a place to park money to keep it for a long time. They have been markedly forgiving when we missed our numbers as long as they had a sense that we were honest about what our problems were and we had a plan to deal with them."

He also noted that loyalty to customers is tied to loyalty to employees. "To have customer loyalty, you must have employees. It is very seldom you have loyal customers that you have high employee turnover, because the employee touches the customer." He also described a recent layoff at his company. Although it was necessary, the departing employees appreciated the care with which they were treated. "You did it as well as it could be done, you treated me honestly, you told me the truth, you gave me severance, you tried to find me another job, you tried to give me placement, you treated me that way even though you are retiring me—I'm not a throwaway."

Mitchell concluded this segment by hailing investors who have the long view. "You want investors who understand that you are building value over the long term and that you might miss by a penny or two in a given quarter, but you will deliver over time."

QUESTION 5: Is Executive Compensation Just?

In the last of the academics' questions, George Brenkert asked about U.S. executive compensation trends and how they compare to business cultures abroad.

"That's a real core issue in American society right now—that we don't have a framework for establishing executive compensation perceived as being just, as being fair.

Johns

What thoughts do you have with regard to the current state of executive compensation? How does it compare here to the rest of the world? In what ways is this a question of governance? Where do you think this ought to go in terms of the question of justice?

The other question is, how should we [*as academics*] *be thinking about it? MBA students don't think so much about the things that you are talking about in terms of success. They are in it for the big bucks. How can we get MBA students thinking about [the ethical] aspect of success in business?*

Johns replied that compensation systems have gotten out of line.

"I personally think that something has gone badly wrong in executive compensation in the United States in the last few years. . . . I think you should be well paid to run a major enterprise; [it takes a lot of skill and talent to do it] but I don't think that the relative value of most corporate CEOs is equivalent in proportion to the contribution of the entry-level worker." With the Enron and WorldCom scandals, the result is "huge distrust" and a "backlash," particularly when the executives involved are not successful in running the business.

He noted that a system for determining the right level of compensation is missing. "That's a real core issue in American society right now—that we don't have a framework for establishing executive compensation perceived as being just, as being fair. It is creating some of the problems."

David Messick, William Cameron and Phillip Hildebrand engage in discussion during the Forum.

Gilbert concurred that executive compensation can be "out of whack," but that some executives do a lot to use their wealth for charitable purposes, so people should not be quick to judge them.

Mitchell reminded the group that escalating CEO compensation arose from an attempt to regulate compensation, when corporations were precluded from deducting cash payments of more than $1 million. The result: stock options on a massive scale. "Let's be careful if we are going to try to fix that, about how we fix it. The issue with stock options wasn't entirely the notion of options; using stock options to compensate a CEO is appropriate. What is inappropriate is allowing the CEO to exercise those options and sell immediately, which led to the Enrons and WorldComs. Let's hype the stock up to a point where we can all exercise our options and bail out."

Mitchell's remedy would be to use a combination of restricted stock, performance shares and some options, together with a requirement that senior executives hold large amounts of equity as long as they are employed by the firm. "If you, in fact, create long-term value for the shareholder, you get a reasonable payment, and if you don't, your options aren't worth anything." Mitchell said he believes that boards of companies are starting to look more critically at this issue.

Cameron agreed with Mitchell's approach. "You ought to be compensated with stock or stock options that run out when you retire or when you leave the company—and not something that you can exercise every quarter or play the market on." Fairness in executive compensation will be perceived as being fair to other employees, who then will be more likely to treat customers fairly, he added. The result: a better corporate reputation in the market.

CONCLUSIONS

To conclude the Forum, Jim Mitchell asked the participants what they learned from the dialogue and what they will reflect on tomorrow.

George Brenkert said, "What I will think further about is the relationship between the values that the executives articulated and how they fit into their particular decisions they talked about in the cases."

Norm Bowie said he was pleased to see how the group thought about capitalism in "a broader sense," particularly because his MBA students are increasingly asking "the big questions." Since his teaching experience does not expose him to a lot of insurance-related cases, he appreciated the opportunity to learn more about that industry.

Mark Schwarzmann thought that the intriguing aspect was reflecting on the notion of trust "as we try to move our distribution and manufacturing arm in the direction of taking the high ground."

Laura Nash, who participated in the first Forum in 2001, remarked on how much the industry has changed since then. She was glad to see executives focused on a long-term perspective. "I actually feel optimistic about a dialogue of leadership occurring in business right now."

David Messick also said he enjoyed the case dilemmas and encouraged all to participate on key questions in the future. Turning the dilemmas into full cases would be invaluable for the academics' use in the classroom.

Bill Cameron said he appreciated the opportunity to reflect, as well as to hear how other companies are handling ethical challenges. "I think this has been a good opportunity to think about things that you wouldn't think about otherwise in those terms. These [other executives] all have much bigger companies. It has been great to learn from them."

Phil Hildebrand benefited from hearing about what his colleagues are doing and their opinions on such matters as disclosure. "I wasn't aware that [the Forum] was so direct, that it would come together and everyone would openly put it on the table."

Johnny Johns said he appreciated the reflection time. "It has inspired me to spend more time disengaging from the day-to-day activities that we all engage in and spend more time contemplating things and reflecting on what this life I lead is all about. It has given me a great chance to go back to a lot of fundamental principles that I have carried with me but sort of lose touch with sometimes."

John Gilbert enjoyed the mix of people and the resulting discussion. "I think there was a rich diversity in terms of where academics come from, in terms of some of their themes, that brought a richness to the discussion." The program made him think about what he could do better as the head of his organization, particularly as he plans to retire.

Joanne Ciulla said, "One of the things I have learned over the years is how wonderful it is to seek good leaders and hear about leadership. Listening to your stories I have a greater appreciation of this. The cases were a really strong point. Bill's solution demonstrated what we call 'moral imagination'... how to creatively do the right thing in your business. Yours was one of those 'Ah hahs.' I think we can all learn from those."

Ron Duska thanked the participants for attending and said he drew a "renewed optimism" from the day's discussions. "I don't get that much chance to talk to executives—I talk usually to people out in the field, the agents—so it is nice to get a different perspective. I was grateful for the discussions of the Marsh disclosure issues, the agency issues, things I'm wrestling with. It is good to get your feedback. I come away invigorated."

Jim Mitchell wrapped things up. He said he and Linda started the Forum five years ago with great optimism. In spite of the fact that one of his colleagues suggested at the time he was "tilting at a great big windmill," he has always felt the session was an opportunity to see companies do more to actively foster ethical cultures, rather than focus mainly on complying with regulations.

"It is terrific to hear from five companies that are really actively working every day to create the kind of culture that encourages people to do the right things. I also very much appreciate the contribution that our philosophers have made. You guys ask great questions, and that's half the battle, because if we are not asking the right questions, we are not going to get the right answers." ■

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