PERSPECTIVES ON ETHICAL LEADERSHIP 2006

sixth 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

FORUM ON ETHICAL LEADERSHIP

The sixth annual James A. and Linda R. Mitchell / American College Forum on Ethical Leadership in Financial Services took place January 14, 2006, in San Antonio, Texas. The event featured debate of key issues confronting the financial services industry along with examination of practical ethical dilemmas encountered by executives during their careers and questions raised by business ethicists from major colleges and universities around the country.

Participants

THE PRACTITIONERS

C. Robert Henrikson, Chairman, President, and Chief Executive Officer, MetLife, Inc., New York, New York

Fred S. Hubbell, Member of Executive Board, Chairman of ING Insurance, Amsterdam, The Netherlands

John H. Jacobs, President, Chairman, and Chief Executive Officer, Union Central Life Insurance Company, Cincinnati, Ohio

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

Mark R. Thresher, President and Chief Operating Officer, Nationwide, Columbus, Ohio

Dona D. Young, Chairman, President, and Chief Executive Officer, Phoenix Companies, Hartford, Connecticut

THE ETHICISTS

Norman A. Baglini, Professor of Risk Management, Insurance and Business Ethics, Fox School of Business and Management, Temple University, Philadelphia, Pennsylvania

Archie B. Carroll, Professor Emeritus and Director of the Non-Profit Program, Terry College of Business, University of Georgia, Athens, Georgia

Joseph R. DesJardins, Professor of Philosophy, College of Saint Benedict and Saint John's University, St. Joseph, Minnesota

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

Patrick E. Murphy, Professor, Department of Marketing, C. R. Smith Co-Director, Institute for Ethical Business Worldwide, Mendoza College of Business, University of Notre Dame, Notre Dame, Indiana

Patricia H. Werhane, Ruffin Professor of Business Ethics and Senior Fellow of the Olsson Center for Applied Ethics, The Darden Graduate School of Business Administration, University of Virginia, Charlottesville, Virginia, and Wicklander Chair in Business Ethics and Director of the Institute for Business and Professional Ethics, DePaul University, Chicago, Illinois

Executive Summary

EXECUTIVE SUMMARY

On January 14, 2006, a group comprised of six executives ("practitioners") and six academic ethicists ("philosophers") assembled in San Antonio, Texas, for the sixth annual James A. and Linda R. Mitchell / American College Forum on Ethical Leadership in Financial Services.

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

1) To give the executives an opportunity to reflect on ethical issues they face on a regular basis, with questions posed to them by academics engaged in business ethics education.

2) To give the academics the opportunity to discuss these issues face to face with top-level executives to hear how they grapple with these issues, so they can bring that experience back to their classrooms.

LIFE SETTLEMENTS

Following introductions of the participants and discussion of their goals for the day, the first topic discussed was life settlements. A life settlement is a vehicle through which a policyholder can sell his or her life insurance policy to a third party for a higher price than the cash surrender value of the policy. Sales of life settlements have exploded from just $2 billion in 2002 to an estimated $19 billion in 2006. This has created a secondary market for policies that is challenging to the financial services industry on both ethical and financial grounds.

Some executives expressed their concerns about the emergence of life settlements as a significant threat to the life insurance industry. A life settlement turns a life insurance policy, which is intended to protect against premature death of the policyholder, into a financial instrument that is owned by an entity which has no insurable interest in the life of the insured. While life settlements might appear to serve the short-term interests of individual customers, they could harm the long-term interests of customers as a group if the consequence is that affordable life insurance policies become more difficult to obtain. Discussion ranged from what was wrong with life settlements to what was right about them, since insurance policies, along with being instruments that protect from risk, are also property that the long-term owners should be able to sell if they wish.

Participants acknowledged that life settlements are already a fait accompli, and the conversation turned to considerations of how to handle them. Companies vary in their responses. Some companies choose not to deal with them at all, while others do so only on the request of customers. Some participants feel that disclosure needs to be more transparent and that marketplace practices need to be regulated more stringently. Overall there was a clear consensus that companies need to be engaged in developing responses to life settlements.

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EXECUTIVES' ETHICAL ISSUES

In this segment of the Forum, the executives each presented an ethical situation or problem that they had encountered in their careers. The first issue discussed was how to align an organization so that it meets the needs of its customers, while at the same time meeting the needs of employees and owners. The second issue revolved around the issue of encouraging ethical behavior within companies, not only at the top level but also at the middle management level. The third issue involved how a multi-national company reconciles different rules and customs in different countries. A fourth issue dealt with how to communicate a different vision for a company when you decide you need to change corporate strategy and merge with another entity. The final issue raised by the executives dealt with the question of how to handle employees or agents who have broken the rules of the company, especially those who were top producers.

ACADEMICS' QUESTIONS

In this portion of the program, each of the academics posed a question for the executives. The initial question was how the financial services industry deals with sustainability issues. The second question asked how the financial services industry is dealing with protecting privacy in light of advances in technology, and also how one sustains an ethical corporate culture when dealing with branches in other countries and cultures. A third question was how to encourage employees to have enough moral courage to push back at their executives, which is necessary if a company is to remain ethical. The next question asked how incentive programs could be designed to encourage ethical behavior rather than cutting corners. The final question dealt with the issue of exploiting customers, such as credit card companies pushing credit on inexperienced youth. What were the executives doing to make sure such activities were not being practiced in their companies?

CONCLUDING THOUGHTS

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

Introduction and Goals for the Day

INTRODUCTION AND GOALS FOR THE DAY

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

THE PRACTITIONERS

Mitchell noted that, during the course of his career, he "had the good fortune to lead a company that became the fastest growing and most profitable large life insurance company in the country." He believes that, over time, a company that has an ethical culture will outperform one that doesn't." His goal for the day was "to learn from the different perspectives that are represented, to provide an opportunity for organized reflection for the executives, and to expose the ethicists to senior executives."

Dona Young from the Phoenix Companies stated, "When I took over the company, I changed the management team and worked toward changing the culture. From my perspective, ethics has kept our organization together during a very challenging time full of change. I have seen firsthand what values can mean to an organization—how ethics can help to lead the organization through its tough times." What she wanted from the day was "to better understand how to incorporate more conscious training around values and ethics and decision-making, and how to build skill sets around making right choices in those grey areas."

Rob Henrikson of MetLife thought an ethics education is necessary "because it is very hard to know what is good and right and what creates long-term value without understanding the difficult decisions and challenges to specific products and services." Further, "having a core ethics upon which you may rely can provide you with a competitive advantage in business. It enables and forces you to analyze decisions more thoroughly, particularly those that seem appropriate on the surface, to avoid unintended consequences." He saw the day as a "great opportunity to release some of my energies without being accused of talking too much, because in the day-to-day business world, there's a lot of emphasis on doing, not talking."

Mark Thresher of Nationwide commented that about four or five years ago, changes in senior management caused his organization to take a look at its' culture. He said, "Our question has become: How do we incorporate performance values in with ethics? If we are going to get people to move throughout the organization, we need to make sure the culture is the same throughout the company." Mark's hope for the day was "to hear what others are doing and to share information about some of the things that we're doing."

Fred Hubbell of ING has spent the past seven years working and living in Europe. He sees the challenge of figuring out what ethics means when different cultures are involved. "It becomes surprisingly difficult to figure out how your ethics and your values apply in new markets with people who don't share the same views. These days, when business is conducted globally, not just in the United States, the requirements of ethics and the requirements of compliance are ratcheting up. In many cases it's done through a rearview mirror. You have to think three or four years ahead and make sure that what you do today will be able to pass the 'rearview mirror test' five years from now." Fred's goal for the day was "to learn more from my fellow practitioners as to how they are dealing with particular issues. It is also useful to figure what people outside the business think about it. It would be particularly interesting to figure out how to bring the practice and the philosophy together."

John Jacobs of Union Central pointed out the importance of ethics with regard to the financial services industry. "We are in a business that is based totally on trust. Any organization in our industry has to start with an ethical base of living up to our promises." At his company, "We've worked to create a values-based organization that helps employees fulfill their whole lives. They are then much more likely to act in an ethical way because they are not conflicted between themselves as people versus themselves as underwriters, claims persons, or whatever." What Jacobs hoped to get out of the day was to continue to learn. "I don't think you are ever done. There's always another better idea or another concept that triggers a different way to get at a problem."

THE ETHICISTS

Ron Duska of The American College, and co-host of the event with Mitchell, indicated that his position gives him a unique perspective and opportunity. "The American College is an institution that was founded with an ethical purpose in mind. [Solomon] Huebner founded The American College because he wanted to turn insurance sales into a professional practice with ethics." He was looking forward to the personal and professional reward of a day of dialogue. "Just sitting and talking with such a distinguished group will be an enjoyable day for me."

Ron Duska listens as Dona Young explains her perspective.

Joe DesJardins of St. John's /St. Benedict's strongly supported ethics training in academia. What he hoped to gain from the day's session was the experience of talking to industry leaders, which would give him credibility with his students. "The challenge of all academics with groups of students is to be able to show what they know about business. I hope today to get into more of the specifics and details that are so very important for us."

Patricia Werhane of The Darden School and DePaul University noted that "one of the things that we're concerned about at the intersection between academic institutions and practitioners is whether our message is getting out so that we're changing some behaviors." Werhane reminded everyone that "many of the recent scandals in the financial services industry involved people in the middle of organizations. How do we get people throughout organizations, particularly large organizations, to care about ethics? And how do we incorporate that in training?"

Pat Murphy of Notre Dame noted that "ethics is always important, and we've had a required ethics class in our MBA program from day one." Murphy stated that he believes the ethical tone of an organization is set at the very top. He hoped "to get more understanding of the issues these executives face in their organizations."

Norm Baglini said that at Temple University, "One of my objectives is to try to influence behavior—not by providing answers, but by encouraging my students to ask the right questions as they make decisions in the business world. Today I want to have a chance to talk about how we can help people learn how to make the right choices. I'd like to hear what's working well in your companies."

Archie Carroll of the University of Georgia said that he looked forward to hearing "how you are thinking about some of the issues you are facing in the financial services industry. I also hope we can all come to a better mutual understanding as to what each of us does and what each of us stands for. In academe, we don't always have the opportunity to sit around with executives like yourselves in an environment where a free exchange of ideas can take place."

Mark Thresher, Fred Hubbell, and Norm Baglini listen to the discussion.

Mitchell summarized the opening comments. "I'm hearing an overarching theme about how we can best help people learn to identify and deal with ethical issues in an effective way. Every decision that's made in a business context is an ethical decision in the sense that every decision requires some balance among the interests of stakeholders—customers and employees, the owners, the community—and will represent some kind of a balance of short- and long-term considerations. These decisions are central to the culture of any organization, which is why I think ethics matters to all of us."

LIFE SETTLEMENTS

Life Settlements

The participants were provided with the following information on life settlements:

A storm is brewing in the life insurance industry regarding the emerging popularity of life settlements. Insured policyowners have a contractual right in many life insurance policies to surrender their policies back to the insurance company in exchange for a cash surrender value. In certain cases, settlement firms (using funds provided by a financing entity) have begun to offer life settlements, enabling the insureds to sell their insurance policies to these settlement firms for more cash than they could get by surrendering their policies back to the insurance company. Life settlements are now being promoted extensively as "innovative financial planning tools." While this might be an attractive possibility for senior citizens whose health has declined and who no longer want to leave an estate, life settlements nevertheless pose ethical and financial challenges.

OBSERVATIONS

1. Life settlements are typically available only to people over the age of 65 with life expectancies of three to twelve years, and with life insurance amounts of at least $250,000 (though that amount is decreasing).

2. It is estimated that sales of life settlements were $2 billion in 2002 and doubled to $4 billion in 2003. There is about $100 billion of life insurance in force today held by people over the age of 65 with impaired mortality.

3. The average purchase price received by the policy owner in a life settlement is some two to three times the corresponding average cash surrender value.

4. Financial advisors are being lured with large commissions to this emerging area. Advisors are not always discriminating in the advice they offer regarding life settlements, and regulation of life settlements by the states is thin. Only nine states have standards for minimum payments to insureds, based on their life expectancy. No separate life settlement broker's license is required for most insurance practitioners, and disclosure requirements are uneven across the states. The National Association of Securities Dealers believes that life settlements are securities, but they are not regulated by the Securities and Exchange Commission.

5. A financing entity provides the funds necessary to finance a settlement. These investors were originally individuals but today are primarily large financial institutions and hedge funds. These large investors pool their risks over thousands of policies, making their returns more predictable. They have no direct contact with the insureds, and do not generally need to be licensed by state insurance departments.

Sales of life settlements have exploded from just $2 billion in 2002 to an estimated $19 billion this year.
Jim Mitchell

6. Once a policy is sold in the secondary market of life settlements, it can be resold again and again. The insured has no control over when or to whom a policy is resold. The insured is responsible for making him- or herself available for medical examinations whenever policies are resold, foregoing the right to privacy about medical conditions.

7. There are significant transaction costs associated with life settlements; life settlement values are higher than cash surrender values, but substantially lower than retaining the policy until death. A 2005 study by Deloitte & Touche and the University of Connecticut found that life settlement companies paid on average only 20% of the face value of the insurance policy, while the intrinsic value of the policy averaged 64% of the face value. Of the 44% difference, only 30% represents risk and profit to the investor, with 70% going for transaction costs. Even illiquid investments such as art have transaction costs only in the 10-15% range. The 70% transaction costs for life settlements include commissions of 14% to the agent and 11% to the broker, as well as fees to the settlement firm and corporate income taxes on the transaction.

8. The Internet may already be transforming the life settlements business. "Life insurance settlement" was the fourth most expensive key-word phrase in Internet advertising during October 2005 according to USA Today, trailing only "Chicago personal injury attorney," "mesothelioma" (cancer developed by workers who inhaled asbestos particles), and "laser hair removal New York."

QUESTIONS FOR THE PANEL

1. What, if anything, is wrong with life settlements?

2. Who is potentially being harmed here?

3. Who are the culprits?

4. Does the total 70% "friction cost" of doing a life settlement transaction seem very large? Who is not getting a fair deal?

5. What facts about a proposed life settlement transaction should be disclosed? To whom?

6. What about the beneficiaries (children, grandchildren or charities) of the insurance policy? To what extent should they be involved in making the decision to sell the policy or keep it in force? Investors in a life settlement expect to make a profit after paying substantial transaction costs and corporate taxes on the death benefit. If such a transaction makes sense for the investors, might it make even more sense for the insured's family or charities to keep the policy in force?

7. A life insurance policy is a piece of property, and one can argue that the owner should *have a right to sell it to anyone. But is it good social policy to be able to sell it to someone without an insurable interest? In fact, to someone whose interest is having the insured die sooner rather than later? Should such an insurance policy continue to benefit from tax deferral on the "inside buildup" in the contract?*

8. What is the effect on insurance companies? Life insurance premiums are determined in part based on the assumption that a certain number of insureds will cease paying premiums, so that their policies will lapse rather than resulting in death claims. If the percentage of policies lapsing drops substantially as a result of the increasing popularity of life settlements, life insurance companies will make less money and perhaps even lose money. Will the financial solvency of some companies be threatened? Will insurance companies be forced to raise premiums for new policies, hurting their sales? Or will any loss of sales due to higher premium rates be more than offset by greater sales to people who start buying life insurance policies as investments with the thought of later selling the policies to fund retirements? What are the implications for retaining favorable income tax treatment on the "inside buildup" in such policies?

THE DISCUSSION

Jim Mitchell started the discussion by providing the participants with additional information about life settlements, a large and rapidly growing part of the insurance business.

"Sales of life settlements have exploded from just $2 billion in 2002 to an estimated $19 billion this year. A typical transaction involves a face amount of about a million dollars. Normally, the cash surrender value might be $100,000 for an elderly person. The life settlement amount would typically be more than double that—say $250,000. An analysis that was done by the University of Connecticut and Deloitte & Touche suggests that this contract has an 'intrinsic value' of $640,000, but the policyholder only gets $250,000. Where does the other $390,000 go? Typically, the agent will get $54,000 for the transaction. The broker will get $43,000. The life settlement firm will get $38,000. The investor will get about $120,000. And the IRS will get about $135,000. The point is, if this $640,000 'intrinsic value' is close to accurate, there are an awful lot of transaction costs. This insured person, while better off than with just $100,000 of cash value, has left a great deal of money on the table."

Joe DesJardins and Rob Henrikson listen to the discussion.

INSURABLE INTEREST

John Jacobs noted that one of the concerns about life settlements is that the policy is being sold to someone who does not have an interest in the policyowner's remaining alive. He gave some history of the concept of "insurable interest." "The insurance industry was almost destroyed in the 1800s in England because of the betting pools that bought insurance on men who were on ships. If the ship went down, the betting pool made a lot of money. This almost wrecked the insurance industry. As I understand it, that's where the concept of insurable interest came about, because the insurance industry only works when the beneficiaries of a monetary policy have more interest in the person who is insured living than dying. The minute you introduce people who have a financial interest in a person's death, not their life, we have destroyed the concept of insurance."

Ron Duska introduced a set of difficulties he saw with life settlements. "Life settlements have positive sides and negative sides. I'm interested in hearing from the executives what they're feeling about this. I know Jefferson Pilot has refused to deal in these until they perform a study of them and see what the pros and cons are. A former executive of a large company shared his thoughts with me on this. First, he believed the whole matter of life settlements was a class action waiting to happen. The companies are not moving aggressively enough to control the activities of their agents or speaking out for strong legislation regulating the practice. They are sitting ducks for class action lawsuits. Secondly, the games that are being played here put the tax advantage of the inside build-up at risk. Congress is always looking for revenue and this is the opportunity for those in Congress who have long sought to end this advantage for life insurance to take away the tax advantage.

Jim and Linda Mitchell at the final banquet.

"One more thing occurs to me: When I've talked to reps in the industry, they emphasize the fact that buying life insurance is a selfless, altruistic act. People take their own money and invest it in other people with no expectation or reward. That's the old traditional concept of life insurance. With the slow transformation of life insurance policies into financial instruments, the pure notion of altruistic life insurance is being corroded. Those are the things that bother me."

Mark Thresher also strongly opposed life settlements. "What's happening is that they're abusing life insurance by turning it into a hedge fund and an investment pool. We are against this."

Dona Young noted, "There is a moral hazard issue involved with using insurable lives as a speculative investment venture. That is fundamentally wrong. It's kind of like the 'wild wild west.' But life settlements based on a changing customer need may be different. At some point the market stabilizes, rationality is brought to it, discipline is brought to it, regulatory overlay is brought to it, and it may well be a very legitimate option from the perspective of the policyholder or customer's best interests."

INITIAL INDUSTRY RESPONSE

Young said the industry needs to address the underlying issues relating to value that have given rise to the emergence of life settlements as an option. "I think the industry makes a mistake if its first reaction is to run and hide. Who best to serve this need being met by life settlements and cut out the friction cost and give more value to customers than we who have written the policies in the first place? I don't have easy answers as to how to do it. But I think we have to challenge ourselves as an industry to not just come up with the 'no,' but to define and to really understand clearly what is driving the customer need and behavior. We should figure out what we need to eliminate and at the same time create the right dynamics for a good value proposition that serves customer needs."

Jacobs doubted whether it was necessary or appropriate to try to make life settlements work. "I fundamentally think that we as an industry make a big mistake when we equivocate and try to find a way to make this workable. Insurable interest is absolutely fundamental to our industry and if we destroy it, we're all done."

Jacobs also noted the adverse effect life settlements could have on charitable giving. "It probably destroys charitable giving because the donees do not have an insurable interest." Consider gifting life insurance policies to universities. "We've allowed ourselves to go down that road because we've assumed that universities won't go bumping off insureds so they can get their money sooner rather than later. But even with that we've moved from gifting the policy into financing the policy. Why start down that road on any basis if the ultimate result is that we end up with something that potentially destroys our industry?"

THE POLICYHOLDER'S PERSPECTIVE

Fred Hubbell raised a point in favor of life settlements. "If the insurance company can't afford to pay more than a $100,000 cash surrender value and yet the policy is worth more than that, is that ethical? There are a lot of friction costs on a basic life insurance policy. There can be more than 100% commission up front. There are still many people in this world who buy life insurance and they pay more in fees over time than the face value of the life insurance. There are ethical issues on both sides."

With the slow transformation of life insurance policies into financial instruments, the pure notion of altruistic life insurance is being corroded.

Ron Duska

Though Jacobs agreed there was legitimacy to the policyholder's point of view, he still had serious concerns from the insurer's perspective. "It's unethical to have a stranger offer to buy a policy on your life. It's arbitrage of ignorance—it's taking advantage of people not understanding."

CUSTOMERS: OWNERS AND BENEFICIARIES

Mitchell mentioned another significant group of stakeholders. "We haven't really talked about beneficiaries—they're players here, too. They could be family or they could be charities the policyowner cares about. The policy we're talking about is worth $1 million to them down the road. They are best off if the policy stays in force until the insured's death, even if they have to pay premiums for him or her."

Archie Carroll pointed out that a distinction should be made between beneficiaries and policyholders as customers. "Obviously the beneficiaries are stakeholders—here, however, they are stakeholders basically without any rights except insofar as policyholders decide they are going to be the beneficiaries. The policyholder is the customer. As Peter Drucker has said, 'The purpose of business is to create a customer, and not only to create a customer, but to maintain a customer.' "

Carroll believed that we need to focus on the policyholder as the customer. The policyholder is the owner. "If you look at it from the customer's point of view, I have a hard time seeing the difficulties many of you are seeing with this. I don't think the line of argument that it's just wrong because it's hurting the industry is going to carry the day. The way these things are judged is whether the customer is benefited or hurt by the action. Clearly, if someone will give me $250,000 for a policy rather than $100,000, I am clearly benefited by this. This is my decision. The fact that there may be some lost transaction costs out there might have some relevance to all of those people who are collecting money up and down the chain, but, in terms of the customer—and satisfying the customer is what business is about—I just don't see the problem with it."

Rob Henrikson with Pat Murphy, Joe DesJardins, and Pat Werhane at the closing reception.

WHAT IF EVERYBODY DOES IT?

Rob Henrikson pointed out the need to distinguish between thinking about the customer at hand and customers in general. What if we universalize the process?

What if everybody does it? While a particular customer might benefit from a life settlement, the consequence of life settlements in general could change the cost structure to the detriment of customers in general. "Not everybody will take that option; therefore, you can price it differently than you would if you assumed that everybody got the value of that option regardless of whether or not they decided to take the present value of that option. The issue isn't that it isn't fair for John Doe not to be able to get $250,000 versus $100,000. What we're concerned about is, if every John Doe is offered that, the entire cost structure of the business goes up and life insurance is no longer affordable."

Even if it's legal, that doesn't mean it's ethical.
Pat Werhane

Carroll commented, "I think that's a legitimate argument. This may destroy the industry and we may no longer be able to provide a good product for a reasonable price. However, I have a hard time seeing that argument carrying the day, particularly if these things are legal. They're growing by leaps and bounds."

A MARKET IN LIVES

Duska pointed out the uniqueness of life insurance. "Should life insurance be treated merely as a commodity that can be bought and sold? This is a product like no other product. This is a product that someone buys getting nothing for him- or herself, but getting security for other people."

Pat Werhane took exception to legality being the primary consideration. "Even if it's legal, that doesn't mean it's ethical." She then asked a clarifying question. "Isn't what we're doing with life settlements actually brokering lives? We all have to think about whether we want to be brokering lives. We have brokerage now for babies. If you want a good embryo, good eggs, you go online now. You can buy and sell just about anything. I find that repulsive, deeply morally repulsive. I don't care if it's legal or not."

Jacobs agreed. "Are you comfortable that there is somebody outside of this room, you have no way of identifying whom, individual or group, who'll collect a million dollars when you die? Therefore, that person or persons have a strong financial interest that you die sooner rather than later. Are you comfortable with that?"

Carroll responded that he could live with that. "There's a level in my mind that it bothers me a little bit, but, if I've made the decision that I'm going to give up my life insurance policy, and the insurance company will only pay me $100,000, and this other group will pay me $250,000, I would probably take that risk."

Things like life settlements drive the cost of the policy up three times because you're taking your premiums out of the pool and you're saying that, if you want them back, you can have them.

Rob Henrikson

Mark Thresher commented on the notion of the intrinsic monetary value of the policy. "Intrinsic value is being used to attract the investors. It's not intrinsic value to the policyholder. The investor group is going down to Wall Street saying, 'Look, if you give us money we can go in and buy this policy and we can get you a 25% return on your money because these people are going to die over this period of time, so we're going to create this kind of return on investment.' It's not the policyholder—it's the value that's being pitched in the street."

Mitchell added that the interest of the policyholder in getting the highest value for the policy might not be served by a life settlement. "As a policyholder, if I actually care about my beneficiaries, I can go borrow a fair amount of money to make payments for another two or three years and they'll have a million dollars, so that $640,000—that has some meaning to me."

PROMISES AND POOLING

Jacobs suggested that it's the "promise" that has meaning, more than the surrender value. "You ask, 'Why doesn't the insurance company give $640,000?' Well, we're not getting the cash flow of the continuing premium payments to cover that amount. The other thing we're forgetting in this discussion is the value that has been provided during the past 40 years. Had the policyholder died during that time, we would have paid a million dollars, because that's our promise. You haven't wasted your money. You bought protection, and you received that protection. There has been a lot of value provided, even if not in terms of the cash value."

Henrikson noted, "It's all about pooling. To the extent you turn everything into cash, you've wrecked the pool and then you can't provide the coverage to individuals anymore in the future. When I bought life insurance, I bought it myself over the years. I never sat down and asked, 'What is the cash value equal to the intrinsic value that some third party may be able to put on this later?' That was never part of the value proposition. The cash value was the cash value and guaranteed as such, period."

INDUSTRY RESPONSE REVISITED

Mitchell asked, "So what is the right role for the insurance company to play here? Is it just to sit back and say life settlements are evil and try to quash them?"

Henrikson answered, "I think it's to protect the vehicle for society where people can avail themselves of mortality pools and be able to contract to protect family interests. Without the pooling concept, you wreck the value proposition for the customer, and it's not just the industry looking after itself. If you believe that there's societal value in what we do, that's what you are destroying. It's not to protect my bottom line. I don't think that's the issue."

Werhane opined that even if life settlements are as bad as she thought, "It seems this train has left the station. This is a multi-billion dollar business. One of the things to think about is how to change the direction of the train—perhaps by adding a car to straighten this out. I don't think it's a right business, but it is a huge business."

Young returned to her earlier point that the industry has to examine the underlying issues that gave rise to life settlements in the first place. "We have to get back to what is going on and why. Is there a legitimate role for the insurance industry to help set policy ground rules, regulation, and so on? Each company is going to have to make its own decisions as to what, if anything, it will do in this environment. I think the heart of the issue is whether a customer can sell his or her 'life policy' for consideration if his or her needs change. We shouldn't confuse life settlements with insurable interest. The law treats life insurance a property. You can pledge it for a loan. You can transfer ownership of it. You can gift it. So why shouldn't you be able to settle it?"

Mitchell asked again, "So what's the role of the insurance company, assuming the company is trying to serve the customer?"

Young responded simply, "To meet the customer's legitimate needs."

Henrikson pointed out that the customer has conflicting needs, not the least of which is to have the opportunity to purchase affordable insurance. "Things like life settlements drive the cost of the policy up substantially. This is like saying you should carve out individual accounts from Social Security. Individual accounts are great for everybody because, if you die, you get to pass them to your heirs. Well, that's a nice thing to do, but what are the unintended consequences? You took money out of the system and now the system is going to need more money to pay people than it did before. We need to think about the unintended consequences, and I think the unintended consequence of life settlements, as the situation is unfolding, is the destruction of the pools that allow people to buy affordable insurance."

Jim Mitchell and Ron Duska enjoy the debate among the participants.

According to Werhane, "As a policyholder, what I look to is my short-term self-interest. When you begin to talk about the social cost, it is about pooling or not pooling. It's hard to get us to think outside our own self-interests. That's why I think we probably need some legislation on this because, as an individual policyholder, even though I'm transparent about it and I don't like selling my life insurance, I might do it. By approaching this from a social perspective, I think you can make a lot more legislative mileage on it. The conflicts are enormous, such that it might take more than us to resolve them."

Thresher noted, "We have to sort this out because of the risk to the industry."

Henrikson stated, "You have to assess the mathematics of it on term life insurance. Let's say somebody has a million dollar policy and he or she is terminally ill: the decision's been made for years. We go ahead and pay them $750,000 and then we make up the difference. That's happened for years. At some point, from a societal point of view, you have to ask, 'At what point does that break the value of the life insurance protection?' Pricing is key. Life settlements represent value added to the consumer, so the goal would be to compete with more aggressive pricing in our policies. The problem is you cannot compete against the life settlements industry and run an insurance company."

Jim Mitchell makes a point as Archie Carroll and Ron Duska look on.

MARKETING LIFE SETTLEMENTS

Pat Murphy shifted the conversation, emphasizing the importance of the way life settlements are marketed. "What about the individual salespeople? Many of these policyholders are older people. Some hold significant policies, but they're having some health issues. What about high pressure selling? People come in and say that this is what you get. Obviously the salespeople can be pretty convincing. What is the salesperson dynamic? Is there full disclosure of the options?"

Norm Baglini underscored the risk involved. "This has tremendous potential for abuse and tremendous potential for serious adverse publicity. The sales material can be very misleading."

Jacobs commented that life insurance companies do exercise control where they can, but it is limited. "The only control we have today is on our agents. We have told them that offering life settlements is unacceptable behavior for our company, and we just aren't going to do it, but the after-the-fact transfer of your selling your policy to the investors is very hard to track. We've had agents push back and say, 'But I could get sued for not telling my client that the option of a life settlement exists.' We have yet to have somebody give us a name of a case, but some are saying that they know of situations where attorneys have threatened that they will sue for not properly advising clients. This makes me think it's a fundamental social issue for this country to deal with."

We have to sort this out because of the risk to the industry.
Mark Thresher

Hubbell concluded the discussion with his thought that the challenge has to do with how life settlements are marketed—more to do with ensuring proper disclosure than with insurable interest. "How do we give proper disclosure to the customer so the customer knows he or she has to keep getting physicals? Maybe we need to set a life settlement up in a way that the person who buys that policy doesn't know the name and address of the person whose policy it is, if this is really an issue. If one has to get a physical, that doesn't necessarily mean that the new owner needs to know the details of the physical. That person or group doesn't need to know who the insured is.

"If we are really concerned that somebody's going to try to kill someone to collect on the policy earlier, that's an issue of management—the disclosure is manageable. The friction costs are manageable through better transparency and better disclosure. Our challenge is to realize we've got to do something about life settlements as an industry and try to figure out how to put the right parameters around it to manage it."

PRACTITIONERS' ETHICAL ISSUES

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

Issue 1: Aligning an Organization to Meet the Needs of Customers, Employees, and Owners

There must be an alignment between customer interest and our corporate needs—the way you design profitable products and processes must be part of the value proposition for your clients.

Years ago, I was asked to lead a new combined organization made up of four businesses, previously treated as silos. I asked my new team a leading question: Are we customer driven? They quickly and enthusiastically answered, "Yes!" I believe that's the wrong answer. My response was that a better answer would be that we are market driven with a customer focus. This was a new and strange message to a group of professionals who had built a franchise by being customer driven and/or customer accommodative. In our business, some even state that our most important customer might be the agent.

My point is that customer demand, however defined, can take you outside your long-term competence and commitments. If so, that demand will lead you to an inferior or flawed product and service model, which may bring apparent immediate satisfaction for the customers, who get what they want in the short term, but it might put the company in a position of promising to deliver that which will not create maximum long-term value. It is not enough merely to assess the risk of the decision to the company. We must assess the risk to the customer as well, even if their intermediaries disagree. What you ultimately deliver to your customers is who you are.

Pat Murphy stated, "If you take the customer demand to its ultimate end, you're getting away from your core competence or your company's ability to drive business. How often do you say to them, 'I don't think we can deliver what you're expecting?' Maybe some business isn't worth acquiring because the price is too high or the consequences are too great."

Jim Mitchell asked how one could systematize this kind of alignment in a company.

Rob Henrikson replied, "You've got to see the company in its activities horizontally—you can't have silos. You also need open communication. You can do this through town hall meetings, management sessions, and management workshops. Top management needs to be accessible via e-mail, the telephone. Constant communication is essential."

It's also important for top leaders to have a horizontal understanding of the organization, Henrikson continued. "A former leader of my company once stated in a company forum, 'I've been with the company 34 years, and I've never worked anywhere but the investment department.' That should never happen. It took us a while to change that culture. Today it's virtually impossible for anybody to get to any senior level in the company without having experience in different parts of the firm."

Dona Young continued with this line of thought. "One of the first things I did when I became CEO was to pick our chief accounting officer to head human resources because it's our largest expense—it's our most valuable asset—and we need a return on that investment in a most positive sense. We need to make sure that we align everything we're doing in terms of our human resources. Who do you select? Who do you develop? How do you reward? To get all of that right is essential. I felt we needed someone who really understood not only how to identify good people, good leaders, and good managers, but also the financial equation and dynamics in terms of the investment we were making."

Young went on, "We worked with an industrial psychologist with whom we still work today. It's been a journey as we make a transition into a competence culture. It has required a significant amount of time and investment, with all forms of communication paramount. We have mechanisms called CEO forums and CEO think tanks. We do cross-functional programs and activities, which involve integrating disciplines as different as portfolio management and policyholder service. It is a hard change to influence people to understand that being nice can lead to bad decisions and that taking a tough stand, making a hard decision, saying no, can actually be a very honorable thing. Competence culture doesn't mean growing at all costs. It means growing the right way. I've concluded that you are never really done with educating and communicating about culture. You are always working at it, and you've always got to bring it to another level. Perhaps most important, it's not acceptable for us to say one thing and live another because it's only by living it that you realize culture change."

John Jacobs, Linda DesJardins, and Archie Carroll converse with his wife, Priscilla, at the closing reception.

Direct ethics training can also help people do the right thing.
Archie Carroll

Issue 2: How to Manage Culture for Ethical Behavior

Here's an example of how a culture failed an organization. Let me read a headline: "Consultants Blame Culture of Trust for College Ties to Florida Diploma Mill." This happened back in the late 1990s and early 2000. A school began an outreach program for minority teachers in Florida. The person in charge was passionate about helping minority teachers. What it turned into, though, was a scam through which people received credits without having to go to class. They'd show up and get a video and that was that.

This all happened because of the existing silos. The person in charge of this program was the most trusted person in the organization. The culture of the organization was such that you didn't go around your supervisor—there was no open discussion. The registrar, who issued the credits, reported to the person who was handing out videos in exchange for credits.

It blew up recently because of a teacher in the Miami-Dade school system who needed additional credits. He approached the person in charge of this program, received a video and was asked for the payment. When he asked "But where's the class?" he was told there wasn't a class. So he blew the whistle on the program.

In this situation, the culture was what allowed the program to continue for so long. Applying this to my company, I ask, "How do I keep what's good about our culture, without ignoring the weaknesses?" My company is built on trust and good values, but we need to integrate an emphasis on performance as well. We are struggling with how to achieve that balance.

Mitchell asked, "How can we keep moving in the direction of more of a performance culture, but one that doesn't prioritize performance at any cost? How do we make clear to the organization what the boundaries are?"

Pat Werhane suggested that, "Organizations have a responsibility to train people properly to do their best. Sometimes, though, people slip through the cracks and don't get trained. Organizations have to make sure they've done their best for people. If the people make it, fine. If they don't, the organization shouldn't feel guilty about it."

Young said that Phoenix spends a lot of time training its wholesalers. One of the principal responsibilities of wholesalers is to train producers and advisors. Many programs qualify for continuing education credit. "We expect them to be the front line of quality control."

Henrikson mentioned that MetLife has developed a profitability model for their agencies. "If you think your agents are going to do everything the right way and be understanding of what the business objectives are, then you need to act in a way that reflects that you're aware of and concerned about their agency being profitable from a distribution point of view. This isn't about people trying to do the wrong thing. It's about helping them run an appropriate business model."

For John Jacobs, "Nothing is a better control than just having enough compliance people. Our compliance people tell us that every bad apple we find in the broker/dealer arena is through self-indictment. If you let them talk enough about what they do, they'll ultimately indict themselves."

Archie Carroll pointed out, "Direct ethics training can also help people do the right thing. Based on my experience, people don't always know where to draw the line, and there are a lot of gray areas out there—such as how clear you need to be about a product's characteristics."

Jim and Linda Mitchell with Ron Duska and his wife, Brenda, at the closing reception.

Issue 3: **How to Resolve Discrepancies Among Rules**

ABC Company is an insurance company with global operations. ABC has done business in a particular country for more than 15 years. During the past couple of years, a significant change has occurred, though, in that local interest rates in this country have dropped significantly. Lapse rates, normally at 10%, fell to less than 2%. At this point, many policies were underwater economically because the guarantee was so much higher than what was being earned.

Under local insurance regulations, there were no solvency or reserve issues. There were also no reserve issues under GAAP. While ABC did have internal reserve policies, it was heavily under reserved, and, according to its own economic capital rules, it was also heavily undercapitalized. At the corporate level (globally), ABC did have sufficient reserves and capital to offset the deficiencies at the local level.

The issue involved disclosure. No other local competitors had disclosed. What sort of message would ABC be sending throughout the company if it ignored its own standards? In addition, you are supposed to be transparent to regulators. On the other side, you do have plenty of global reserves and solvency.

An alternative is that you can always walk away from that business, but that opens up even more concerns.

ABC Company had a lot of discussion about this but went ahead with full disclosure. The stock market was surprised by the size of the additional reserves required. Interestingly, other international companies that operated in that country got hurt in the stock market—and some were hurt more because, in the absence of information, the stock market assumes the worst. It reinforces that the right answer was actually to make the disclosure and be upfront even though it had a lot of other implications associated with it. I think openness pays and the whole market is benefiting from it now.

Norm Baglini explained, "The job of an insurance commissioner is complicated—it is not just about the insolvency risk. One of a commissioner's primary responsibilities is assuring that policyholders are protected. Commissioners have to be careful because, when they act, it's public information. What's the first thing that happens when a commissioner takes over a company? The company loses its best customers, especially those that have alternatives. Yet, if the commissioner doesn't disclose potential problems, it could quickly become a liquidation situation."

Pat Werhane emphasizes a key point.

Jacobs expressed his concern regarding globalization. "It is true that business is different in a lot of countries and that some of those differences affect their business practices. It gets back to a key question for us: Where do your core values get left behind? If the way business is done is against your values, then you need to walk out of a country. You need to just say we won't do business that way."

Issue 4: How to Manage Changing Expectations

Our company worked hard at getting the entire organization to buy into a vision of an independent mutual insurance company operated in the best interests of the policyholders. The vision was hammered into all of us and was communicated regularly, so that people really believed in it.

We recently decided to merge with another company. The business case for doing it was compelling. It meant we could do a better job for our policyholders and for agents who choose to write with us. We would be financially stronger, bigger, more competitive, and better capitalized. For our company, it allowed us to take what was working and work it better through more capital, better *ratings, and better opportunity to take advantage of what works in the marketplace for us today rather than waiting to grow to that position on our own. A mid-sized company is fairly vulnerable in today's world. When you're facing competitors with deep pockets, you can't handle some of the dislocations that occur in the marketplace nearly as easily as a bigger company.*

But the merger meant we would have to give up our vision of independence, even though we could still be mutual. The problem was that while considering the merger, we had to do everything in secret because you can't really negotiate in public. But that secrecy meant we would suddenly walk in one day and say we're merging with somebody else, even though our vision said we always wanted to be independent.

It's difficult to manage the whole balancing act of your duty to your various constituents—policyholders, board members, employees, and the community—while you're negotiating with another company that is trying to balance the very same concerns on its end in a deal where neither party is leaving; you both have to live together after the deal as well as before the deal.

How do you keep your own personal self-interest in check, if not out of the equation? It's a very difficult process of trying to step aside in the middle of some of the more intense moments and ask important questions: Am I taking a position because it's in my personal best interests? Am I taking a position because it's in the best interests of the people of my home city? And is that really in the best interests of policyholders who live elsewhere?

Young commented, "The fact that you kept challenging yourself and asking these questions suggests that you were doing this for the right reasons. You kept getting back to the ultimate question of what's good for the company."

To a concern that initially a number of employees felt betrayed because of this vision the company had had: "It was on placards, it was etched in the wall," Fred Hubbell commented, "The only constant is change; if organizations and people in organizations don't like change and fear change, they're not going to be successful. Change is inevitable. This means that part of a lender's challenge is to get them to see that change isn't the enemy. It isn't necessarily bad. Even if we make a little turn, the basics of the values and the ethics aren't modified—we're just adapting with the environment, and we have to change."

Mitchell agreed that, through effective and open communication, "You have the opportunity to be very clear to employees about what's not going to change, as well."

The job of an insurance commissioner is complicated—it is not just about the insolvency risk.

Norm Baglini

I would argue that they're probably better off by his not being there, because it sends a clear message to them that these are your principles and these are your standards.

Pat Murphy

Issue 5: What to Do When Rules Are Broken

A leading top five salesman with an impeccable background of credentials was accused of falsifying an application for variable life insurance. The salesperson was young, about 27 years old. He was well-liked within his agency, and clearly viewed as a rising star. He had endeared himself to top management of the company as a representative of the best and brightest, just a fabulous guy.

When compliance discovered the situation, an audit of the individual's business was conducted. Two more questionable situations emerged. The salesperson was confronted, and he acknowledged that he did engage in some shortcuts. He completed the applications by signing as the insured because he was under time pressure. Since the three insureds involved were family and personal friends of the salesperson, they were willing to drop the issue. It wasn't really their problem. They said, "It's o.k. Just give us our money back. We think he might have said 'Insurance.' We weren't sure if he said 'Insurance.' We thought it was kind of like an investment, but he might have said insurance. Just give us our money back, and we'll be fine."

Agency management requested leniency because he was a bright rising star—very smart, huge future, huge potential. His fellow agents begged, literally, for him to be given a second shot. They just chalked it up to a lesson learned and believed he would be better off in the long run because he learned early. This was uncovered in January or February. It had already been announced that he was in the top five and he had his plane ticket for the conference coming up in May. What should be done?

The company's position was that compliance requirements couldn't be ignored despite personal considerations involved. This was a test of niceness versus doing what's right—not just about what feels good at the moment. The situation was reported to the NASD according to standard operating procedures. Refunds were made to the three individuals, and, despite some ambiguity regarding disciplinary actions required by NASD rules and pending their determination, the individual's contract was terminated. Obviously, he did not attend the conference.

There are many questions that can be raised here. Were there mitigating circumstances? Did the company fail in training? Was there an obligation to the salesperson that wasn't fulfilled? Did senior management have any *obligations to the salesperson, given the relationships they had established with him and the good feelings they had for him? What will be the impact of the decision on the agency? What is the risk of losing other agents from that agency as a result of the decision? What message is being sent? Is how the company does business more important than how much business the company does?*

The bottom line was that when the NASD reached a decision, they imposed a penalty on him, but didn't strip him of his license. He was not barred. Today he is a very successful agent for a life insurance company broker/dealer. He has been in the leadership of that company and, apparently, has never had another compliance violation. With the benefit of hindsight did management overreact? Did the company miss an opportunity to give him the chance to redeem himself?

Jacobs commented on the case. "There is a big difference between an act of omission versus an act of commission in a agent's behavior. You get agents that periodically do things wrong because of a lack of training or simply from making an inadvertent mistake. My company's position has always been that we have a relationship with our agents. We expect them to help us when we make mistakes, so we have to help them when they make mistakes, if those mistakes are mistakes of omission."

Werhane stated, "You are not helping someone by ignoring his mistake. If he stays with that company, he's going to do it again. I've seen this happen. When people are forgiven for these terrible things, people will do it again, because they think, 'Well, it's really o.k.' He's much better off—even though you lost a great salesperson—because he learned a huge lesson."

Young agreed. "At the end of the day, the answer was a no-brainer, really. The fact that he's doing really well in another insurance company broker/dealer isn't bad. It suggests that the consequences the first time helped him improve going forward."

Rob Henrikson , and his wife, Mary, at the closing reception.

Murphy added, "It's interesting that co-workers came to his defense; I would argue that they're probably better off by his not being there, because it sends a clear message to them that these are your principles and these are your standards."

PHILOSOPHERS' QUESTIONS

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

Question 1: How does the financial services industry deal with sustainability issues?

I'd like to hear where your industries are going with regard to sustainable futures and the environment. A number of authors of recent books have the view that we're really entering a new economic era, and it's an era in which ethical, environmental, and economic issues are brought together. The topic of sustainability and those issues play out pretty clearly in manufacturing and in retail. What's happening in the financial services industry to address that future? Are you even talking in the language of sustainability? Is it on the radar in your businesses?

Fred Hubbell said, "I think the NGO community is much more active and vocal on these issues in Europe than in North America. Most European financial firms produce a corporate social responsibility report. We happen to also be a bank, so we're a little different. There are guidelines for bank lending called The Equator Principles, which regulate the kind of lending one does in some of these developing markets. And NGOs are on top of all of this. If an istitution is out there doing something that's in violation of these principles, they are right back in your face in the press.

"In terms of the brick countries—Brazil, Russia, India, China—in the long-term view, we have no choice but to be there because of their tremendous size. That raises issues, though. There's a lot of non-sustainability in the way those economies operate, and so the NGOs are actively trying to make sure that we're alert to the issues over there, particularly on the bank lending side. Are we doing it in a way that's helpful to the environment rather than just promoting the wrong, but profitable, kind of projects? It's increasingly not a trivial issue—it goes to the heart of your activities."

Question 2: How is the financial services industry dealing with challenges of the 21st century, such as protecting privacy and increasing globalization?

An initial question involves how you protect privacy, with a key factor being computer firewalls. For example, when you have a merger, you have two sets of customers. How do you set up firewalls that protect those interests? This *is particularly problematic when huge organizations, wanting "one-size-fits-all," take over smaller operations.*

John Jacobs stated, "It seems to be a fact that the people trying to crack firewalls are always ahead of the people building them. Nothing is absolutely and totally safe except what's in your mind since it's never been written down or recorded anywhere. About the only private things are our private thoughts. But I also think that this whole cry about privacy is a little bit overblown. I'm not aware in our industry of any leaks of any importance where somebody's medical records got out or somebody finds out an address or phone number or an account number and creates havoc with it."

Rob Henrikson agreed and pointed out that, in the group life insurance business, employers "have a very difficult time building customer information files that we can use just to service their employees. Corporations typically have more information about their employees than we do, because historically they kept the life records, and we just audited them. That was to verify billing and financial experience—not to provide service to the employee."

Jacobs was more concerned about marketing data mining, which is legal. "Nine digit zip codes and transaction histories, most of which are included in public records, can tell you a lot about people: where someone would likely vacation, how much they would likely spend on particular consumer items, what their house is likely worth, and so on."

Another issue involves the ethics of organizations, particularly in light of increasing globalization. How do you train your offshore employees and how do you think about bringing them into the company—into the ethos and into the program. I think that's a real challenge, and I think some companies address it well and some don't.

According to Jacobs, "A company can create an environment—a value environment—where people's ethics don't get compromised. We don't need to ask employees to deal with ethical dilemmas involving doing their jobs versus what they think is right. The company's responsibility is to figure out how to create the right ethical environment."

Pat Werhane noted that you can't teach the "basic values that we learn as children—or that we should have learned but didn't. Once in a while we run into somebody who somehow didn't get on that page, and I don't believe we can fix that person. But I think we can talk about how to integrate values in your work so that they're

The company's responsibility is to figure out how to create the right ethical environment.
John Jacobs

part of the values you follow at home. That's why quality control really makes a difference."

Norm Baglini noted that most of the research he's seen "indicates that corporate culture, along with the input of peers and co-workers, tends to influence ethical behavior more than personal values. Given that, one of the things you can do is to state clearly what is or isn't acceptable in your company."

Question 3: How to get information and pushback from your people.

> *Moral courage is an interesting notion. One of the things I propose to my students is that companies should have multiple avenues for people to come forward when they have ethical concerns about a company's practices. Perhaps they won't confront their supervisor, but they might use a hotline or an anonymous reporting system or some other mechanism.*
>
> *I work on my students' peripheral vision. Ethical problems often do not come at you head on—but from the side. Understanding decision models and some of the theories and rules broadens your perspective, so you can see a problem coming. Part of our job, collectively in this room, is to help people go through life with an ability to recognize ethical issues. Following that suggestion, what is the biggest ethical challenge that you face?*

Hubbell agreed that, "One of the biggest challenges we have involves giving allowance to people to speak up. One thing I am conscious about is that I don't tell people just to have the smartest people around them. I also tell them to get people around them who are not like them—who have different mindsets, who think differently, and who analyze differently. Those sorts of people are more likely to challenge us. In more ways than one, the challenge is to create openness to what I call sort of civil disobedience in the organization—for people to speak up and challenge and say I don't understand it. Maybe they are right, maybe they are not, but at least they get the issues on the table."

Dona Young and her husband, Roland, with Jim Mitchell at the closing reception.

Jacobs admitted that his "biggest fear is making a decision and not having all the information. The day I became CEO was the day I became isolated from the organization. I can get all kinds of reports I want in writing. What I really want to know is what somebody deep in the organization knows, and my biggest fear is not knowing something that I should know and not being aware of it. I want to make sure that I learn about it. My predecessor used to refer to the emperor having no clothes—he wanted us to tell him if he had no clothes. When I took over I told my staff, 'Don't wait until I'm naked, tell me if my clothes don't match.' "

Continuity from one generation to another, even through times of rapid change, is valuable.
Dona Young

Dona Young added, "One of the things I worry about is our company's history. I'm one of the longest service employees of the company today, and we've reduced our workforce in three years by a third. I want to keep alive the oral history of the company, because I truly believe there are many important lessons from our history that can serve us well as we move forward. I think that continuity from one generation to another, even through times of rapid change, is valuable. We have to keep that oral history alive because it's instructive. The question is how to keep those stories going."

Henrikson worried "about opportunities we lost. We've lost markets, while we were still winning overall. As long as you're worrying about it, I think you are in pretty good shape. That's the nature of the business. You can do things today that won't show up for five or six years or longer. You can plant the seeds of capital destruction today, and it won't happen until after you retire. It's a challenge to understand that."

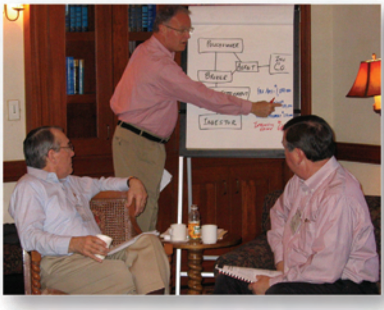
Question 4: How can incentive programs be designed to encourage ethical behavior?

Many of the corporate scandals that have taken place in recent years were driven by financial incentives, such as large numbers of stock options. Acting unethically can really cost you, as the participants in the scandals have found out. But there's still a problem with incentives: They work. How can incentives be designed to encourage high ethical behavior?

According to Henrikson, "An incentive program has to have baked into it how you do things. In our performance management system, for example, it's very possible for someone to hit all of their numbers but to receive a performance rating that is in the bottom 20% of the organization. If that happens frequently, you've got a problem with your whole organization."

Jacobs said that he struggles "with the idea of building ethical behavior into an incentive program, because I think that ethical behavior is the starting point. I don't think I would incentivize ethical behavior because that implies that, without the incentive, people aren't going to behave ethically. I don't think the problem is the incentives. I think the problem occurs when you have incentives without the qualifying language of how we expect you to behave."

Young explained the Phoenix system. "The corporate incentive pool only funds if we hit a certain target that we think is the best alignment of where we are today with our shareholder obligations. That will determine whether or not the pool is funded for everyone other than portfolio managers and salespeople. Once the pool is funded, we have a competency plan, which is a set of metrics that apply to each business. They are, for the most part, quantifiable—but there are clearly qualitative measures, too. The results are published every quarter for the entire organization, so we have full transparency about how every area of the company is doing."



Norm Baglini and John Jacobs look on as Jim Mitchell illustrates how life settlements operate.

Hubbell added, "The flip side is what doesn't get rewarded doesn't get done or gets done badly. To be effective, the program has to be willing to give somebody a zero bonus. If you don't make that differentiation on a regular basis, people won't really see the need to do the right thing. Also, there should be at least as much value on the table for the long-term incentive as there is for the short-term. It is important that, if the payoff doesn't show up in the first year, it does show up in second or third year. This will make people more inclined to make the right decisions because they will realize that they will get the benfit in the long term.

"I think that overall incentive compensation levels in this country are too high, not just in our industry, but in business in general. The numbers are so large that, frankly, it becomes too big a temptation for people."

Question 5: **How do you treat customers?**

> *One area of concern is with the possible exploitation of customers—particularly young people and older people. This already happens as banks prey upon college students. Why? Because they make more money in charges for bounced checks and other such fees. This also happens in the aggressive marketing of credit cards to students on college campuses. Are there identifiable groups that are particularly vulnerable to being taken advantage of by the financial services industry? If so, is there anything you do systematically to protect them?*

Jacobs gave an example. "I was presented last year with an idea of a product with an embedded option in it, and people said it will really be profitable. When I asked why, they said, 'Because the option will never happen.' So I asked, 'Well, why sell it? Why would you go out and have a policyholder pay for something that they perceive has value when we, being the experts, know it really has no value?' My answer was that that was wrong, and I did not approve the product with that option.

"Our industry is a little different from others because a lot of what we do is highly regulated. We are required to consider things like whether a particular sale is suitable for the customer, whether it happened for the right reasons. We need to prevent things like selling an annuity with a 10-year surrender charge to an 85-year old widow when the money going into it is all the money she has. Our industry has some built-in safeguards which, though not perfect, are there to protect against someone who is doing something that's not in a client's best interests."

Overall incentive compensation levels in this country are way too high, not just in our industry, but in business in general.
Fred Hubbell

According to Hubbell, "One of our company's values is fairness to the customer. So we spend a lot of time trying to educate our employees about what that means. We find our employees are raising this issue with us more since we have started to talk about it more and really train and educate around it. Employees are asking us, 'Now, wait a second. We're selling this policy and how does the customer get a return? Isn't it too expensive?' By having a brand out there that we have to stand behind every day and in every interaction with every constituent we have, it reminds us we need to deliver value to the customer. We're getting a lot of feedback on that very issue to make sure we aren't just going through the motions to make money, but we are also giving the customer products and services that are valuable. The brand has made it a lot easier to bring that conversation to the forefront."

Conclusions

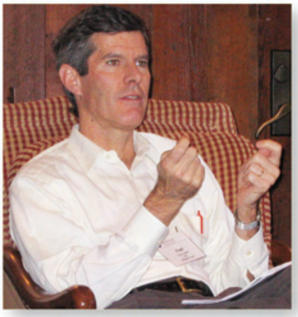
CONCLUSIONS

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

Dona Young got "the benefit of the collective thinking of a group of people for whom I gained a lot of respect. I think that enhances my ability to think through issues. I received a break from CEO isolation just by being with a different group of people in the spirit of openness. What will I reflect on tomorrow? I really want to get very concrete about how to drill down some of the ethical decision-making framework within our training program, and this is something that we are actively working on. I have gained some insights out of this dialogue to bring back."

Joe DesJardins "received an understanding of an industry of which I was totally ignorant. I think the field of business ethics tends to concentrate on issues affecting manufacturing and retail. Being introduced to an entirely new industry was important, and I heard a lot of good examples and stories that will be useful in my teaching."

Rob Henrikson suggested, "I like to think that I don't need extra courage to do certain things but, nevertheless, it's nice to be outside of your own organization to hear others talk about these same things. Even if you're thinking you would agree with what's being said, it's nice to hear from other people how they would phrase the issues and what problems they have with them. I think that's unbelievably valuable.



Fred Hubbell contributes to the ongoing dialogue.

"In my organization I use the comment that ethical issues are like crabgrass. You've got to watch them. They will always come back. That's what I worry about all the time—ways to see the crabgrass before it overcomes the good grass in the yard. It's always a challenge."

Pat Werhane thought "that people just talking freely and truly about what these companies are doing is enormously valuable for all of us. So much of what the media talks about is the bad news. I think we need to tell more good stories and, further, I think we all need to make much more fuss about these life settlements. I think that's under the radar screen. Finally, I am going to continue thinking about how I can develop courage and moral imagination in my students."

Pat Murphy said, "I think the information about your industry and your dilemmas and the examples throughout the day were very good, and I agree that the case on life settlements is one that we can take back. One of my terms is ethical business and one of my passions is how to promote ethical business. Today we had many excellent examples of ethical business. We, as instructors, need to spend more time on the good news stories in our lectures as well as in our writings."

Fred Hubbell commented, "It's helpful to see there are other important organizations in the United States that are also willing to be leaders in the area of ethics. I think that gives all of us more confidence to go in that direction. Like it or not, that's an important issue. We don't call it ethics in our company—we call it business principles. We have these principles, and we train people in them. The message I received from today is that we can be more clever about how we do it. We need to be more constant in the effort, and we need to spend more time at it, across our whole organization."

Norm Baglini acknowledged that he got to hear "a lot about the best practices that I was looking for. The scenarios from executives and the educators' questions were food for thought, and the life settlement issue really got my attention. I see this as a huge business issue. There are a lot of dimensions here, so I want to give them more thought. I'm also going to think about how we can help to develop moral courage and ethical creativity in students."

John Jacobs said, "It's challenging to hear different perspectives and reinforcing that other companies take ethics seriously—as seriously as we think we do. I got some interesting ideas."

Mark Thresher observed, "You could tell that life settlements is a very tough topic and one that we as an industry need to sort out. Another takeaway was that several of us are dealing with the same issues. How do you take the best of what you have today—a values-based culture—and insert performance values, without giving up any core values and ethics. Our industry is all about trust, and it starts with the advisor. How we train our internal and external sales forces, and how we monitor what they do is key."

Archie Carroll commended the hosts. "Jim and Ron have put together a wonderful model that more of the world ought to know about in terms of dialogue between academics and business executives."

Being introduced to an entirely new industry was important, and I heard a lot of good examples and stories that will be useful in my teaching.

Joe DesJardins

Ron Duska thanked everyone "for the insights they have shared and for the inspiration. For those of us who keep getting challenged that business ethics is an oxymoron—you are living examples that it's not. What I got out of today was satisfaction of my desire for enjoyment. I'm optimistic. I think business is getting better, and what leads me to that belief is working with people in the financial services industry. I think this is one of the most ethical industries."

Jim Mitchell concluded and said, "I fully appreciate the opportunity to engage with this fine group of people. There is a part of me that marvels that the financial services industry is as highly ethical as it is. We're selling long-term promises to consumers, and we need to be able to keep those promises decades later. Our products are complicated, with some provisions that a lot of consumers don't understand completely. We're selling through salespeople who are out there a thousand miles from home and still need to represent our values. Yet my whole experience is that most people in the financial services industry feel a fiduciary duty to do the right thing by their customers. I think it's wonderful, and it clearly needs to be reinforced. That's what this Forum is all about."

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notes

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CENTER FOR ETHICS IN FINANCIAL SERVICES

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

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

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

Linda and Jim Mitchell at the final banquet.

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