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A photograph of the Lincoln Memorial in Washington, D.C., taken at dusk. The monument is illuminated from within, and its reflection is visible in the water in the foreground. The sky is a deep blue, and some city lights are visible in the background.

PERSPECTIVES ON  
**ETHICAL**  
LEADERSHIP  
**2015**

**FIFTEENTH ANNUAL**

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



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## **FORUM ON ETHICAL LEADERSHIP**

The Fifteenth Annual James A. and Linda R. Mitchell/The American College Forum on Ethical Leadership in Financial Services took place on January 17, 2015 in Palm Beach, Florida. The event featured a discussion of several key issues confronting the financial services industry, along with an examination of practical ethical dilemmas encountered by executives during their careers and questions raised by business ethicists from major colleges and universities around the country.

### ACADEMICS

**Dawn Elm**, Professor, Ethics and Business Law, Opus College of Business, University of St. Thomas

**Robert Johnson**, President and CEO, The American College

**Christopher MacDonald**, Associate Professor, Law and Business, Ted Rogers School of Management, Ryerson University

**Donald Mayer**, Chair, Business Ethics and Legal Studies, Daniels College of Business, University of Denver

**Robert Prentice**, Professor, Business, Government and Society, McCombs School of Business, University of Texas at Austin

**Julie Ragatz**, Director, Cary M. Maguire Center for Ethics in Financial Services and the Charles Lamont Post Chair of Ethics and the Professions, The American College

### EXECUTIVES

**Rand Harbert**, Executive Vice President, Chief Agency, Sales & Marketing Officer, State Farm Insurance Companies

**James Mitchell**, Chairman of the Advisory Board, Cary M. Maguire Center for Ethics in Financial Services, The American College; Chairman and CEO (Retired), IDS Life Insurance Company

**Victoria Sweeney**, Principal, Legal, Risk and Regulatory, KPMG LLP

**John Taft**, CEO, RBC Wealth Management –U.S.

**Mark Weber**, Principal, Private Client Services, SilverStone Group

**Thomas Workman**, President and CEO, Life Insurance Council of New York, Inc.

## EXECUTIVE SUMMARY

On January 17, 2015 a group of six executives and six academic ethicists gathered in West Palm Beach, Florida to participate in the Fifteenth Annual James A. and Linda R. Mitchell/The American College Forum on Ethical Leadership in Financial Services.

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

- To provide executives with an opportunity to reflect on ethical issues they confront on a regular basis with questions posed to them by academics engaged in business ethics education.
- To afford academics the opportunity to engage in discussion about these issues with top-level executives so they can bring that experience back to their classrooms.

### ETHICAL ISSUES THAT EMERGE WHEN DEALING WITH ELDERLY CLIENTS

After the participants introduced themselves and shared their goals for the day's discussion, the conversation turned to the case study. The case centered on the situation of a financial advisor who was concerned that one of her client's children was taking undue advantage of his father, perhaps exploiting the fact that he was suffering from some form of diminished capacity. Another of the client's children, who informed the advisor that she believes her brother is untrustworthy and unstable, acutely shares these concerns.



*Don Mayer, Dawn Elm and Rand Harbert listen to Robert Prentice.*

The participants believed that most people would agree on the right course of action for the advisor to take; the advisor should follow up in some way to ensure that her client was not being exploited or abused. The real challenge, the participants agreed, was to create an environment in which the advisor would be supported in helping the client. Companies need to implement a support structure that the advisor can rely upon for guidance and to find ways to alleviate any anxiety the advisor may experience in this situation.

The participants discussed how problems posed by diminished capacity were likely to become more common, given demographic factors. They agreed that this problem was exacerbated by the fact that our regulatory system is based on the importance of preserving individual autonomy. An autonomous individual is someone who can make decisions in his or her own best interest without influence or coercion from outside forces. It is this value on autonomy that provides the foundation for mandated disclosure of all relevant information. However, individuals suffering from diminished capacity, by definition, have lost part of their capacity to process the information necessary to make decisions in their self-interest. Because the regulatory system assumes autonomy, it does not provide solutions for advisors like the one described in the case.


One of the participants mentioned the importance of the financial advisor's autonomy. Professionals, such as attorneys, physicians and teachers, are granted professional autonomy in the form of self-regulation. Members of these professions are able to develop their own standards of best practices and enforce compliance with these standards. Participants discussed to what degree the advisor could freely determine her own action and to what degree her options were constrained by layers of regulation and company policy.

The participants discussed the need for companies to provide support and guidance to the advisors in the absence of clear regulatory direction. They acknowledged that it would be easy for the advisor in this case to turn aside and fail to do what is right. The goal of any ethical organization is to make it easier for people to do the right thing. In this case, participants believed that perhaps this could be accomplished by appointing someone within the organization to be responsible for providing assistance in these cases, or by working with other companies in the industry to come up with a common solution. Participants agreed that companies will need to support their advisors on this issue, as it will only become more pressing over time.

### **EXECUTIVES' ETHICAL DILEMMAS**

In this segment of the Forum, the executives each presented an ethical situation or problem that they had encountered in their careers.

## PERSPECTIVES ON ETHICAL LEADERSHIP



The first situation concerned an executive's response to knowledge that some individuals were 'gaming' a certain part of the incentive system. This meant that individuals were acting in accordance with the letter, but not the spirit of the incentive program. In this particular case, the incentive was earned when an individual hit certain goals in terms of recruitment of new agents. While the executive liked the immediate results that the 'gaming' produced, he knew that these practices were not in the long-term interest of the organization and needed to be changed. The difficult decision was not to decide to amend the incentive system; according to the executive this was clearly the right decision. The hard part was implementing the changes and dealing with the disappointment of those individuals who had benefited from the former practices. While it was a challenging situation, the executive was buoyed by the support he received for his decision from senior leadership.

The second situation originated with the request from a valued partner, who was an attorney, to solicit quotes for a life insurance policy on behalf of one of his clients. The clients were a husband and wife who were seeking a large life insurance policy. The executive and his team submitted the information to their preferred carrier companies and were delighted when the attorney and his clients selected one of their quotes. The executive and his team 'won' the business because they were able to offer the policy at the lowest price. However, when members of the executive's team were reviewing the policy, they discovered an error: one of the clients had been rated as a non-smoker when in reality she was a heavy smoker. The mistake was clearly on the part of the issuing company and all that remained was to issue the policy and collect the premium payment. This raised a difficult question for the executive: to whom did he owe a primary obligation? While he and his firm frequently talked about how they put the client first, it is clear that he had a legal obligation to the issuing company. If he took the obligation to the client as pre-eminent, it would appear that he should simply issue the policy without alerting the company to the error. However, if his primary duty is to the issuing company, it seems that he should alert the company of its mistake.



## Executive Summary


In the third situation, an executive, who was newly arrived at the organization, was faced with the difficult task of heading up an unpopular audit of a random selection of associates. While most of the individuals selected participated willingly, there were some who did not. One of these individuals simply refused to participate and was belligerent and confrontational when the executive followed up. The individual referred to his status within the organization and emphasized the value he added through his business activities. He also made it clear to the executive that in a contest of wills, he would be the one who would come out on top with senior leadership. The executive was committed to completing the important task assigned to her, and looking at the organizational chart, followed up with several senior leaders in the organization. After their intervention, not only did the reluctant individual comply with the audit request, but was also assessed the largest-ever personal fine for his initial lack of cooperation. The response of senior leadership assured the executive that they 'had her back' and that she had made the right choice in coming to work for the organization.

In the final situation, the executive of a service organization was placed in the difficult situation of dealing with the unprofessional behavior of a company representative. The executive and his staff tried to satisfy this individual's increasingly inappropriate demands, but at



*Bob Johnson pays attention to John Taft's comments.*

## PERSPECTIVES ON ETHICAL LEADERSHIP



some point the executive believed that this individual's behavior had crossed a line and he had a candid conversation with the leadership of the company. The leaders listened to the executive's thoughtful and detailed account, but ultimately took no action to change the behavior of this individual. The executive and his staff continued to deal with the inappropriate and harassing behavior, but when there was a subsequent change of leadership at the company, the problem was at last addressed and resolved.

**ACADEMICS' QUESTIONS**

In this portion of the Forum, each of the academics posed an issue or raised a question for the group to discuss.

The first questioner was interested in learning from the executives what message about business ethics he should be communicating both to the students in his classes and the people he engages with as a public intellectual commenting on business ethics.

The second questioner offered a case study for the group's consideration. The case posed the question of the appropriate response of a money manager who witnesses the likely death of an influential CEO as a result of an airplane accident. While it may be possible to achieve quick financial gains by trading on this non-public information, is this the right thing to do?

The third questioner was interested in the group's comments on the role of capitalism in the financial crisis. He wondered whether capitalism had evolved to a system in which it was possible for people to become tremendously wealthy by taking the rewards while passing on the risk to another party, either to the government or to another market participant. He wanted to know whether it was possible to fix the culture of Wall Street and, if so, what would be the necessary steps?

The fourth questioner was interested in how to balance the benefits of social media both inside and outside of the workplace with the concern about maintaining employee privacy. Social media provides employers with a wide variety of information about potential employees that was never before available. But this desire to know more about the people we hire needs to be balanced with a respect for the



privacy of individuals. Similarly, the amplification effect provided by social media creates a broad platform for employees of the organization to comment, both positively and negatively, about the organization and its policy. How should companies respond when employees talk about them on social media?

The final questioner was interested by the fact that many of the people convicted of white-collar crimes were widely believed by their family, friends and coworkers to be very good people, that is, they were loyal spouses, devoted fathers and dedicated members of their communities. He tried to pass on the message to his students that simply being ‘a good person’ does not immunize you from the possibility that you could do bad things, things that you would not expect you were capable of doing and would roundly condemn as wrong. He was looking for additional stories about ‘good people who do bad things’ that he could pass on to his students as examples.

### **BUILDING AND MAINTAINING AN ETHICAL CULTURE**

The participants then turned to a conversation about what factors were necessary to build and maintain an ethical culture. The participants believed that both rewards and punishments are necessary to encourage the right sort of behavior. Participants agreed that in many organizations the focus remains on effective punishments, rather than developing creative ways to reward people for doing the right thing. Participants also believed that “tone at the top” was crucial. Individuals look to the leaders of the organization to show them what behaviors will be rewarded. Moreover, the participants agreed, employees are attuned to the actions of



*Jim Mitchell, Chris MacDonald and Bob Johnson listen to John Taft.*

## PERSPECTIVES ON ETHICAL LEADERSHIP

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leaders, not merely their words. They will look to see what the leaders actually do, rather than be distracted by what they say. Participants discussed the 'social mission' of the financial services industry, which is often overlooked in a barrage of negative media coverage. However, they noted that the social mission of the business, to help individuals organize their finances in a way that minimizes risks and helps them to achieve their goals, is very important. It also is inspirational to many people who choose to make their career in this industry. This is a solid basis on which to develop an organization's purpose, mission and values.

### CONCLUSION

The executives and academics all agreed that the candid sharing of opinions was very helpful. They were all grateful for the opportunity to spend the day reflecting on ethical issues and learning from one another.



"I believe that applied ethics doesn't mean that I tell you my theories and ask you to go out and apply them. It means that I bash my theories against real world problems, and then I go home and lick my wounds and fix my theories."

Chris MacDonald

"I became absolutely convinced that good ethics really is the root of good business, and that companies would be more successful with good ethics than without it."

Jim Mitchell



*Tom Workman participates in the discussion.*

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## INTRODUCTION AND GOALS FOR THE DAY

Jim Mitchell began by noting that he was fortunate to spend his career working for two highly ethical organizations, organizations that were also highly profitable. "I became absolutely convinced that good ethics really is the root of good business, and that companies would be more successful with good ethics than without it." His goal in retirement has been to promote ethical business leadership.

In terms of what he wanted from the day, Mitchell believed that it was important for everyone, but especially for executives, to take time for organized reflection. "It troubles me these days that we are all so darn busy. We don't take the time to think about what is really good and true and right. It's hard, it seems to me, to lead an organization to do the right thing if we don't take the time to think about what the right thing is."

Chris MacDonald shared that his experience, as the only philosopher teaching in the largest business school in English speaking Canada, has given him an interesting perspective on the teaching of ethics. Given its location in Toronto, his students come from a wide variety of backgrounds and many of his students are first generation students. "I try to figure out how to communicate with these bright young students who want to do the right thing, but who have to reconcile that with the fact that business is competitive. On day one, I tell them business ethics isn't about trying to figure out how to be a saint. It's about figuring out some reasonable rules for how we can get along as we compete."

MacDonald was looking forward to testing his ideas against the practical experiences of the executives. He added that part of the reason he chose to work at a business school, rather than in a philosophy department, was that he really enjoyed the interaction with business people. "I believe that applied ethics doesn't mean that I tell you my theories and ask you to go out and apply them. It means that I bash my theories against real world problems, and then I go home and lick my wounds and fix my theories."

Bob Johnson remarked that he has often thought of himself as a 'pracademic' because he has worked at the intersection of academia and business his entire career. He noted that his interest in taking the CEO position at The American College stemmed from his belief that it is, "a place where practice and academics intersect in service of the professional community of the financial services industry."

Johnson hoped that he could learn strategies to make ethical issues real and relevant to practitioners. "Part of the problem is that at times people are not even aware that a situation raises ethical concerns. There are a lot of really good people who want to do the right thing, but who aren't even attuned to the potential ethical issues that are there."

PERSPECTIVES ON ETHICAL LEADERSHIP



“The longer I attended business ethics meetings and read and wrote articles in business ethics journals, the more convinced I am that while the law is necessary, ethics is a whole lot more important.”

Don Mayer

John Taft shared that as a member of the Taft political family, he took seriously the legacy of public service and engagement for which his family is known. Unlike other family members, he took a different path that led to a career in the financial services and the unique experience of having a leadership position at SIMFA (Securities Industry and Financial Markets Association) during the financial crisis. There he had the opportunity, “to be one voice of the industry trying to respond to public and regulatory outrage around the perceived misdeeds of the financial services industry.”

He added that his latest book was entitled, “A Force for Good” and dealt with the ways in which the financial services industry could contribute to positive social outcomes. “But I don’t feel like I have a good answer as to how we can restore trust and confidence in financial markets or for how we can move from irresponsible to responsible finance. So my participation today is one of many attempts to find out from smart people how we can make these things happen. What are the actual levers you can pull and the practical steps we can take together?”

Don Mayer said that he had an eclectic academic background, having studied philosophy for a number of years before earning a law degree. His interest in business ethics stemmed from the fact that, “the longer I attended business ethics meetings and read and written articles in business ethics journals, the more convinced I am that while the law is necessary, ethics is a whole lot more important.”



Tom Workman and Jim Mitchell listen as Julie Ragatz makes a point.

## Introduction and Goals for the Day

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He noted that in our financial markets, “power and money seem to be the order of the day at this point in our history and that’s a shame.” His questions echoed those of Taft, “What I want to know is how we can restore trust in the financial industry and what would be the role of regulation in making sure that people are acting responsibly.”

Dawn Elm shared that she was driven to return to graduate school to study strategic management and organization to answer the question, “why people would do things at work that they would never do outside of work with their family or their friends?” She has been in the field of business ethics for a long time, working both as a teacher and as a consultant and feels that, “I talk and I talk and things don’t change.”

She wanted to think about how we can operationalize the idea that the purpose of business expands beyond the maximization of shareholder wealth to encompass real duties to the community and other stakeholders. “Peter Drucker is known for pointing out that profit is a result of meeting your customers’ needs and providing a solution that works for society. And we haven’t been able to communicate that idea to a critical mass of people. I hope that we can talk about different ways to do that.”

Robert Prentice shared that about a decade ago, he became interested in a field called behavioral ethics, which focused on how people make ethical decisions and is based on cognitive science and psychology, rather than philosophy. “I think that philosophy is extraordinarily important since there are still really difficult ethical issues that we need to resolve and philosophy can help us to do that.” But, behavioral ethics is particularly helpful when considering unethical behavior in business. “In the cases that you see in the newspapers, folks doing the ‘perp walk’, they did not need Kant or Mill to know that insider trading or fraud was wrong. To me, the most interesting question is how we can help people who know the right thing to do to actually do it.”

In terms of the conversation today, Prentice was looking forward, “to being in a room full of people who are interested in talking about ethics. It’s going to be a great day for me.”

Rand Harbert shared that he was lucky and proud to be a part of an organization, “that literally would choose failure before they did the wrong thing from an organizational standpoint. And that is pretty remarkable in today’s age.” He noted that he had begun his career with State Farm as an agent and later accepted the opportunity to go into leadership. “I remember thinking then, and I still think this twenty years later, that this place is too good to be true. Organizations just don’t behave this way.”

PERSPECTIVES ON ETHICAL LEADERSHIP



*"It's all about credibility. If you lose that, they will not listen to you. So ethics is really a threshold issue for your advocacy to be successful in the long run."*

**Tom Workman**

*"It is always wonderful to see what happens when you give people the opportunity to think and reflect on topics that are important to them."*

**Julie Ragatz**

Like some of the other participants, he thought that, "great people with great backgrounds and great work histories don't always do the right thing." In the dialogue today, he was interested in learning ways he could continue to help the organization improve.

Mark Weber shared that his background may provide a different perspective to the group. "It is interesting for me to see companies and regulatory organizations try to draw sharp lines between what is black and what is white. In reality, when you are actually working with clients, it is not always so easy to see the differences. At that point, you realize that ethics can't be legislated, it has to be internalized."

He added that he was heading up the Ethics Committee at his firm, which is now in its 70<sup>th</sup> year. "What is interesting is dealing with the different generational perspectives, and how individuals view ethics differently. We are trying to bridge the gap through telling stories." He was looking forward to the day because he doesn't "get the chance to be exposed to academics very often."

Vicki Sweeney noted that her organization had a "pretty mature ethics and compliance" program. A benefit of its stage of development is that the organization was able to work with both universities and professors and provide them with a sort of 'toolkit' of cases and material to help educate people about ethics in the field of accounting. "I think what is really helpful for professors are the case studies – we try to figure out a way to tell the story and make it meaningful. I think that they appreciate that."

Her hope for the event was that she could, "be a sponge and take in information." She was looking forward to a good conversation and specifically wanted to learn strategies that she could use, "to bring ethics training to life for people at every level of the organization."

Tom Workman mentioned that as he listened to everyone share their thoughts he felt that, "I've lived a sheltered life in the world of ethics. Every organization that I have been involved with has had a very high level of commitment to ethical conduct." He knew that as the leader of an advocacy organization, he needed to be perceived as ethical by all of his stakeholders. "It's all about credibility. If you lose that, they



## Introduction and Goals for the Day

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will not listen to you. So ethics is really a threshold issue for your advocacy to be successful in the long run.”

Julie Ragatz said that she was delighted to be here. “I have attended these events for the past five years and every year I am just so happy that everyone has agreed to participate.” She added that it was the participants that made each event great. “It is always wonderful to see what happens when you give people the opportunity to think and reflect on topics that are important to them.”



*Don Mayer listens to Dawn Elm's remarks.*

## CASE STUDY

**“ETHICAL ISSUES IN DEALING WITH ELDERLY CLIENTS”**

Alissa has been Susan and Robert’s personal financial advisor for a number of years. Susan and Robert have two adult children, Sarah and Elias. Elias lives in the area, while Sarah lives in a neighboring state. Both children have been involved in the financial planning process at the request of their parents. After Susan’s death, Elias moved in with Robert to provide assistance with daily living. Shortly after Elias moved in with his father, Alissa began to receive frequent requests for cash disbursements in increasingly large sums. Robert called to make these requests, but Alissa often heard Elias directing and coaching him through the calls in the background. When Alissa inquired as to the reason for the disbursements, Robert claimed that he and Elias were doing work on the house in order to put it on the market. This seemed reasonable to Alissa and she did not think much more of it until she heard from Sarah a few months later. Sarah was concerned about her father’s diminishing mental capacity, as well as his living situation. Sarah reported that, far from improving the house with the intention of putting it on the market, the house had fallen into disrepair. She wanted information about her father’s account and Elias’ role in her father’s financial decision making.



*Chris MacDonald listens to Jim Mitchell make a point.*

### THE ETHICAL CHALLENGE FOR THE FINANCIAL SERVICES INDUSTRY

The basic moral responsibility for every professional, including every financial services professional, is to pursue the best interest of the client. The basic moral responsibility for financial services organizations is to strive to create the conditions that facilitate the practitioner acting in the best interest of the client.

What does it mean to act in the best interest of the client?

- The first and most obvious answer is not to benefit yourself at the expense of your client. But this is not sufficient to meet our moral obligations to the client.
- Ethics demands a second answer—that the advisor creates the conditions under which clients are able to exercise autonomous choice.
- To act autonomously means to pursue one’s self-interest (as one understands it) in an uncoerced manner. It means to be free from emotional, mental or physical manipulation during the process of selecting and implementing one’s choice.
- The conditions under which autonomous choice are possible:
  - Not overwhelmed by emotion (either positive or negative)
  - Free from unwanted interference
  - Armed with all relevant facts
  - Relevant facts are placed in the appropriate context
  - Providing sufficient time to reflect upon alternatives
- Following this process does not ensure that the resulting decision will be what the advisor would have chosen or that it will lead to the most optimal outcome. The emphasis is on the moral obligation to create a ‘just’ or fair process.
- Paternalism is defined as replacing the client’s judgment about what is in their best interest with our own judgment about what is in their best interest.
- Financial Advisors (and other practitioners) act paternalistically in a variety of ways:
  - Failing to inform the client about other options
  - Lying or withholding information from the client or otherwise being deceptive
  - Making important decisions for the client without his or her knowledge
  - Presenting information or portraying options in a way that the client cannot make an objective decision

## PERSPECTIVES ON ETHICAL LEADERSHIP

- But, while paternalism has gotten a ‘bad rap’, many thoughtful commentators make the argument that under some circumstances it is appropriate to substitute our own judgment for the judgment of other people.

The central ethical dilemma when dealing with elderly clients is that the standard model used to promote the best interest of the client creates outcomes that may harm the client (according to a reasonable standard of harm). In other words, there is a conflict between promoting the autonomy of the client and promoting the good of (or avoiding harm to) the client.

### DEMENTIA AND DIMINISHED CAPACITY

Dementia is defined as the “loss of cognitive and mental functions severe enough to impair a person’s daily functioning. These losses reflect declines from a previous baseline, and they must include the impairment of memory and at least one other cognitive function.”<sup>1</sup>

#### Symptoms of Dementia

1. Memory Loss
2. Disorientation
3. Difficulty performing simple tasks
4. Difficulty speaking
5. Difficulty with abstract thinking
6. Misplacing items
7. Drastic mood swings
8. Changes in personality
9. Increased passivity
10. Poor judgment

<sup>1</sup> Hsu, Joanne W. and Robert Willis (2013) “Dementia Risk and Financial Decision Making by Older Households: The Impact of Information” *Journal of Human Capital* 7(4): 343

Dementia is not a natural part of the aging process. “A person experiencing typical aging will be largely independent in his daily activities, in spite of possible complaints about memory loss. A person aging with dementia becomes dependent on others for activities necessary for daily living and will begin behaving in socially inappropriate ways. During typical aging, a person may complain about memory loss but can generally recount in detail these bouts of forgetfulness, whereas a demented person would generally be unable to recall these incidents.”<sup>2</sup>

It is believed that about 50 diseases can cause dementia. However, Alzheimer’s disease is the most common form of dementia and represents 60-90 percent of all dementia cases. Currently, 5.4 million Americans are living with Alzheimer’s disease and by 2050, this number is expected to rise to 14 million.<sup>3</sup>

### DEMENTIA AND FINANCIAL CAPACITY

Financial capacity is defined as “an individual’s ability to independently manage personal financial affairs in a way that is consistent with her self-interest and long-term values.”

- Overall financial knowledge involves being able to describe basic facts and events related to one’s investments, bank accounts, and other financial arrangements.
- Performance skills are those routines and systems a person has in place so he can handle basic tasks such as writing checks, balancing checkbooks, counting money and storing important documents such as investment statements.
- Judgment skills relate to one’s ability to make sound decisions in social environments that are both familiar and unfamiliar. Such decisions should allow the person to consider his own self-interest and be consistent with his long-term values.<sup>4</sup>

Research has shown declines in financial capacity in those individuals diagnosed with Alzheimer’s. In particular, research from Marson and his colleagues in 2000 demonstrated that individuals with only mild to moderate cases of Alzheimer’s can have significantly impaired financial abilities. Marson also discovered that Alzheimer’s patients are also susceptible to rapid declines in their financial capacity as well as being more vulnerable to simple fraud.<sup>5</sup>

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<sup>2</sup> Hsu and Willis, 343

<sup>3</sup> Reif, Brandon “Protecting Vulnerable Aging Clients” *Investment News* 18(42)November 3, 2014: 10

<sup>4</sup> Rudd, Greg “Aging America: The Financial Planner’s Growing Responsibility to Older Clients” *FA Magazine* 29 January 2009

<sup>5</sup> Hsu and Willis, 344-345

PERSPECTIVES ON ETHICAL LEADERSHIP

Financial Risks Associated with Diminished Capacity:

- (1) High costs of care, including the costs of in-home nursing care and assistance with daily tasks.
- (2) Can lead to financial mismanagement.
- (3) Increase vulnerability to different forms of elder financial abuse.

**ELDER FINANCIAL ABUSE –  
BACK ON THE REGULATORY AGENDA**

According to a 2010 survey, one in every five Americans age 65 or older has been abused financially.<sup>6</sup>

People 60 years and older made up 26% of all fraud complaints tracked by the FTC in 2012, the highest of any age group. In 2008, the level was just 10%, the lowest of any adult age group.<sup>7</sup>

A 2011 study by the MetLife Mature Market Institute and the National Committee for the Prevention of Elder Abuse revealed that the financial losses suffered by victims of elder financial abuse were estimated to be at least \$2.9 billion in 2010, which represents a 12 percent increase from 2008.<sup>8</sup>

Many experts believe that the problem of elder abuse will continue to get worse. Many elderly victims who suffered financial losses during the recent downturn may be more willing ‘to roll the dice’ or more ready to believe in the false promises made by the scammers. Older adults present a ripe target for perpetrators; not only on account of their wealth, but research shows that older adults may be less able to pick up on visual cues that someone is untrustworthy.<sup>9</sup>

Representatives of the “Office of the Investor Advocate” of the SEC recently cited preventing the financial abuse of elders as one of the six

<sup>6</sup> Browning, E.S. “Financial Scammers Increasingly Target Elderly Americans; One in Every Five Americans 65 or Older Has Been Abused Financially” *The Wall Street Journal* 23 December 2013

<sup>7</sup> *ibid*

<sup>8</sup> MetLife Mature Market Institute et al. “The MetLife Study of Elder Financial Abuse: Crimes of Occasion, Desperation, and Predation Against America’s Elders (June 2011) <https://www.metlife.com/assets/cao/mmi/publications/studies/2011/mmi-elder-financial-abuse.pdf>

<sup>9</sup> Graham, Judith “Aging Brains May Miss Signs of Untrustworthiness” *The New York Times* 11 December, 2012: D5



priorities of 2015. Daniel Gallagher, a SEC Commissioner, said that the time had come to “step up our game again” after the distractions caused by the 2008 financial crisis.<sup>10</sup>

The North American Securities Administrators Association (NASAA) formed a new “Committee on Senior Issues and Diminished Capacity” to explore the problems of elder abuse. The goals of this committee, led by Montana Deputy Securities Commissioner Lynne Egan, are to assess the extent of the problem and determine a set of best practices, which may result in the publishing of a model law later this year.<sup>11</sup>

In the summer of 2014, the Department of Justice, working in collaboration with the Department of Health and Human Services announced the release of the *Elder Justice Roadmap*, a comprehensive plan to combat different aspects of elder abuse, including financial abuse.

Organizations and individual practitioners are going to need to do their part as well. Wells Fargo, for example, is developing a “Department of Elderly Client Initiative” to help financial advisors detect and prevent elder financial abuse. Other organizations are working closely with their compliance and legal divisions to offer better advice and counsel to their agents and representatives.<sup>12</sup>

But, as in many other areas of professional ethics, proper preparation can save the day and a great deal of angst. As Carolyn Rosenblatt recommends, “Policy can be created to obtain from every client a signed permission to communicate with a family member or trusted other appointed to step in when the advisor (and her compliance department or officer) has reasonably concluded that the elder is being taken advantage of financially or otherwise.”<sup>13</sup>

## THE ETHICAL CHALLENGE FOR FINANCIAL ADVISORS

### Thoughts from Practitioners...<sup>14</sup>

*“I would say the hardest stress is emotional in nature. I have also found during this process that most financial institutions are not willing to work with families even after they have a legal durable power of attorney. As much as our industry knows that this is an issue we will face more and more in the coming years, regulators and institutions are making it hard to assist the client and their families.”*

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<sup>10</sup> Schoeff, Jr. Mark “Senior Investor Concerns, Abuse Gets More Regulator Attention” *Investment News*

<sup>11</sup> *ibid*

<sup>12</sup> Ricker, Matthias “Firms Combating Elderly Financial Abuse; Wells Fargo has created a “Department of Elderly Client Initiative.” *The Wall Street Journal* 29 April, 2014

<sup>13</sup> Rosenblatt, Carolyn “Can Financial Advisors Protect Aging Clients from Financial Abuse” *Forbes.com* 25 July, 2014

<sup>14</sup> Comments taken from survey of financial advisors published on the website of *Investment News*. Please see <http://www.investmentnews.com/section/specialreport/20141106/GAMECHANGERS>

## PERSPECTIVES ON ETHICAL LEADERSHIP

*"The client will tell me everything is okay, but his actions at times are out of character. He will ask me to do something out of the ordinary, such as request a major withdrawal from his IRA to make a frivolous purchase. But then the next time I see him, he seems fine."*

*"In my experience, the client may seem to understand and be agreeable to whatever is presented, but shortly after have no recollection or understanding. They are vulnerable and trusting, therefore easily taken advantage of ... and it is imperative that we, as financial advisors, educate ourselves on effective and respectful communication, and recognize potential elder abuse – including financial exploitation – in order to best meet the social and financial needs of our seniors and their families."*

*"The children usually don't want to recognize their parents are slipping mentally, especially if the kids live out of town. We have eldercare attorneys we work with as well as several home care companies who have done a good job with our clients or their parents over the years, and we encourage the children to get involved in taking over their parents' financial affairs as their parents' mental capacity declines."*

*"We have had to intervene more than once when we felt older clients were being taken advantage of by very hard-selling salespeople pushing unneeded products to our clients. The client usually calls and requests a large sum of money from their portfolio, and we try to ask what they are going to invest in..."*

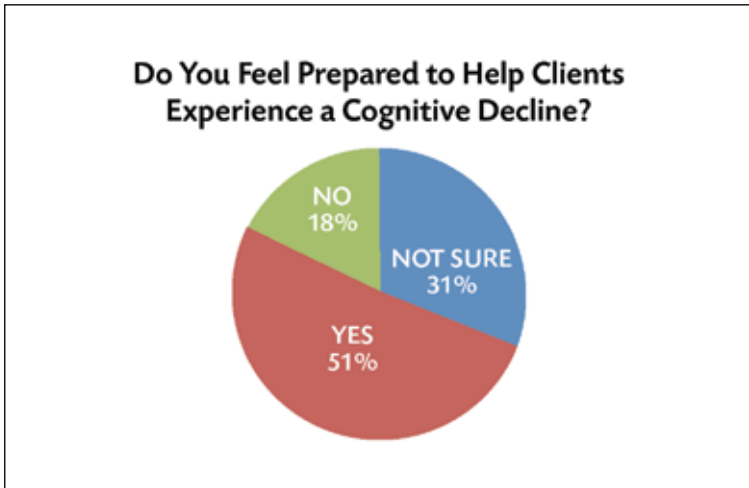
According to a survey in *Investment News*, only half of advisors feel prepared to handle clients who are suffering from a cognitive decline:<sup>15</sup>

### **STEPS THAT THE FINANCIAL ADVISORS CAN TAKE TO PROTECT THEMSELVES AND THEIR CLIENTS<sup>16</sup>**

- (1) Create a questionnaire that solicits information about the client's life stage and lifestyle beyond information required to pass a suitability review.

<sup>15</sup> Braswell, Mason "Unraveling Minds" *Investment News* 18(42) November 3-7, 2014. <http://www.investmentnews.com/article/20141103/FEATURE/141039973/unraveling-minds?issuedate=20141106&rsid=GAMECHANGERS>

<sup>16</sup>Reif



- (2) Identify other financial decision makers, particularly whether clients have a durable power of attorney in place.
- (3) Seek client updates on an annual or biannual basis, and document material changes in client's circumstances for further review with a compliance department, if necessary.
- (4) Outline changes to goals and investments triggered by various life events (such as a divorce, health issues or the need to provide financial support to children or other dependents).
- (5) Document the potentially unsuitable investment.
- (6) Train representatives to deal with vulnerable clients.
- (7) Establish guidelines for an 'enhanced action plan' that would be triggered when an advisor suspects elder abuse or diminished capacity.

Some advisors suggest that as a 'best practice' advisors ask their senior clients to sign a "Diminished Capacity" letter. The proposed text of such a letter often looks like this:<sup>17</sup>

*"It's vital that we are able to offer sound advice to our clients so they can make informed decisions regarding their financial future. In the event that we believe a client has shown significant changes in behaviors or patterns, or we have reason to believe that their financial integrity to be at risk, then we have an*

<sup>17</sup>Please see <http://www.investmentnews.com/assets/docs/CI970171027.PDF>

### PERSPECTIVES ON ETHICAL LEADERSHIP

*obligation to that client to act not only in their best interests, but also in line with their wishes. We will always respect your wishes regarding our business together and will always first try to discuss any concerns with you. To that end, we would like your input in preparation for the unlikely event that you can no longer make decisions on your own. Please provide the contact information for the individual(s) we are authorized to contact regarding concerns about your ability to effectively manage your financial affairs.”*

#### QUESTIONS

- (1) What information should Alissa share with Sarah? Should she tell her about Elias coaching their father on what to say on the phone?
- (2) Did Alissa have an obligation to investigate the situation earlier? E.g., should she have stopped by the house to see whether renovations were being done?
- (3) Should more be done to educate the public about the dangers of elder financial abuse? Who should do it?



*The participants listen as Dawn Elm shares her thoughts.*

- (4) What is the value of an early diagnosis for a condition like Alzheimer's disease? What role, if any, should the individual financial advisor and the financial services organization play in informing/encouraging this form of testing?
- (5) What should financial services organizations do to support their field representatives in identifying and dealing with these issues?
- (6) What should regulators and legislators be doing about this issue? Could there be some sort of "safe harbor" for advisors? What would that look like?
- (7) Do we agree with the conditions of autonomy presented in the Notes? Does this represent an unrealistic ideal? How does the idea of a "Diminished Capacity" letter jibe with the notion of autonomy?
- (8) Richard Thaler and Cass Sunstein in their 2009 book "Nudge" argue that it is morally appropriate and practically necessary to 'nudge' individuals into making choices that reflect their best interest through strategic manipulations of choice architecture. What are some 'nudges' that could be instituted by organizations, industry and regulators that may lead to better outcomes?



## CASE STUDY DISCUSSION

Julie Ragatz began the discussion by noting that both our ethical and legal framework is based on the elevation of personal autonomy, “and the way that we promote personal autonomy is to provide people with information sufficient for them to make a decision in their own best interest.” She added, however, that a dilemma arises when an individual lacks the capacity for personal autonomy, to make decisions in their best interest. It is very hard for both the regulatory and ethical systems to respond. But, it was important that both academics and industry leaders think about the dilemma that situations of diminished capacity pose for practitioners. “We really need to help. That is our job as senior leaders and that is our job as academics. We need to come up with a solution for practitioners. I am interested in any of your thoughts on this.”

Robert Prentice thought that most people would agree on the right way to handle this situation. “So the question is how do we make it easier for the advisor to do what we all know is the right thing. This is a really difficult kind of situation to find yourself in.”

### **The Role of Autonomy and Determining Diminished Capacity**

Chris MacDonald thought that it was important to focus on the autonomy of the other parties involved in this situation as well. “There is the autonomy of the individual advisor as a professional, which means the capacity for the person to make a decision on her own, according to her best understanding of her professional obligations. There is also the autonomy of the profession, which can either be fostered or limited by regulation. Is the financial services industry given the privilege of self-regulating or do you have to follow a bunch of rules set by the state capital or Washington?”

Don Mayer wondered whether people are able to assess autonomy. “My experience as an attorney is that you are presumed competent unless you are adjudged to be incompetent. We probably all agree that the client in the case is being unduly influenced. But, if you change the facts just a little bit, it would be harder to tell what was going on

*“In real life, there is a continuum of ability. It isn’t that you pass this point and all of a sudden, you’re diminished. People can have bad days and good days; they can have bad days with certain competencies and good days with other competencies. It is not black and white.”*

**Bob Johnson**



and how limited, if it all, Robert really is.” This additional ambiguity clearly raises the question of whether it was possible for the practitioner in this case to actually determine the client’s level of capacity.

Tom Workman noted that the standard is pretty clear for someone writing a will. “You have to ask, ‘does my client appreciate the extent of his or her wealth, the nature of his or her property, and the family members and friends who would normally qualify to receive the benefits of the assets of the estate.’ But, even if the standard client appears to be clear about this, it is up to the attorney to make the judgment call as to whether the client meets the legal standard or not. This can be a pretty fuzzy line in some instances.”

Bob Johnson noted that the situation is complicated by the fact that the bifurcation between competent and incompetent is artificial. “In real life, there is a continuum of ability. It isn’t that you pass this point and all of a sudden, you’re diminished. People can have bad days and good days; they can have bad days with certain competencies and good days with other competencies. It is not black and white.”

Workman added that part of what makes coming up with a solution to the problem of diminished capacity so difficult is that every situation presents a different fact pattern. But even given the disparity, he wondered whether we could learn something from other professions. “For lawyers, there are rules of ethical conduct and those standards are specific and enforced.”

### **Making it Easier to Do the Right Thing**

Robert Prentice went back to the issue of how we can make it easier for Alissa to do the right thing. “If I am Alissa, I am just thinking to myself, ‘why can’t this be a normal client’. You know that she can foresee that this is going take up a lot of her time and she may be fearful that she will handle it wrong and get into trouble. And so I think that the natural human reaction is to start rationalizing to say, ‘you know, maybe there is a reasonable explanation for everything that is going on here. Maybe Robert is just fine; he is just having a bad day’. We need to focus on what can be done to help Alissa do the right thing.”

Vicki Sweeney observed that Alissa is in a position where she could be forced to have some challenging conversations, both with her client and with his children. One way that the organization could help Alissa is to provide training on how to conduct these sorts of conversations. “It’s actually getting the scenarios, having people put together their thoughts and practice the conversation, so that they develop the muscle memory to have a successful conversation.”

## PERSPECTIVES ON ETHICAL LEADERSHIP



*“Just like pelicans are competitors, they are also cooperative when they need to be. Your companies are competitive with each other. But cooperating to come up with something that is a workable solution as we have an aging population, is in everyone’s interest.”*

**Vicki Sweeney**

John Taft said that when people are faced with an ethical dilemma or a tricky situation, they do not turn to a rulebook; they walk down the hall and talk to someone. “One of the things we have done with other issues is to take someone in the branch, make them a resource on that issue. Practically speaking, that approach has worked pretty well.”

Mark Weber wondered if that approach might cause some problems. “If that contact person or the point person is an employee of the firm, then he or she may have the firm’s interests first.” He shared that earlier in his career he had made an error that would have resulted in a significant loss for his client. “I called the Errors and Omission insurance carrier and basically what they did was circle the wagons, and say ‘don’t put this in writing’. So what I did was to ignore the advice, I went to the accountant involved and I went to the client and told them what happened. Luckily, we were able to reverse the transaction and undo the damage I could have done. My point is that I don’t want to talk to the company contact person to find out how to stay out of trouble and how to help the company stay out of trouble. What I want to know is how to do the right thing. ”

Sweeney thought that this was an area in which different organizations could come together to find a solution to a common problem and referred to Tom Donaldson’s work on the ‘Pelican Gambit’. “Just like pelicans are competitors, they are also cooperative when they need to be. Your companies are competitive with each other. But cooperating to come up with something that is a workable solution as we have an aging population is in everyone’s interest.”

Taft noted that not every company could or should handle the challenges posed by elderly clients in the same way, depending on their business model or segment of the market they serve. “But if you are going to try and develop a solution to be responsive to these issues, you’ve got to do it right or you will expose yourself to all sorts of problems.”

Tom Workman believed that the diminished capacity document could be very helpful. “It’s not a silver bullet, but if something like this is in place it could be presented like this: Given the fact that this is a

long-term relationship, we have to think about the future and what it could hold, so this is one of the documents that we think is appropriate for you to put into effect. It provides us some clarity around what to do when or if various circumstances arise.”

Chris MacDonald wondered about the client who simply refused to have that conversation. “Think of the client who just says ‘my mind is fine, next topic?’”

Rand Harbert said that the attorney or planner would have to document the refusal. “The obligation of the planner and the attorney would be to say, ‘we strongly encourage you to pursue this path, and if you are not willing to do so – there may be consequences’. This is a difficult situation for the advisor to find himself in.”

Taft had a question for the group, “Is it ever ethical to fire the client if he or she won’t sign?”

Prentice did not think that it was ethical for an advisor to fire the client in an ongoing relationship. “You can’t fire them in the middle of the relationship. That does not seem like a fair thing to do.”

### Take-Aways

Rand Harbert mentioned that a concern is when the children of clients come back and question the decisions that were made regarding their parents’ finances. “So Sarah, who lives in another state, comes in and says ‘why did you do this versus that? I have an attorney with me who says that you should never have done this in the first place.’”



*Robert Prentice listens to Rand Harbert.*

PERSPECTIVES ON ETHICAL LEADERSHIP



Mark Weber agreed and offered another example. “Imagine that 15 years ago you sold your client a universal life policy with a face value of \$500,000. Since then the interest rates have only gone down and now they are at 4%. The client has a choice: pay a premium that will increase 300% or stop paying the premiums. But if you stop paying the premiums, the policy decreases to \$100,000. For all the right reasons, they stop paying the premiums. But when the parents die, and the children who were expecting \$500,000 only receive \$100,000, they start asking questions.”

Dawn Elm wanted to focus on the take-aways. “It seems to me that we have some really good ideas that suggest we are really talking about something that has to be handled at multiple levels. We need better regulations about diminished capacity to provide clear guidance in terms of what are our responsibilities to individuals who have diminished capacity defined in one way. We also need to make sure that people in Alissa’s position are supported as much as possible.” Elm continued that another layer was bringing the different organizations together to work on common solutions, as Sweeney suggested. Finally, she concluded, “All those different layers all lead to a picture of where we can put some effort that would at least address some of these issues.”



*Dawn Elm, Mark Weber, Tricia Weber and Mike Norton enjoy the closing reception.*



*Mark Weber listens to Vicki Sweeney's comment.*

## THE EXECUTIVES' ETHICAL DILEMMAS

### CASE #1

*My example concerns how we drive growth in our organization. One of the strategies concerns the establishment of goals on an annual basis. As a result, we structured our compensation system to reward people based on their ability to accomplish specific objectives. The incentive system was deadline driven; you needed to meet your targets by the last day of the year or you missed your goal. The problem was that some goals worked with the natural deadline, while others did not. The results were good, but it was clear that games were being played in order to meet the year-end targets due to a poor decision on the organization's part. The lesson for me is that these types of details cannot be overlooked or there will always be negative consequences. I think this is especially true as it relates to issues surrounding variable compensation.*

Robert Prentice noted that it was the distorted incentive system at Enron that ultimately brought the company down. "People were not willing to forsake the gains from their compensation system. It was set up so that they could project what they were going to make in 20 years and then they would receive a bonus based on that figure. No one had the courage to raise their hand and say, 'This needs to change; this isn't sustainable.'"

Julie Ragatz added there are intangible harms that can result from the presence of a distorted incentive system. "The danger is that you allow a system to go on in which people are being rewarded in spite of the fact that they are clearly 'gaming' the system and at the same time, all of your language about core values seems to fly in the face of what you're allowing. When

**PERSPECTIVES ON ETHICAL LEADERSHIP**

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that happens, it undermines the ethical culture and leadership begins to look hypocritical or inept. People begin to think that either you don't know what's going on in terms of people 'gaming' the system, which means that you're inept or that you know and don't care, which means that you're a hypocrite."

Jim Mitchell pointed out the important thing is to admit that the original system wasn't working and to do that as soon as possible. "One of my former colleagues used to talk about 'failing successfully'. The important point was to 'fail fast' and to learn from our mistakes."

**CASE #2**

*Our firm received a referral from a well-respected estate planning attorney. His client was about to purchase a large survivorship life insurance policy. The proposed annual premium was in excess of \$1,500,000. The attorney suggested for a purchase of that magnitude the client may want to get a "second opinion." The client agreed. We were brought into the case along with another agent for "second opinions."*

*Virtually every major carrier was asked to look at this case and submit its best offer. Fortunately, we were able to negotiate the most favorable underwriting and delivered the lowest price to the attorney. He indicated he would recommend the client purchase the life insurance from us.*



*Julie Ragatz listens to the discussion.*



*Our staff was delighted. It was near the end of our fiscal year. The commission on the case was over \$700,000, enough to allow the staff to qualify for maximum bonuses. When the staff reviewed the actual policy from the carrier they came into my office, shut the door and said we may have a problem. Upon review of the policy it became clear the carrier misclassified one of the proposed insureds. On the application and in the cover letter we had clearly disclosed the fact that both proposed insureds were smokers. Yet, the final offer showed the wife classified as a nonsmoker. It was this error that made the difference in having the lowest priced product.*

*We had the policy in hand. To put it in force and bind the carrier, all we needed to do was collect the first annual premium, deliver the policy to the owner and have a policy receipt signed. The staff asked "What should we do?" This was a large, national life insurance company. They had been provided exactly the same information as every other carrier. Believing the carrier had made an error in pricing the contract, should we point it out to them or simply place the policy? Whose interest did we represent? We hold ourselves out to the public as representing "the best interest of the client." If the only party we should be concerned about was the client, then it seemed clear we should "seal the deal," ignore the error, and place the policy. On the other hand, according to most agent licensing agreements, the agent is an agent of the insurance company and has a legal agency relationship. Furthermore, this carrier was one we have had a 20-year business relationship with that was based on mutual trust and respect.*

*As we talked it over, we wondered if it really was in the client's best interest to ignore the error. We did not know the client. Our relationship was with the attorney. Would the attorney and client be pleased we had locked in the carrier to the lower pricing? Or would they be upset that they were somehow complicit in what could be construed as a less than ethical business transaction? What about the staff? They would likely not receive a large bonus if this case were not placed.*

*After about a half an hour of this back and forth, we decided to call the carrier. I spoke with the head underwriter and said, "We obviously won the business, but it was the result of an error in the policy and we wanted you to be aware of that."*

*The twist is how he responded. He said, "Thanks for the call, but that was not an error. It's the end of the year and we want the business. The marketing department has a budget that they can help pay for favorable underwriting concessions like this. You're one of our preferred brokers, we can't just go and give a lower price, we have to give it a rate classification. We are willing and happy to sell it this way."*

*That obviously let us off the hook, everybody won, the clients got the policy, the company got the business and everyone on my team got their bonus. But I am still not sure that I had an answer to my original dilemma, which was to whom I owed my primary obligation?*

## PERSPECTIVES ON ETHICAL LEADERSHIP

Rand Harbert remarked that another ethical issue was the behavior of the issuing company. “They may have earned the business at an important time of the year, but they weakened the position of the entire company, especially if this is not a one-off case. Imagine what would happen if this was disclosed to regulators!”

Julie Ragatz felt another element of the case that may go overlooked. “I think that the person who brought the error to your attention was kind of the ‘sleeper’ hero in the case. I am assuming that this is one of the people who would have benefited from the bonus.” She also noted the importance of the conversation the team had about what to do next. “You had a candid and open conversation with your team about what to do, keeping alive the option that you would jeopardize the sale by making that call. That would be an extraordinary conversation and conclusion in many organizations.”

John Taft believed that this was one of the cases in which good ethics was good business. “In this case, there were good business reasons for what you did. There was the integrity issue with the client, attorney, the insurance company and the employees.”

Bob Johnson noted that the CFA Code of Ethics had the advantage of dealing with duties to multiple groups; including to the client, the



*Bob Johnson, Heidi Johnson, Linda Mitchell, Kelly Harbert, Rand Harbert and Jim Mitchell at the closing reception.*

firm and the market. "I think when you start thinking about that, it is too simplistic to only consider the impact on the client. As a professional, you have other obligations, for example, to the integrity of the market and to your firm. But when these duties come into conflict, it can present a serious dilemma."

### CASE #3

*When I first arrived at the organization, one of my first tasks was to put together a compliance process to audit independence. I had to select 200 partners and tell them that they were going to be subject to an audit for independence. Since this was the first time that the organization had ever done something like this, you can imagine that most of the 200 were not very happy to have been selected. Most of them wondered why they were picked and there were genuine concerns about how their personal financial information would be protected. Some of the 200 had their binders of personal information to me within days, some people had submitted partial information and some did not respond at all. I put all of those names on a list and began making phone calls. One partner that I called went a little crazy on the phone, yelling at me, cursing and asking why we had picked him and saying that he would not cooperate. I responded that I could not make the audit notice go away, but that I would do everything in my power to make it go as smoothly as possible. He was just irate and told me to ask the Deputy Chairman how much money he made for the organization.*

*But I have to get the job done. I am not a Partner; I am only a Director and new to the firm. So new that I have to pull out the organizational chart to see who is the person who can help me get this partner on board. So, I called the professional practice partner and told him about the situation and he just said that, "he would take care of it". I wasn't quite sure what that meant, but I was sitting at my desk and the Deputy Chairman called and asked me what I thought that the problem was. I wasn't sure if he was going to be angry that I had upset such a high performing partner, but he said that he would take care of it, and in a couple of days the partner sent all of the documents I needed. As a follow up, the partner had close to a perfect audit, he clearly did not have anything to hide. But, he was still punished by the organization. The leadership levied a heavy fine on him because of his lack of cooperation with the audit process. When things like this happen, the sanctions are confidential, and they should be. What is important about the process is that there is institutional knowledge and a clear set of facts that can be shared, if necessary, with anyone who is new to a leadership role leadership role so that they are not blindsided. This takes place through the stories that leaders share with each other. You don't have to be involved or even know that is taking place.*

*I think about this situation when I think about how we want to encourage people to 'raise their hand' in the organization. We have to convince people that something is going to happen in response to the issue that they raised and that they will be protected from any backlash or retribution. The last part is very important and we take it very seriously. We track metrics to make sure that people who have had the*

## PERSPECTIVES ON ETHICAL LEADERSHIP

*courage to report a concern do not suffer any adverse consequences for doing so. For me, personally, it was an important experience because it was when I learned that the firm really had my back.*

Dawn Elm suggested that the power of stories was really important. “There is an enormous amount of research that talks about the importance of stories in building and maintaining an ethical organizational culture. This is a powerful story. What’s interesting is that obviously other people in the organization knew about the incident and the fine that was assessed. You may have not told the story, but other people did.”

Jim Mitchell mentioned that it could be difficult for senior leaders to get an accurate picture of the overall culture of the organization. Employee surveys can be helpful tools to let the leadership know what is going on. “An employee survey that is truly anonymous, and that people believe is truly anonymous, is a powerful tool. It helps you spot the problem areas in the organization. You can say, ‘Look, it seems that the team in Marketing is having some problems. We should dig a little deeper and see what is going on there.’”

Vicki Sweeney pointed out that focus groups can be helpful as well. “People really appreciate the opportunity to share their thoughts. But, you have to be responsive to their comments because people’s hopes are raised when they participate in a forum like a focus group. Some change needs to happen, even if it is not everything that they are asking for.”

Don Mayer believed that this was a good example of speaking the truth to power. “A former colleague of mine, Jim O’Toole, talked about speaking truth to power. He gave some examples where some of the best companies that he knew did not mind hearing contrary thoughts, and indeed, welcomed them. If you could make that inquiry and be backed up by the organization, it must have been tremendously helpful to your confidence going forward.”

**CASE #4**

*An interesting challenge is how organizations monitor and assess their people who act as representatives to other organizations and outside groups. In some*

“There is an enormous amount of research that talks about the importance of stories in building and maintaining an ethical organizational culture.”

Dawn Elm

*cases, it appears that there is little or no monitoring going on and that can lead to serious problems. Unfortunately, sometimes you have individuals who take advantage of their power relative to the people they are working with and engage in unprofessional behavior. I dealt with one situation like this. There was an individual who was bullying a couple of our people. Of course, we went to great lengths to satisfy this person, but as you know, the more a bully is accommodated, the worse the bully becomes. This conduct persisted for quite some time, and I finally decided that for the good of our organization I needed to take a risk and describe this problem to his leadership. It was harmful to his company because other companies saw what was going on, but they were not in a position to stop it. And since we are service providers, we were not in a position to stop it either. Unfortunately, the leaders of his company at that time chose not to try to change his conduct and the situation continued. We went back to doing our best to provide value and satisfy this person's demands and ultimately, new leadership came into office. This time, the problem was recognized quickly and solved. There is nothing new about bullying. I think that the key lesson is, it's important, particularly for large organizations, to have a system in place to assess how their people interact with others outside of the organization.*

Jim Mitchell did not believe that this was an isolated occurrence. "I would be willing to bet that this person was not just bullying people in this organization. If they had had an employee survey, I'll bet that it would have jumped out that the bully's subordinates were not happy either."



*Julie Ragatz, Chris MacDonald and Leah Selekmán at the closing reception.*

Rand Harbert agreed with Mitchell. "I suspect people who behave in this fashion don't just treat people poorly on the outside, they do it on the inside as well."

Julie Ragatz thought that the executive had provided a valuable service. "I imagine that many senior leaders would have appreciated a candid and reasoned assessment of the behavior of one of their reports, especially with documentations. You did him a tremendous favor by alerting him to a potential landmine in his own circle."

## ACADEMICS' QUESTIONS

## CHRIS MACDONALD'S QUESTION:

*I have a two-pronged question since I communicate to two different audiences: the students who take my classes and the people who read my blog on business ethics. What message or key lesson should I be putting forward to make sure that I communicate to these audiences about business ethics?*

John Taft thought that it was important for people to know that most business leaders would reject the proposition that the only purpose of business is to make a profit. "Most leaders recognize that businesses have responsibilities to multiple constituencies, including employees, shareholders, customers, clients and the communities in which they live and work." Regarding the message he believed that MacDonald should be sending to his students "it is that there is an expectation that people in business will behave responsibly."

Tom Workman believed that it was important to emphasize the public's responsibility to become informed about and involved in the legislative process. "It is critical for businesses to broaden their focus from their own business objectives and remember that they have a civic responsibility to become involved in the legislative and regulatory process. If businesses don't fulfill this obligation, our system of government and our individual liberty are at risk. In fact, I would say that it is unethical to fail to participate in the system that underpins our liberty. That amounts to taking the benefits without doing the work."

Vicki Sweeney thought it was especially important for students to know that there is one set of behaviors for the workplace and another set for private life. "While everyone wants to be friends and stay connected, the people you work with are your colleagues, they are not your friends. We try to help people make good decisions around the work/life distinction, but it is challenging. The world has moved in a direction that is riddled with complications."

Mark Weber believed it was important to be mindful of different perspectives. "People often say, in regards to ethics, that I know it when I see it, but it is more complex than that. You have to think through a lot of different ways of looking at any particular issue."

"People often say, in regards to ethics, that I know it when I see it, but it is more complex than that. You have to think through a lot of different ways of looking at any particular issue."

Mark Weber



Jim Mitchell believed that it was important for people to know that the financial services industry is full of good people who really try to do the right thing. "The mission of our Center for Ethics is to help raise the level of ethical behavior in the financial services industry. We believe that, based on our experience, the level of ethical behavior in this industry is actually quite high, but it can always be better."

### **BOB JOHNSON'S QUESTION:**

*I'm going to take this in a different direction. I want to share a case study with you and get your feedback on it. It is a vignette I utilized recently when I was a finance professor at Creighton University teaching financial ethics.*

*"A money manager is sitting in an airport bar waiting for his flight to take off. He notices a well-known CEO for a large publicly traded firm called Watershed sitting at a table nearby. The CEO is highly regarded because the firm has grown significantly under his leadership. This growth includes a significant increase in the stock price. The manager owns the stock of Watershed personally, as well as having large positions in client accounts. The CEO's plane, which takes off before the manager's plane boards, crashes on takeoff in a horrific crash that most assuredly could not be survived by any of the plane's passengers. The money manager realizes that he is likely one of the few people who know immediately that the CEO was on that plane. The money manager looks at his watch and notes that the stock market will be open for a few more hours. Can the money manager trade on this information? Is this information material? Is it non-public? If it is non-public, when does it become public?"*

*Just as a further detail: "I spoke with some regulators about this case and while, legally, he could be prosecuted, in fact, they told me, they almost assuredly would not prosecute him. The regulators are largely concerned with inside information that is obtained improperly. He is not a company insider, he is not a temporary insider, he is not a tippee or a misappropriator."*



*Bob Johnson listens to John Taft.*



## PERSPECTIVES ON ETHICAL LEADERSHIP

Robert Prentice wondered that if he did make the trade, “Is he somehow undermining the integrity of the market because he is trading with information that other people did not have a chance to get? The challenge is that he has a fiduciary duty to his clients and he has an opportunity to make money for them. If he passes that up, they could certainly be upset.”

John Taft remarked that it was usually bad business to be unethical. “You have to bring it to your reputational risk committee. You have to ask yourself what sort of reputational ‘blow-back’ could result from the action. Usually, if you skate too close to the edge, the potential for serious reputational damage outweighs the initial gain.”

Julie Ragatz added that when you talk about reputational risk, you’re actually talking about ethics. “When you talk about reputational risk, you’re usually saying one of two things: if the public knew the true story, what would they think of me or what would they think of the organization? Or, you’re asking: given what the public will likely hear, whether it is true or not, what would they think of me or the organization?” But what the public thinks is based upon the shared social and ethical norms of that society. “You’re putting outside eyes on our actions and those eyes are making an ethical judgment about your behavior.”



*Jim Mitchell and Chris MacDonald listen to the discussion.*



Rand Harbert listens intently to Robert Prentice's comment.

### **DON MAYER'S QUESTION:**

*"I'm concerned about the drift that I see in our understanding of what capitalism is and the duties that the system imposes on both individual and institutional participants in the market. It seems to me that the business model that led to the financial crisis was to do what you could to take the rewards upfront and pass the risk to another party. The individuals who picked up the tab when this model wrought havoc on the world economy are not the ones who benefited from it – the people who picked up the tab did not work on Wall Street. I am not sure whether the culture of Wall Street was always like this, but how can we fix this culture and this business model? What should capitalism mean and what sort of duties should it impose on people and institutions who participate in it?"*

Bob Johnson thought that part of the problem was the increasingly complex nature of financial products. "When I did my doctoral work in the 1980s, financial instruments were really pretty simple. At this point, the ingenuity of investment bankers often exceeds the ability of financial professionals to understand those financial instruments. Very few people have any idea what they are buying and selling."

Rand Harbert wondered if that was the point. "Maybe the creators of such instruments don't want people to understand how they work."

John Taft noted that he had spent a lot of time thinking about these issues. "Capitalism is an enabler; we get the sort of capitalism that we want." Taft noted that society became used to the growth rates of 3% after World War II, "and the only way you could consistently get those growth rates was to start employing leverage." He continued, "So, in some ways, we got what we wanted, only we didn't fully understand what the consequences could be." Taft added that society is in the process of determining what version of capitalism it wants, and trying to bal-

PERSPECTIVES ON ETHICAL LEADERSHIP



“Society is in the process of determining what version of capitalism it wants, and trying to balance the desire for growth with the desire for stability. But, until we can reach agreement on this issue, we cannot put the right regulatory system in place.”

John Taft

ance the desire for growth with the desire for stability. “But, until we can reach agreement on this issue, we cannot put the right regulatory system in place.”

Dawn Elm agreed with Taft. “In essence, it requires completely rethinking what we want the system to do for us. This is not just an issue for Wall Street.”

Julie Ragatz agreed that the system was certainly designed to achieve growth, but she noted that not all companies did this in the same way. Some companies were more reckless than others. “It seems to me that part of the disillusionment of the American public is that the organizations were not held accountable for the poor decision making. Not all companies got mired in the mortgage backed security mess, not all companies engaged in reckless lending practices. The companies shouldn’t be looked at as passive actors.”

**DAWN ELM’S QUESTION:**

*“One of my areas of research is the role of social media in the workplace and how we balance the use of social media with concerns about maintaining privacy. The ethical question is whether the information you can now find out*



*Mark Weber considers Vicki Sweeney’s remarks.*

*about people, much more easily than you could before, is relevant to the skills and competencies they need to do their job well. Another ethical issue concerns the use of social media at the organizational level; how should companies respond when employees refer to the organization on social media? There are discussions about the duty that employees have not to say anything derogatory about their employers on social media, but then this can raise the question of what is derogatory. My question for all of you is what kind of things you would do in your organization to find some kind of balance between the use of social media inside and outside of work, and taking into account privacy considerations and any responsibilities that the employee has to the organization."*

One participant shared that their company had a very specific policy as it relates to this topic. "We make it very clear that individuals are to never speak for the organization, pro or con, on social media." But he was also interested in the use of social media to expand business opportunities. "It is possible to access all sorts of data on life events, when people get married, when they move, when they have children. The question is where the appropriate line is as it relates to gaining information to make a sale?"

Vicki Sweeney noted that her organization did not have a social media policy per se, but we do have a set of guidelines. "Good judgment regarding social media is covered in our HR policies, risk management and Code of Conduct." She added that a helpful innovation was the development of an internal social media site. "People want to be connected to each other and to share their best ideas and opinions, and we wanted them to do that – we just did not want them to do it on Vine or Snapchat." The internal site has enabled greater communication across the organization. "It brings together all of our employees from KPMG member firms across the world. That connectedness, I believe, is really going to benefit our clients and teams."

Mark Weber remarked that his organization tried to make employees aware of the public nature of social media in a humorous way. "We announced at our annual meeting that we were going to look at everyone's Facebook page and then create a montage of the highlights. That certainly got people's attention." He explained that what they actually did was to fabricate pictures by superimposing the faces of leaders on images of people acting foolish. "But when it was done, we said that this was the trial, next year it will be for real."

### **ROBERT PRENTICE'S QUESTION:**

*I teach kids in the business honors classes and these are great kids from great families with all of the best intentions. One of the things that I try to impress on my students is that even with the best background and good intentions, it can be hard to do the right thing. You see it in the media, when reporters cover the stories of people who are convicted of white-collar crimes, like fraud and insider trading, and over and over again people say, "He is such a good father, a loyal friend and husband, a pillar of the community". The*

## PERSPECTIVES ON ETHICAL LEADERSHIP

*question remains, why do good people, people who inspire these sentiments from their friends and neighbors, do such unethical things? What I find works best to communicate this idea to my students are real-life stories. So what I would like to ask you is whether you have any stories you can share of good people who have done the wrong thing?"*

Vicki Sweeney said that part of the problem was people have a sort of moral ledger. "There are probably people who say things like 'I've done so much good for the organization that this one little thing shouldn't matter', but of course, that is not acceptable, and there can't be any bad." She gave an example about bullying. "We've had people that are very hard-driving leaders. They push and push their staff beyond what is acceptable. I remember that one leader said, 'Well, I bought every-one pizza and brownies!' as if that would make everything all right."

Rand Harbert believed that it is human nature for people to offer rationalizations. "There is a mindset that bending the rules this one time will be OK if I commit to not doing it again."

Tom Workman remarked that, unfortunately, people do not always have good intentions. "You think that they're good people. They put on a good show for you. You give them the benefit of the doubt, but sometimes they disappoint."

Chris MacDonald referred to research done in the field of criminology. "The consensus in the field is that jails are full of people who were able to rationalize their behaviour – people who think for example that their victims deserved it or that everyone is out to get them." He added that researchers have come up with a list of rationalizations. "Some of them are just based on obviously faulty reasoning, but others are more subtle, such as 'no one really got hurt, so no harm was done.' Some of these people may have the right values, but the wrong implementation."

Prentice noted that, "rationalizations are the reasons that good people give themselves for not living up to their own standards." He added that being familiar with a common list of rationalizations could provide a helpful check. "When you hear yourself say one of the phrases on the list, alarms should go off in your head that you're about to screw up."

"Rationalizations are the reasons that good people give themselves for not living up to their own standards."

Robert Prentice

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## BUILDING AN ETHICAL ORGANIZATIONAL CULTURE

Jim Mitchell asked the group to consider the question, “What are the characteristics of an ethical culture?”

Robert Prentice thought it was about both rewards and punishments. “I think that it’s important that a company punish bad behavior, but also reward good behavior. Most companies get the first one right, but they don’t get the second one right.”

Dawn Elm believed that the ‘tone at the top’ was crucial. “The leadership of the organization has to be clearly committed to building an ethical culture and work towards putting the systematic infrastructure that we have been talking about in place.” She added that managers needed to know what is going on. “I think that MBWA (management by walking around) is a big part of it as well.”

John Taft thought that it began with mission, purpose and values, in that order. “I think that constantly talking about the mission of the organization and your purpose in terms how you make the world a better place is really important.” This is especially true for the financial services industry, which is an evolving profession. “Our work is noble because we help people organize their financial affairs in ways that help many to achieve their life goals better than they would without us. That makes the world a better place.”



*Don Mayer contributes to the discussion.*



PERSPECTIVES ON ETHICAL LEADERSHIP



“I think that some leaders don’t think that the normal rules apply to them. They believe that they don’t need to care about what their employees think. This is what gets them into trouble.”

Rand Harbert

Tom Workman believed that it was leaders’ actions, rather than their words, that make the difference. “I think employees are a lot smarter than many people think. I think that they are quite discerning and notice when a leader’s personal conduct deviates from his stated values.”

Rand Harbert agreed with Workman. “I think that some leaders don’t think that the normal rules apply to them. They believe that they don’t need to care about what their employees think. This is what gets them into trouble.”

Vicki Sweeney believed that new hires get acculturated very quickly. “When people join your company, they will look to others. And I think that you have a window of about 60 to 90 days to shape that perception. If they are surrounded by people who give them good guidance and help them to make good decisions, the likelihood of problems down the road is significantly diminished.”

Chris MacDonald thought it was important to distinguish between ethical behavior in personal life and ethical behavior in business. “You want to be just as ethical in business as you are at home, but the standards are going to be different. Roughly speaking, at the office you should be driven by shared values of team work, in the market and with outsiders you should be driven by the values of fair competition and in the home you should be driven by values and principles related to love.”



*Dawn Elm makes a point to the group.*



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Don Mayer noted that the same issues emerge in academia as in business in terms of poor ethical cultures. “Some people may think of academia as an ‘ivory tower’ but people still play power games, run up debt and pursue their own vendettas. It’s not pretty and we have a long way to go.”

## CONCLUSION

Jim Mitchell asked the group to share their thoughts on what they learned today.

Chris MacDonald was very glad that he was able to attend. “I have been in academia all of my life and so when I need examples from the real world to share with my students, I have to steal yours. I have a lot of great examples of people standing up and doing the right thing. Fiction is never as good as the truth.”

Bob Johnson believed that part of what worked about the event is that it was relatively unscripted. “I also appreciated that it was a diverse group of perspectives. I was able to learn a lot.”

John Taft was glad that he attended. “I got a couple of ideas and a couple of areas where I would like to learn more. You are a real resource on this topic, and many of us are sponges for information.”

Don Mayer particularly enjoyed the discussion of the case study. “When I first read the case I was like, ‘okay, it’s more elder law’, but I thought that we teased out some amazing stuff and I was very gratified to be part of the discussion. It was a great case.”

Dawn Elm appreciated the opportunity to interact with all of the participants. “The case got people really involved and engaged. I think that there was an amazing amount of mutual learning that went on with people from different backgrounds and with different experiences.”

Robert Prentice enjoyed the opportunity to learn from the other participants, as well as share his thoughts. “I think that everyone really participated and that is the thing that I appreciated the most.”

Rand Harbert thought it was a “great day” and appreciated the chance to interact with the academics. “What I liked best about today was being with the academics. What is interesting is that you would not have known who was an academic and who was a practitioner based on the fact that we are all talking about the same issues.”

Mark Weber was glad to hear the different perspectives. “I always like to hear from academics and enjoy hearing the perspective of CEOs. I was not sure what to expect, but it exceeded any expectations that I had.”

PERSPECTIVES ON ETHICAL LEADERSHIP

Vicki Sweeney found the discussion “inspirational”. She added that the opportunity to “get in a room with people and be able to talk freely really inspires me to go back and think about things a little differently and that was one of my goals in coming here.”

Tom Workman appreciated talking about ethics with people who have studied the subject. “It’s so insightful, particularly from the business side, to spend time with folks who have given a great deal of thought to these ethical considerations.”

Julie Ragatz was grateful for everyone’s participation. “I think that all we have tried to do is to create an environment in which people feel like they can participate and share – the rest is up to the group.”

Jim Mitchell shared that he had learned a lot. “I love rubbing minds with all of you people who care about ethics. It’s a wonderful thing. It’s a joy in my life.”



*The Breakers, Palm Beach, Florida*



The James A. and Linda R. Mitchell/  
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The American College Cary M. Maguire Center for Ethics in Financial Services is the only ethics center focused on the financial services industry. The Center bridges the gap between sound theory and effective practice in a way that most ethics centers do not. Under the leadership of Director Julie Ragatz, the Center's mission is to raise the level of ethical behavior in the financial services industry. We promote ethical behavior by offering educational programs that go beyond the "rules" of market conduct, help executives and producers be more sensitive to ethical issues, and influence decision making.

The Mitchell Forum is a groundbreaking, one-of-a-kind event that underscores the Center's emphasis on collaboration and conversation among academics and executives. Jim Mitchell was recognized in 2008 for his dedication to business ethics and was included in the "100 Most Influential People in Business Ethics" by *Ethisphere*, a global publication dedicated to examining the important correlation between ethics and profit. The list recognizes individuals for their inspiring contributions to business ethics during the past year.

The Forum is the cornerstone of the Center's activities highlighting how to bring industry leaders, accomplished producers, and prominent business ethicists together to reinforce the need to connect values and good business practices.







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