When I talk to financial services professionals, I always ask people what they believe are the most important ethical issues the industry will face in the near future. A frequently mentioned concern is the debate over mandatory compensation disclosure. The question of mandatory compensation disclosure is particularly pressing for those agents who write insurance business in New York. Regulation 194, effective January 2011, legally mandated compensation disclosure for all insurance products sold in New York.

The Argument for Mandatory Compensation Disclosure

The argument for the necessity of compensation disclosure should be considered as two distinct claims. The first is that mandatory compensation disclosure is desirable. Regulators believe the requirement to disclose compensation arrangements will render producers less likely to take advantage of the "knowledge asymmetry" which exists between them and their clients, while at the same time empowering consumers to make well-informed decisions about which product is in their best interests.

Without access to detailed information about producer compensation, consumers are potentially subject to abuses which result from the inherent conflicts of interest entailed by commission-based compensation models. Moreover, regulators believe that this regulation is reasonable and does not place an undue burden on insurance producers. As Andrew Cuomo argues, "It is not a radical concept for a customer to know how the customer’s representative is being compensated so that any potential or actual conflict of interest may be evaluated."

The second claim is that compensation disclosure should be legally mandated rather than encouraged on a voluntary basis. In the various documents related to the public hearings and judicial activities surrounding the development and promulgation of Regulation 194, regulators and commentators frequently referred to the 'bid-rigging' and 'steering schemes' uncovered in 2004 by the New York State Insurance Department.

After fourteen years of distinguished service with The American College, Dr. Ron Duska will be retiring from his position as Director of the Center for Ethics in Financial Services and the Charles Lamont Post Chair in Ethics in the spring of 2011. We are grateful to Ron for his incredible contributions to the College and the Center over the years. He is deeply respected by his professional colleagues and prized by the many students who have taken his classes over the years. We will miss him enormously.

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Mandatory Compensation Disclosure (Continued)

These investigations culminated in settlements between 2005-2006 in which producers and insurers paid more than $1 billion to recompense customers for harm resulting from bid rigging and steering. The lesson regulators learned from these episodes was that it was necessary to go beyond voluntary actions in order to implement what they believe are necessary consumer protections.

Opponents argue that mandatory compensation disclosure distracts the consumer away from the most important factor that should be considered when selecting an insurance product—namely, “does this product meet my coverage needs in the context of my financial situation and other commitments?”

The assumption is that consumers may believe that if a producer is being paid more for selling a particular product, then this product is less likely to meet their needs than another product which compensates producers less. Another related objection is that the obligation to provide compensation information for all quoted products will render a producer less likely to provide the consumer with a wide range of options.

The second objection is that the increased compliance burden will distract producers from the business of selling life insurance. If, as it is often suggested, life insurance is a product which is ‘sold, rather than bought’ then bogging producers down with additional compliance requirements creates a net level of harm to the extent it prevents them from selling life insurance. This is especially true since life insurance is an important social good which, among other benefits, relieves the state of the burden of caring for financially-dependent survivors in the event of the death of a financial provider.

Finally, opponents cast doubt on the need for mandatory compensation disclosure in the first place. Richard Poppa, the President and CEO of Independent Insurance Agents & Brokers of New York, argues that the relationship between producers and their clients should be based on trust. “If a client wants to know about the producer’s compensation to achieve that trust then we believe that the client should ask and the producer should tell. If for some reason the producer does not want to tell, then the client has the option to go to someone who will. Consumers are smart and know this.”

The assumption is that if consumers are interested in compensation disclosure, the pressures of the market will compel producers to be more transparent about their compensation, and producers that refuse to do so will be punished in the marketplace.


Continuing Education Update

As Corporate-Level or Agency-Level Members in the Center for Ethics in Financial Services, members of your organization receive 1/2 off on every Ethics CE class.

All you have to do to get the discount is enter “ETHICSCE” when prompted for a “promo” code

Our newest class is CE 110 which is a specialized course designed to deal with ethical issues that emerge when interacting with elderly clients through scenarios, lecture and thought-provoking questions. CE 110 is a 1 hour webcast which is eligible for 1 hour of CE Ethics credit in most states.

The next webcast for CE 110 is scheduled for June 7th from 1:00-2:00 pm.

For more information or to register for the webcast, please go to www.theamericancollege.edu/center-for-ethics/
Mandatory Compensation Disclosure (Continued)

Another Problem?

Another perspective challenges the connection that both sides assume exists between increased disclosure and better consumer decision making. In other words, does more information and in this case, more information about compensation, really enable clients to make better decisions? As Daylian Cain and his colleagues point out, it is not sufficient merely for consumers to know that a potential conflict of interest exists. What clients really need to know is how this potential conflict of interest may bias or influence their agent. More importantly, they need to know that if the advisor is actually affected by the conflict of interest, how it is possible to discount or correct that biasing influence. 3

Unfortunately, studies show that people are not especially good at this final, crucial step. Simply put, people tend not to discount information about bias appropriately. When agents reveal a potential conflict, principals may interpret this disclosure as evidence of the agent’s good intentions. Cain and his colleagues suggest that such disclosures may even lead to clients to place greater, rather than lesser, weight on the advice. Perhaps even more troubling, research by McAlexander and Scammon indicates that disclosure requirements focusing on a financial advisor’s education, experience, and form of compensation may have little of the desired impact upon low-knowledge consumers. They find that although this information may be helpful to more savvy consumers who are confident in their ability to interpret disclosed information, it is less helpful to less sophisticated consumers, precisely the type of people these sorts of regulations are designed to protect. 4

Conclusion

If mandatory compensation disclosure may not achieve its intended goals, what is the next step? Ethics demands that we imaginatively think of solutions to meet our ethical obligations. As mentioned earlier, we have a strong moral obligation to increase autonomy, defined as the capacity for individuals to independently make decisions that are in their best interest. This obligation is particularly strong for those individuals serving in the relation of trusted advisor to a principal who lacks the informational expertise possessed by the agent. If autonomy is not necessarily promoted through the mere disclosure of information, we need to make sure that we can find a way to promote autonomy in another way or through other means. Undoubtedly, this will require the agent to be transparent and open regarding their compensation models and incentive structures, but it could demand a particularized approach based on the needs of the individual client. It will most certainly involve a commitment to client education.

One of the dangers of increased regulation is that financial services professionals may begin to believe that the obligations to their clients are exhausted by fulfilling the mandatory disclosure requirements. This could reduce the professional’s internal motivation to look out for the interests of their clients by reducing their feelings of responsibility and accountability. If ethics is a matter of freely choosing the good, then limiting the space available for choice creates a sort of ‘compliance mentality’. Ethics often requires something more. This deadens our moral imagination and blinds us to our genuine moral obligations. We all have a responsibility to prevent this outcome.

For more information on Mandatory Compensation Disclosure, as well as questions for facilitating group discussion on the topic, please go to our website. http://www.theamericancollege.edu/center-for-ethics

Our Advisory Board

An Interview With
Frank Collins

Frank Collins of Merrill Lynch recently was nominated and appointed as a member of the Advisory Board of the Center for Ethics in Financial Services. We were delighted to have a chance to talk with Frank about his thoughts on ethics in the financial services industry and hopes for his time on the Center for Ethics’ Advisory Board.

Frank joined Merrill Lynch in 1978 in the back office in Manhasset, New York. He is currently the Complex Director in Central Pennsylvania and has spent his entire career with Merrill Lynch.

Frank believes “ethics is paramount” to his daily business practices. “The primary mission (of a financial advisor) is to help clients meet their financial goals. We are serving a specific purpose. If we don’t have the client’s best interests first, we’re doing it wrong.”

Frank credits his belief in the importance of ethical business practices to the training he received at Merrill Lynch, which does a “wonderful job” instilling ethics in their employees. As the Complex Director, many of the ethical situations he deals with on a day-to-day basis concern management and training. He believes that it is imperative for people in leadership positions to lead by example. An ethical leader needs to, “demonstrate the highest ethical standards and act as a role model to your employees.”

The mission of the Center for Ethics in Financial Services caught Frank’s attention—and prompted his desire to serve on the Advisory Board. “Ethics plays an important role in business, and it sometimes is not given the attention it deserves.” He believes that ethics should be a part of every conversation happening in Washington, “whether it is about the product or the process, the Center for Ethics in Financial Services should assist our country through these difficult times”. He believes that the Center for Ethics needs to find a way into the public conversation and serve as a reference point for Washington decision-makers.

We are very excited to have Frank on our Advisory Board and believe he will add a wonderful dynamic to our efforts.

A Moment With The Faculty: Gerry Herbison

Gerry Herbison is an Assistant Professor of Management and Director of the CLF® (Chartered Leadership Fellow®) Program at The American College. Prior to joining the College, Professor Herbison worked as an investment advisor for AXA. He completed the Masters of Science of Management (MSM) at The American College in 2009 and is currently pursuing a doctoral degree, in Organizational Development at Wilmington University.

Gerry believes a major threat to the industry is the inability to distinguish between ethics and compliance. As Director of the CLF® program, Gerry mainly works with field leaders and he is able to witness first hand the emphasis on compliance. “There is a division between ethics and compliance in the field and ethics tends to take a back seat — what is compliant isn’t always ethical.”

Regarding the regulations being considered in Washington D.C., Gerry sounds a note of caution. “It’s not possible to regulate ethical behavior, but there should be serious consequences in place to ensure that the weakest link — the client — is protected.”

Gerry believes that an important contribution the Center for Ethics in Financial Services can make is to focus on training people to recognize the existence of an ethical dilemma. This is the phenomenon that ethicists call ‘moral perception’ or ‘moral sensitivity’. He explained, “most people miss important ethical clues. We need to be able to show our students what a ‘small’ ethical situation looks like.”

Gerry also thinks that it is important address the question of ‘raising your hand’ when you witness ethical issues or unethical behavior in the workplace. “What happens to the whistleblower? How can you protect the powerless person who is trying to raise these issues and encourage them to speak out?” Financial services companies, and the industry, both depend on courageous people to tell the truth when they see ethical problems, but this can be a dangerous task for people who believe that their careers are on the line.

Gerry looks forward to continuing to partner with the Center for Ethics in its mission of raising the level of ethical behavior in the financial services industry and we certainly appreciate Gerry’s consistent support of our efforts. For more information about the CLF® program, please look at their website http://www.theamericancollege.edu/insurance-education/clf-field-or-office-leadership
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