

Center for Business Ethics

AT BENTLEY UNIVERSITY



Raytheon Lectureship in Business Ethics

APRIL 2, 2013

Business Ethics and the Financial Services Sector: The Way Forward

ROGER W. FERGUSON JR.

President and Chief Executive Officer of TIAA-CREF

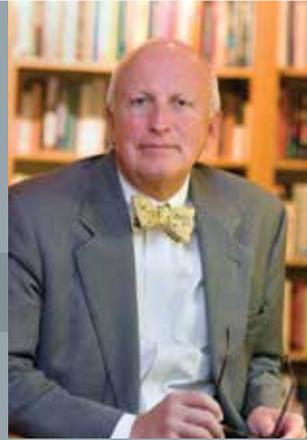
BENTLEY UNIVERSITY is a leader in business education. Centered on education and research in business and related professions, Bentley blends the breadth and technological strength of a university with the values and student focus of a small college. Our undergraduate curriculum combines business study with a strong foundation in the arts and sciences. A broad array of offerings at the Graduate School of Business emphasize the impact of technology on business practice, including MBA and Master of Science programs, PhD programs in accountancy and in business, and selected executive programs. Enrolling approximately 4,100 full-time undergraduate, 140 adult part-time undergraduate, 1,430 graduate, and 34 doctoral students, Bentley is located in Waltham, Mass., minutes west of Boston.

THE CENTER FOR BUSINESS ETHICS at Bentley University is a nonprofit educational and consulting organization whose vision is a world in which all businesses contribute positively to society through their ethically sound and responsible operations. The center's mission is to provide leadership in the creation of organizational cultures that align effective business performance with ethical business conduct. It endeavors to do so by the application of expertise, research, education and a collaborative approach to disseminating best practices. With a vast network of practitioners and scholars and an extensive multimedia library, the center offers an international forum for benchmarking and research in business ethics.

Through educational programming such as the Verizon Visiting Professorship in Business Ethics, the center helps corporations and other organizations to strengthen their ethical cultures.



Executive Director,
Center for Business Ethics and
Hieken Professor of Business and Professional Ethics
Bentley University



W. Michael Hoffman, PhD

When we consider what the factors are that contributed to America's success, many things come to mind such as democracy, freedom, diversity, and an enterprising spirit. One of the things that is not likely to appear at the top of the list is banks. But it should. And thankfully it did for George Washington, and that is why one of his important initiatives in the early years of our nation was to work with his protégé Alexander Hamilton to create a strong banking system. The impact of banks permeates every aspect of our nation's activities. The simple fact is, without banks, economies can't function and without a functioning economy, national development is impossible.

What would Washington and Hamilton have thought if they observed America's banking system over the last decade? I'm sure that much of what has transpired would have horrified them ... but not all. They also would have been amazed at the strength, integrity, and creativity that some financial firms like TIAA-CREF exercised during a period of great economic duress. And it is for this reason that I was especially pleased and honored to have welcomed Roger Ferguson, president and CEO of TIAA-CREF, to deliver the Raytheon Lecture in Business Ethics. As someone who served as vice chairman of the Board of Governors of the U.S. Federal Reserve with extensive experience in the insurance industry, and as an adviser to the President of the United States, his qualifications are second to none. And yet, in his sound and insightful analysis, Roger Ferguson was an antidote to the cynicism of our time. As the leader of a firm known for integrity-driven success, he models the leadership needed in an industry that has been rocked to its core by scandals, corruption, and lost trust.

Never since Washington and Hamilton made their mark has our country so needed a sound banking system. For those who think of business ethics as abstract and academic, think again. It is ethical businesses led by articulate thinkers such as Roger Ferguson that are leading the way to the recovery so sorely needed by the United States and nations around the globe.

The RAYTHEON LECTURESHIP IN BUSINESS ETHICS at Bentley University is made possible through the generous support of the Raytheon Company.

The Raytheon Lectureship in Business Ethics at Bentley University is made possible through the generous support of the Raytheon Company. Raytheon is a technology and innovation leader specializing in defense, homeland security and other government markets throughout the world. With a history of innovation spanning 91 years, Raytheon provides state-of-the-art electronics, mission systems integration and other capabilities in the areas of sensing; effects; and command, control, communications and intelligence systems, as well as a broad range of mission support services. The company reported sales of \$24 billion in 2012 and employs 68,000 people worldwide. It has built a reputation for adhering to the highest ethical standards in the industry. The Raytheon Lectureship in Business Ethics series aims to illuminate and promote ethical values and conduct in business, highlighting best practices in corporations throughout the United States. Learn more about Raytheon online at raytheon.com.



Roger Ferguson delivers the Raytheon Lectureship in Business Ethics to students, faculty, staff and friends at Bentley University.

Chairman and Chief Executive Officer
Raytheon Company

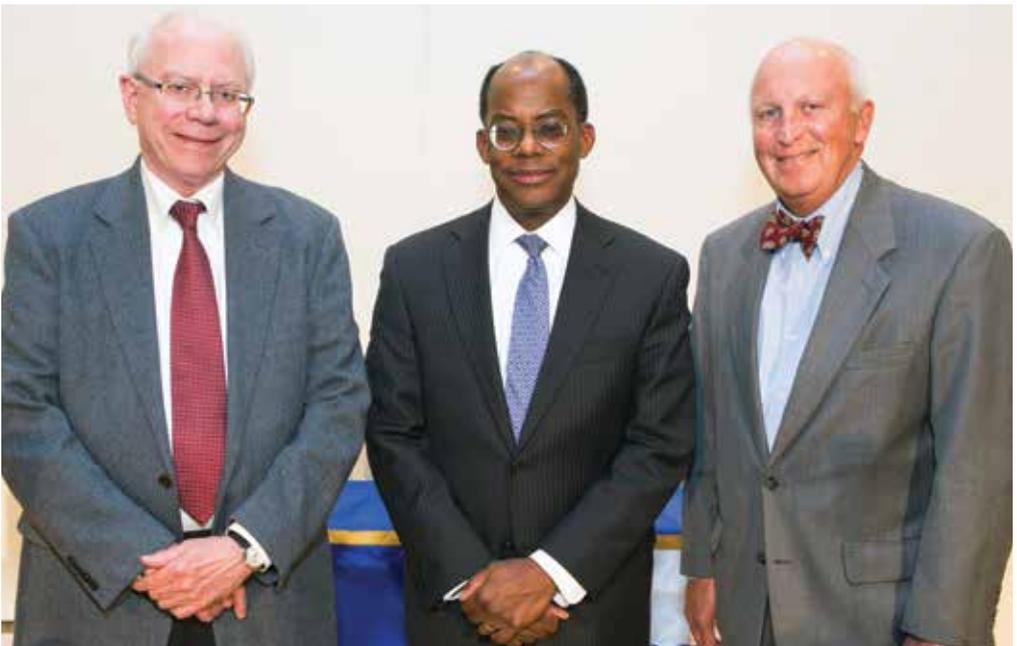
William H. Swanson



Ethics in business is about so much more than just following rules. Fundamentally, it is a matter of creating the right culture in our organizations, so that people have the ability and support to make decisions that are not only effective, but consistent with the values and principles we hold dear. Raytheon has worked very hard in establishing an ethical business culture that is accepted by our employees and woven into the fabric of the ways in which we work. Our continued growth and profitability depend on it.

Raytheon has supported the Center for Business Ethics at Bentley University for many years, and our sponsorship of its lectureship in business ethics is an important commitment for the company. We recognize the enormous value of the leadership given by the center for almost four decades, to promote ethical business practices and cultures in the United States and around the world. And ethical leadership — illuminating and inspiring conduct that is instinctively ethical — is what the Raytheon Lectureship in Business Ethics is about. I'm proud that Raytheon can play a part in bringing to the Bentley campus highly respected leaders of companies that have a manifest and deep-rooted commitment to doing business in the right way. Their insights contribute much to an important discourse on how the business community can and should achieve ethical excellence.

TIAA-CREF is a full-service financial services company. It is the leading provider of retirement services in the academic, research, medical, and cultural fields and a Fortune 100 financial services organization. The company employs more than 8,000 people located in over 90 local offices. It has over \$500 billion in assets under management and serves 3.9 million active and retired individuals.



(From left) Tim Schultz, director of business ethics and compliance at the Raytheon Company; Roger Ferguson, president and CEO at TIAA-CREF; and W. Michael Hoffman, founding executive director of the Center for Business Ethics and Hieken Professor of Business and Professional Ethics at Bentley.

President and Chief Executive Officer
TIAA-CREF

Roger W. Ferguson Jr.



Roger W. Ferguson Jr. is president and chief executive officer at TIAA-CREF. Prior to joining TIAA-CREF, he served as vice chairman of the Board of Governors of the U.S. Federal Reserve System. He was a voting member of the Federal Open Market Committee and chairman of the Financial Stability Forum. He was also head of financial services for Swiss Re, chairman of Swiss Re America Holding Corporation, and a member of the company's Executive Committee. He is a fellow of the American Academy of Arts & Sciences and a member of its Commission on the Humanities and Social Sciences. He served on President Obama's Council on Jobs and Competitiveness. He received a BA, JD, and PhD from Harvard University.

Business Ethics and the Financial Services Sector: The Way Forward

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April 2, 2013

ROGER W. FERGUSON JR.

President and Chief Executive Officer at TIAA-CREF

It's a pleasure to be here today and an honor to be delivering the Raytheon Lecture in Business Ethics. I want to thank Mike Hoffman for inviting me — and more than that, for all he's done for the field of business ethics since founding the Center for Business Ethics here at Bentley nearly four decades ago. Mike and Bentley have put business ethics on the map and have driven the development of this field ever since, through the center's innovative thought leadership, research and education.

It feels great to be here on the Bentley campus, because it feels like I am among good friends. My company, TIAA-CREF, and Bentley have been partners since 1960. We work together toward a very important aim: helping Bentley's faculty and staff get to and through retirement with financial security. In partnership, we've been able to help several generations of the Bentley family achieve that goal, and it's a record we at TIAA-CREF are very proud of. We are also proud that our company has done so while upholding the highest standards of integrity and ethical conduct. That is a critically important part of the DNA of TIAA-CREF.

In my remarks today, I'll talk about that record, and I'll do so in the context of the larger financial services industry in which we operate. First, I'll take a look at the current landscape in the industry and assess where we are today, five years or so down the road from the financial crisis that nearly caused a global meltdown. Then I'll explain why it's absolutely essential for the financial services

industry to regain the trust and confidence of the public, given the sweeping demographic and economic challenges our nation faces today. I'll describe what I believe is the best way forward: namely a series of governance reforms affecting boards, management, regulators and shareholders in the industry. I'll give you some insight into how TIAA-CREF has been able to maintain such a stellar record for 95 years now, and what we're doing today to protect that reputation. And I will look forward to hearing your thoughts and engaging in dialogue with you during the Q&A after my talk.

Ethics and the Financial Services Industry

So, to begin, let's take a look at the landscape.

As I said, it's been about five years now since the financial crisis hit, thrusting us into the worst economic downturn since the Great Depression. The crisis, with the financial services sector at its center, wreaked economic chaos and imposed enormous costs on society. Our nation is still healing from the trauma. Perceptions of the industry took a big hit then and have remained rather dismal. But perhaps that's not surprising, since we continue to see scandals involving the industry splashed across headlines around the globe. Just in the past year or so, there was the LIBOR rate-fixing scandal and several high-profile insider trading cases. A trader was convicted of fraud in conjunction with a \$2.3 billion loss for his bank, and there are continuing congressional hearings about the factors underlying another bank's trading loss of more than \$6 billion.

Against the backdrop of the crisis and continuing scandals, financial services has become one of the least-trusted industries in the world. In fact, for the third consecutive year, banks and financial services firms placed dead last in the annual global rankings of trust in industries published by the Edelman public relations firm. Topping the list as most-trusted industry was the technology industry. The Edelman Trust Barometer survey found that the lack of trust in banks and financial services is driven by both poor performance and by the perception of unethical behavior.

The news was nearly as grim in another poll conducted by Gallup last year that measured perceptions of honesty and ethics among different professions. Nurses ranked highest in the survey, with 85 percent of respondents saying they would rate nurses as either high or very high in terms of honesty and ethics. Just 28 percent said the same of bankers, and stockbrokers were viewed even worse, scoring just 11 percent, barely edging out members of Congress at 10 percent.

So, although our economy is slowly coming back to life in the wake of the financial crisis, it's clear that the financial services industry has some work to do in terms of rebuilding trust. This brings to mind a great quote I read in an article about a speech by former Bank of Canada Governor Mark Carney, who in July will become governor of the Bank of England. As he put it: "Trust arrives on foot, but leaves in a Ferrari." Unfortunately, trust does not return in a Ferrari. It must be rebuilt painstakingly, and it won't happen overnight. But it's vital that it does happen — because the financial services industry is simply too important to our economy and our global competitiveness to be looked on so warily by so many people.

The Industry's Key Role

The financial services industry represents a significant portion of our GDP — nearly 9 percent in 2010, according to the U.S.

Commerce Department, which is higher than its previous peak in 2006 and far above its 1950 level of less than 3 percent of GDP.

The U.S. financial markets are the largest and most liquid in the world, and the sector drives substantial economic activity in the nation as well as direct and indirect job creation. But beyond the purely economic calculations, the economist Robert Shiller argues that finance has a larger social role and purpose and that, in fact, it is one of the most powerful tools we have for solving common problems and increasing society's well-being. In his book *Finance and the Good Society*, published last year, Shiller says that finance is not about making money per se, but that "financing is really creating the architecture for reaching a goal. The goals served by finance originate with us." If you think about it in terms of the lives of average Americans, the financial services industry makes possible everything from college loans to 30-year mortgages to life insurance to retirements.

Let's specifically consider that last one, retirement, for a moment to illustrate why we need a strong, healthy and trusted industry.

Retirement has become a source of great angst in our nation. You may have seen the recent article in *The Washington Post* saying that for the first time since the New Deal, a majority of Americans are headed to a retirement in which they'll be financially worse off than their parents. The Senate issued a report last July saying the nation is facing a huge retirement savings deficit — as much as \$6.6 trillion, or about \$57,000 per household. Americans' confidence about achieving a comfortable retirement has hit record lows. Certainly, the financial crisis was a big factor in creating that pessimism. As the *Post* article noted, the crisis wiped out about 40 percent of Americans' personal wealth and has led to a period of high unemployment.

But there are a number of longer-term factors at work. One is the shift away from traditional pensions in the private sector. Under the old system, companies committed to providing their workers income for life in their retirement. But today, the 401(k) is king, and the responsibility for funding retirement has shifted from the company to the employee. The problem is that many Americans simply don't have the financial literacy skills they need to make sound decisions about the saving and investment choices that now rest squarely on their shoulders.

Another factor driving our increased concern about retirement is the aging of our population. This is the result of two trends: people are living longer — 85-and-up is the fastest-growing segment of our population — while the fertility rate is declining. The upshot is that there are fewer and fewer people working and they are supporting more and more people who are retired and not working. This is an unsustainable imbalance that threatens the long-term health and stability of programs like Social Security, Medicare and Medicaid, which already account for roughly 40 percent of all federal spending and 10 percent of the nation's GDP. Average Americans worry about whether the programs will be there to provide support in their old age.

At the same time, people are not saving enough for retirement or anything else. We've seen a sharp decline in the personal savings rate in recent decades. As of January, the U.S. savings rate was just 2.6 percent — down from 12 percent in the early 1970s and 1980s. In terms of retirement savings specifically, only 57 percent of workers are currently saving for that purpose. More than half of workers say they and their spouse have less than \$25,000 in total savings and investments, according to the just-released annual survey on retirement confidence by the Employee Benefit Research Institute. Meanwhile, there's been an explosion in healthcare costs, which threatens the long-term viability of even well-funded nest eggs.

This is the backdrop in which the financial services industry will be operating in the coming decades.

More than ever before, people will need help in achieving financial well-being throughout their lives and especially in retirement. They will need sound advice — but advice that is given in the context of what's best for the customer, not what's best for the firm's bottom line. Americans need a financial services industry that can step up and meet this need. And looked at from the vantage point of our society as a whole, the nation needs an industry that will tap its vast expertise to address the critical issue of financial literacy among Americans. For all of these reasons, our nation needs a strong and healthy financial services industry — and an industry it can trust to do the right thing for clients.

The Way Forward

So what can the financial services industry do to regain trust and instill confidence? Certainly, there's been an unprecedented process of regulatory reform to remedy the weaknesses that the crisis laid bare. Much of the focus of industry leaders has been on regulatory reform, such as the Dodd-Frank legislation of 2010, which has yet to be fully implemented.

To be sure, strong regulation is essential. But it's not enough by itself. Equally important is having effective governance at financial firms — and by governance, I mean the system by which companies are directed and controlled. Governance is more than just rules and processes though. Rather, it involves the relationships between a company's management, board, shareholders and other stakeholders — which, in the case of financial services, includes the regulators charged with ensuring the system operates safely, soundly, ethically and for the public good.

Weak governance has been widely cited as a key contributor to the financial crisis. One of the more influential reports on the crisis was issued in 2009 by the chair of the U.K.'s Financial Services Authority. It identified seven proximate causes:

- Large, global macroeconomic imbalances
- An increase in commercial banks' involvement in risky trading activities
- Growth in securitized credit
- Increased leverage
- Failure of banks to manage financial risks
- Inadequate capital buffers
- A misplaced reliance on complex math and credit ratings in assessing risk

Weak governance at all levels was a factor underlying each of these causes. Boards failed to grasp the risk that their institutions had taken on. Management failed to understand and control risks. In many cases, spurred on by shareholders, both management and boards focused on performance to the detriment of prudence. Regulators missed the potential systemic impact of entire classes of financial products, such as subprime mortgages, and in general failed to spot the large systemic risks that had been growing during the previous two decades. So it's clear that when we consider the way forward for the financial services industry, we need better governance at all levels.

I'd like to share some of the ideas recommended by the Group of 30, an international forum of public- and private-sector financial leaders of which I am a member. Our recommendations are based on an extensive survey we completed last year on governance at 36 of the world's largest, most complex financial firms.

We created a detailed report that you can find on the G-30's website. It outlines specific steps that boards, management, regulators and long-term shareholders should take to restore confidence and ensure the strength and stability of the financial system. For example, we urge boards to take a long-term view that encourages long-term value creation in the interest of shareholders — and to ensure that firms are prudent in their decision-making. We urge management to model the right kind of behavior and to support a culture that promotes long-term thinking, discipline and accountability.

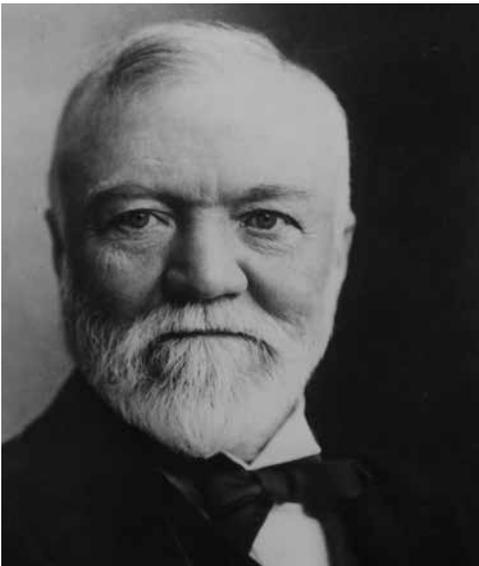
We urge regulators to take a broader view of their roles, one that includes understanding the overall business, strategy, people and culture of the firms they oversee. We urge shareholders to use their influence to keep companies honest about performance and focused on improving governance. We underscore that governance is an ongoing process, not a fixed set of guidelines and rules.

In the end, what matters most is not rules, but how people actually behave. And what is it that determines how employees behave? Behavior is driven by a company's values and its culture. That's why values and culture are the ultimate keystones of governance. They are what lead people to do the right thing, even when nobody is looking. For that reason, it's just as important for a company to focus on the so-called "software" of governance — its culture, people, leadership and values — as it is to focus on the "hardware" — the structures and processes. And leadership is a critical part of the equation. The tone is truly set at the top. Companies can have the most extensive processes and procedures, but if they have the wrong people in positions of leadership or if those people do not behave with transparency and integrity, they won't necessarily have a culture that promotes doing the right thing. That's why boards need to champion an appropriate culture within the business — a culture of integrity, independence of thought, and respect.

Management needs to be very active in promoting a strong culture and high standards through their own example. Financial firms need to undertake a serious and wide-ranging effort to ensure that they have the right software in place. Changing culture and values is not easy, but it will happen given the right amount of encouragement and support from leadership.

How TIAA-CREF Does It

At TIAA-CREF, culture, values and strong governance are things we've always taken very seriously. I'd like to share with you some insights into why that's so, and how it is that we've been able to maintain a stellar reputation for 95 years now.



TIAA-CREF traces its founding to philanthropist and industrialist Andrew Carnegie.

It all begins with our history. Our roots stretch back to the great philanthropist and steel baron, Andrew Carnegie. In 1890, he joined the board at Cornell University and became appalled to learn how poorly professors were paid. Many of them became destitute when they retired. He thought teaching was one of

the most noble of all professions, so he wanted to help teachers be able to retire and live out their lives with financial security. Carnegie set up a pension fund that ultimately gave birth to our company and our mission: to serve those who serve others.

Today, we still serve employees in higher education but we also serve the broader not-for-profit sector as well as government. We've become a Fortune 100 firm with 3.9 million individual clients, more than 15,000 institutional clients, and over half-a-trillion dollars in assets under management (as of December 31, 2012). Our mission and non-profit heritage set us apart, as does our focus on keeping our customers' interests front and center in all that we do. Those aspects of who we are have freed us from some of the pressures other financial firms face. Unlike publicly owned companies that seek returns for shareholders, our guiding goal is to create value for our participants, in the form of things like lower fees, more services and guaranteed income for life. Unlike firms that feel pressure to meet Wall Street expectations every quarter, we are able to take a longer-term perspective that's driven in part by the very nature of our business. We fund retirements, so we are naturally in it for the long haul. But we've also taken steps to further inculcate a long-term perspective in our culture. For example, we've developed a compensation structure that incentivizes long-term behavior. We've created a very strong risk management culture as well. Our risk management team is independent and reports directly to me. In fact, I see myself as the top risk officer in the firm. We've put in place strict risk protocols for our investment teams to help us avoid unnecessary risk while enabling us to uncover new opportunities for growth.

Our board supports this emphasis on risk. And we have a very transparent relationship with our board, which is directed by a chairman who is independent of management.

To help guide the behavior of employees, we have created a strong Code of Business Conduct — one that embodies the high ethical standards that are the foundation for our reputation and tradition. It's posted on our website for all to see, and I encourage you to take a look. Our code is not a series of policy prescriptions. Instead, it embraces the basic principle of "doing the right thing." It directs people to be honest and fair. To use good judgment. To be accountable and respectful. To promote inclusion. To comply with laws and regulations. To protect customer and company information. And finally, to ask questions and speak up.

We also developed Business Conduct Guidelines to give employees direction for understanding and following the code. Our guidelines ask people to consider some key questions when they are making decisions or taking action, questions like "Are you acting in the best interest of the customer?" and "Would you be embarrassed if the details of this activity were known by your colleagues, team members, family and friends, or if they appeared in a newspaper or on the Internet?" Our code is not just a toothless piece of paper. Every year, we require employees to acknowledge, in writing, that they have received and understood the code and will follow it.

The code is the foundation for our formal ethics program, which we introduced last year. We also designated a chief ethics officer for the first time. We realized we had many of the components of an ethics program already in place, but decided to join them in a formal program. We wanted to send a clear message on where we stand as an organization. It's another way to set the tone.

There's another side to our commitment to good governance, and that's what we do as one of the world's top institutional investors. We've been a leader since the 1960s in advocating for strong governance practices

at the companies in which we invest. We use our "seat at the table" to try to influence these companies on a range of issues that we believe could affect long-term sustainable shareholder value. The issues range from aligning executive compensation with performance to combating climate change to ensuring sustainability in energy developments. We meet with hundreds of companies to address topics like these every year. And we practice what we preach. We were the very first U.S. company to adopt an advisory vote for our own executive compensation policies and disclosures, beginning in 2007.

We've taken a leadership role on the global stage. We are a signatory to the U.N.'s Principles for Responsible Investment, a global association of over 800 asset managers, pension funds, and other institutional investors and service providers who believe that good corporate governance and responsible business practices can enhance the long-term economic value of companies, and that environmental, social and corporate governance issues all can affect the performance of investment portfolios. As one of the world's largest institutional owners of farmland, we are a founding member of the Principles for Responsible Investment in Farmland, a group of international institutional investors committed to improving the sustainability, transparency and accountability of investments in farmland. We are a founding partner of the Global Initiative for Sustainability Ratings, whose mission is to design and maintain a generally accepted ratings standard for assessing the sustainability performance of companies. Finally, we also have one of the largest social investment programs in the United States. This type of investing, also known as impact investing, represents our commitment to directing capital toward high-quality, risk-adjusted investment opportunities that also generate specific social and environmental outcomes. Our three focus areas are affordable housing, inclusive finance, and community and economic development,



As one of the world's largest institutional holders of farmland, TIAA-CREF is a founding member of the Principles for Responsible Investment in Farmland.

and our current portfolio consists of \$664 million in total commitments around the globe.

There's a simple reason why we devote time and resources to socially responsible investing: We are committed to our participants' financial well-being. We believe that when companies focus on being socially responsible and having good governance practices, they may be exposed to lower risk and thereby achieve better financial performance. This in turn contributes to the strength of the returns we seek for our participants. That's why we believe it's critical for investors like

TIAA-CREF to participate as active owners of their portfolio companies. We call it "doing well by doing good." The bottom line is that as a socially responsible investor and as an advocate for good corporate governance, we have one overriding goal: promoting long-term investment value for all TIAA-CREF participants.

Closing

I'll close now, but let me reiterate the messages I'd like to leave you with.

Today, our economy is showing signs of recovery from the trauma of the recent financial crisis, but trust in the financial services industry remains weak. The financial services industry plays an essential role in our nation, so it's vital that we restore trust and confidence in it, especially given the challenges we face in areas like helping people achieve financial security in retirement as our nation ages and faces economic challenges.

To restore trust and confidence, we need stronger governance measures for all of the key players in the financial services industry: boards, management, regulators and long-term shareholders. We need measures that address not just processes and procedures but things like values, culture and leadership, which are the keystone to good governance. TIAA-CREF provides a strong example of how commitment to values, culture, setting the right tone at the top, and putting customers first can create the conditions for achieving a trusted reputation.

Thank you for listening, and I now look forward to answering any questions you may have.

Questions & Answers

Below are highlights of Roger Ferguson's question-and-answer session with Bentley University students, faculty, staff and guests.

QUESTION: I think you said we need trust in financial institutions because they help us to achieve various goals. I wonder why we need trust in them to do that. Exxon and various other companies provide me gasoline for my car. I don't know that I have any trust in them beyond their ability to provide gasoline. I know they will provide it because they make money by doing so. So I wonder why you think we need trust in financial institutions other than for me to expect them to provide good investments because I expect them to make money for their own company.

ROGER FERGUSON: I think there's a fundamental difference between goods and services. Goods are tangible. You can look at them and have a sense of what they do or are supposed to do. Over time, they may degrade in some way, but you take the good, use it, and get value from it. In the case of a bottle of water, you can pick up the bottle, open it, pour it out, and see that it's water. Services in general — and financial services in particular — are quite different from goods. For one thing, a service is not a physical item, so it can be hard to independently validate that it's doing what it's supposed to do. For example, in financial services, the average investor has very little tangible evidence that what is being said is actually what is being done. Think about one of the great Ponzi schemes that was uncovered recently; it was all about trusting that a piece of paper was accurate. Another important point is that the provision of financial services often involves long-term relationships. When our participants entrust TIAA-CREF with their savings, we make a promise to invest those savings wisely so that they can achieve a comfortable retirement. That's a 25- to 30-year relationship. And there has to be a large element of trust behind it. Ultimately, at the end of the day, it's all about trust, and that's one of the things that makes financial services firms very different from companies like Exxon.

QUESTION: You spoke about the need for increasing financial literacy among populations. Hopefully those of us studying at Bentley will find that our financial literacy increases before graduation, but how does that apply to the general population?

ROGER FERGUSON: There are three or four components, each of which has a generational angle. First, there are the younger students — high school or younger; today, only about half of our states have financial literacy requirements of any kind in their K-12 systems. So, the first component might be for more states to incorporate financial literacy into their curriculums. One of the things we discovered when I was at the Fed is that many teachers don't feel qualified to teach courses about financial literacy. So the second component might be to get the teachers themselves more comfortable with this topic. The third component pertains to parents, many of whom need better financial literacy skills so that they can teach their children. In a recent survey, adults age 50 and over were asked three relatively simple questions about inflation, diversification, and compound interest — things that any person in this room would have known when you were in junior high school, if not before. About two-thirds of the respondents

could not answer all three questions correctly. The final component is that society as a whole has to evolve from where we are to where we need to be. Here I put on my macroeconomist hat. We are a society that is heavily driven around consumption and imports. If we had a society that was more balanced and driven more towards savings and investments, then individuals would be more likely to take an interest in their own financial well-being and start building the financial literacy skills that are necessary to achieve it.

So I think there are different components for doing this, some very macro and some very micro. But regarding the point that you made, let me commend all of you, because by the time you finish your studies here at Bentley, you will certainly be in the category of the financially literate, and perhaps you can help us drive the solutions to this challenge forward.

QUESTION: Since the financial crisis, what is one thing — other than a lack of trust — that has posed a significant ethical challenge in association with the retirement services industry?

ROGER FERGUSON: I think one of the things that is happening and that should be watched closely pertains to a huge amount of what we call “money in motion” as people get closer to retirement. I have observed that almost every financial services firm that five or 10 years ago was focused on performance and asset accumulation is now repositioning itself as a retirement company. I think everyone will notice that as Baby Boomers get older and start to think about what to do with their nest eggs, suddenly they are finding more companies positioning themselves as retirement companies. True retirement companies offer safe and secure retirement products. In my estimation, only companies that guarantee income for life should call themselves retirement companies. Many companies are mainly in the business of capturing rollovers and putting them into mutual funds. They are not focused on creating guaranteed income for life. And I think this is a big challenge, because if you are positioning yourself as a company that can help individuals succeed in retirement, you have to be offering them time-tested, safe, and secure retirement products, which I believe must by definition include guaranteed income for life or annuities.

The second ethical challenge that I see [pertains to] retirement decisions, as these are very complicated. In order to be a trusted provider of retirement advice, I believe that a company has to do what my company does, which is to offer objective advice, rather than “hawking” products per se. In the case of many companies that are positioning themselves as retirement experts, if you listen to their advice, [what they are saying] is mainly “Make sure you buy our product” as opposed to putting the client’s interest first and saying “Here is what is best for you.” I see these things as ethical issues. There is no legal issue per se; any financial services company can [claim to be] a “retirement expert.” But the reality is that some of these companies have very few of the products or retirement services or the kind of advice that I would say make them appropriately positioned as retirement companies.

QUESTION: You said that regulation is necessary but insufficient. Can you imagine a point in the future where that will no longer be the case?

ROGER FERGUSON: I think that regulation is always hampered by a couple of factors that make it necessary but not sufficient. The first is that regulators are, by the very nature of what they do, always catching up with the latest developments. I have been around the financial services industry as a lawyer, consultant, and now as the CEO of a major financial services company,

and the amount of creativity that goes on in this space is far greater than regulators can get ahead of. This is a good thing. You want an innovative financial services industry, but it's critical that companies are highly ethical, which is the kind of company we [at TIAA-CREF] are. Because as we have seen, there have been some great financial innovations, but there are others that have been misused. Securitization is an example of an innovation that started out as a positive development but has recently proven to be problematic. Many of you are probably too young to remember this, but some of you may remember when Orange County went into bankruptcy because of a poorly placed financial services bet. The product in question was not necessarily wrong, but it was mis-sold to the county. That's just one of many examples of why regulation will never be sufficient by itself and why strong corporate governance of firms is necessary.

Another obvious reason [why regulation alone is not sufficient] pertains to the notion of profit that came up in an earlier question. What we've seen is that profit is ephemeral in the financial services world; a trade that looks really good today can go sour the next year. If you have already paid the bonus based on the performance that led to those profits, you may end up in a world of moral hazards in which you have a disproportionate payout for the trader, while the company ends up eating the loss after something goes wrong. Those are the kinds of things regulators can't control.

The final point I will make pertains to compensation. It is really hard for regulators or even shareholders to think through all the compensation structures in the layers of an organization. Right now, there is a lot of focus on the compensation of CEOs of financial services firms, but in reality the place where you may find the biggest mismatch is down three or four layers in the organization, and that is something regulators are unlikely to get to. So my perspective on all this is that regulation is necessary and good regulation is the right thing to do. However, because regulators are always playing catch up, we need a strong dose of corporate governance and business ethics to make financial services safe and secure for all of us.

QUESTION: From your speech, it is clear that you take your code of conduct very seriously. Of course we hear about major breaches of conduct in the news. How do you deal with smaller ethical breaches in your company and keep your code of conduct functioning?

ROGER FERGUSON: The approach that we take is to ask people to report even small breaches. We have a system where we do internal investigations if needed through our internal audit function. We do try to use balanced judgment. There are things that are completely unacceptable that have to do with disrespectful behavior. My colleagues know that I have zero tolerance for harassment of any sort against any group. But in the case of minor infractions, we try to use these as a chance to educate. On the other side, I also work really hard to reinforce positive behavior. Once a quarter, one of my senior-most colleagues and I give what are called "Raise-Your-Hand Awards" to [recognize] individuals or teams who see an issue — maybe it's a process that's not as efficient as it should be — confront it, and fix the problem or bring us back to the right position. In terms of conduct issues, it's important to have a [code of] conduct that is both strict and fair, where yes, you punish people appropriately in the case of grievous offenses, but in the case of minor offenses, you educate and rehabilitate them. And as I mentioned, we spend even more time celebrating people who are doing it the right way.

QUESTION: During your years in the corporate world, have you ever faced ethical decisions that you had to struggle with?

ROGER FERGUSON: All of us, even CEOs, have to face ethical choices or decisions. One example is the kinds of issues I've been talking about, regarding violations of our code of conduct, both large and small — and deciding on an appropriate response. Obviously I don't find that we face too many big ethical issues at TIAA-CREF. There are different kinds of decisions that one makes in my role, or any role, some large, some small, that have some ethical element to them. How do you think about what is right versus wrong? The final point I would make is that many don't actually see the decisions I make. Some are big, and some are important, but decisions not to do something are not necessarily visible. I always have to ask myself what it would feel like if [the decisions I made] were on the front page of *The New York Times*.

QUESTION: When you were talking about corporate governance you didn't mention board composition or the individuals who serve on those boards. To what extent was that a factor in the financial industry situation and to what extent is that a factor in TIAA-CREF's approach to its portfolio management?

ROGER FERGUSON: Board composition is very important because the board has a very important fiduciary obligation. Consequently, on the board you need a range of points of view, experience, and expertise. We absolutely do look for that on our own board, and on the boards of our portfolio of companies as well. Board members absolutely have to understand the business. We are also seeing more and more individuals on boards who have a corporate governance role. You also need people with specific knowledge for certain roles; for example, you must have individuals who can handle accounting activities in the role of chair of the audit committee. And finally, thinking about risk and risk management is very important for board members. We are looking for individuals who can handle all that. We don't have a one-size-fits-all view about the issue of independence of the CEO and the chair — that is, of having an independent chairman — although it is a topic that is on our mind. We have not come to a point of view that says that independence is the only approach. It is case-specific, but there have been a few cases when we voted to separate the chairman's role from the CEO's role because we thought that the CEO, who was also the chairman, had not done a good job.

QUESTION: What kind of relationship does the ethics officer have to the board? In other words, does he or she report directly to the board in addition to reporting to you as CEO? How does the chief ethics officer maintain an independence that is essentially guaranteed? And how does the board get proper information from the chief ethics and compliance officer?

ROGER FERGUSON: At TIAA-CREF, our chief ethics officer is also our chief compliance officer, and the relationship is one of independence in a number of ways. First, that individual, who is a woman, has an independent executive session with our board's finance and risk committees and has the right to meet directly with the overall board. Importantly, at every meeting, management is excused, and she stays to give her perspectives to the finance and risk committees. Second, beyond that, she meets individually with the head of the audit committee as well. And third, the board takes a particular interest in her compensation and how it's decided — making sure that it is appropriately set with some outside benchmarks. So there is a type of reporting relationship intended to foster independence. We have a relationship now that I think works incredibly well to maintain the independence and direct reporting relationship that I think you are talking about.

Please note that TIAA-CREF has asked to include the following:

Guaranteed lifetime income is subject to the claims paying ability of the issuing insurance company.

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