UNIVERSITY OF ESWATINI

FACULTY OF COMMERCE

DEPARTMENT OF BUSINESS ADMINISTRATION

MAIN EXAMINATION

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TITLE OF PAPER	:	BUSINESS ETHICS
DEGREE	:	MBA
COURSE CODE	:	BUS 606
TIME ALLOWED	:	THREE (3) HOURS
INSTRUCTIONS	:	1.THIS PAPER CONSISTS OF SECTIONS (A) AND (B) 2. THE CASE STUDY ON SECTION (A) IS COMPULSORY. TOTAL MARKS POSSIBLE: 40 MARKS 3. ANSWER ANY THREE QUESTIONS FROM SECTION (B): TOTAL MARKS POSSIBLE: 60 MARKS
NOTE:		MARKS WILL BE AWARDED FOR GOOD COMMUNICATION IN ENGLISH AND FOR ORDERLY PRESENTATION OF WORK

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SECTION A

CASE STUDY

Through the Eyes of a Whistleblower

Citigroup (Citi) was a multinational financial services company headquartered in Manhattan, New York. It was the sixth largest residential lender in the United States in 2004 and was rapidly growing. Mortgage lending was an important line of business for Citi and all large U.S. banks, as mortgages kept them in the black. A dependable and low-risk source of profits, mortgages were typically the last expense homeowners defaulted on when faced with financial troubles.
On March 22, 2011, Sherry Hunt, vice president and chief underwriter at CitiMortgage had just had an impromptu meeting with Jeffery Polkinghorne—an executive three levels above her. His face had reddened as he raised his voice and pointed at her. If the mortgage defect rate reported by Hunt and her quality control unit did not fall substantially and immediately, he said, menacingly, "It's your asses on the line." As she struggled to regain her composure, Hunt considered her options. She knew the defects she was finding were legitimate and some even indicated fraud. They put Citi at serious risk, and she could not sign off on reports that obscured the facts. However, the financial crisis had hit the mortgage industry hard and there were no available jobs for someone with her qualifications. She felt both scared and angry that she was being asked to fudge reports. What was she going to do?

Richard Bowen was CitiMortgage's business chief underwriter for correspondent channels. Underwriting is the process by which a bank checks that each mortgage file contains all policy-required documents (e.g., proof of income, employment verification, etc.) and meets the minimum criteria established by a bank's credit policy. In learning about the work of the underwriters in his building, Bowen began to uncover problems. "I discovered that front-line employees were telling me one thing, yet their boss was telling me something completely different." Their boss was Connie—Hunt's direct supervisor, who reported directly to Bowen. He dug deeper and found that reporting done by the quality assurance (QA) underwriters whom Connie oversaw was dubious. QA was the group of underwriters who underwrote a small sample of already-purchased loans obtained through the delegated flow. The QA underwriters would assign each mortgage file in their sample an *agree*, *disagree*, or *agree-contingent* decision. This signified whether QA did or did not agree with the originating mortgage company (the correspondent lender) that the file adhered to Citi credit policy. Citi's expectation was that if the flow were functioning properly, 95 per cent of loans purchased through the delegated flow should receive the agree designation.

In 2006, the results that QA reported to the committee confirmed the 95 per cent agree to 5 per cent disagree ratio. However, upon further investigation, Bowen discovered that the total of the agree and agree-contingent decisions was being reported as the agree rate. To Bowen's shock, most of the Citi underwriters with whom he spoke believed that over half of the 95 percent agree rate comprised agree-contingent files that were missing required documents. The reports should have reflected that QA's results were 40 per cent agree, 55 per cent agree-contingent, and 5 per cent disagree. This meant that 60 per cent of the mortgages that Citi had purchased in 2006, were likely defective. Bowen quickly acted to improve the accuracy of reporting and to terminate Connie in September 2006. Now, Hunt reported directly to Bowen. Bowen recalled. Hunt's team found all kinds of defects in the loans that Citi had already purchased from correspondent lenders. "For example, to get a loan, you have to live in the home as your primary residence. We found a guy who had nine loans with nine different banks, saying he was going to live in all of these houses, and then he didn't live in any," Hunt recalled. And the borrowers were not always the perpetrators. Sometimes it was the bank's loan officers. "We found that loan officers sometimes backed up the numbers. When filling out applications for stated income loans, which did not require back-up documentation, they would think, 'What income do I need to put down that the borrower earns in order to qualify for the loan?' Hunt elaborated, "How many nail technicians do you know who make $10,000 a month? The loan applicant only has $50 in the bank. How could they buy a half-million-dollar home at 100 per cent financing? Hunt reported the defects in regular reports, but colleagues did not welcome her warnings. "Instead they fought us on why or how we found the problems. It ended up being a war every day," Hunt recalled. They didn't like her very much and being disliked was not new to Hunt. There had been objections from upper management when Bowen tried to formally promote her to Connie's position.

In the years that followed, Citigroup's corporate emphasis was placed on growth and market share. To achieve this and meet investors' high demand for mortgage-backed securities at the time, Citi had incentives in place. The discretionary salary and bonuses of CitiMortgage employees up to its CEO depended upon the percentage of loans approved. Anything that opposed sales or getting new business in the door was squashed a lot of times. During this period, Hunt and Bowen recalled the defect rate of REL's mortgages hovering between 60 and 80 per cent. The industry's rule of thumb was to keep the rate below 5 per cent. Starting in 2006, they worked together to try to identify and fix the myriad problems underlying the high defect rate: Citi's systems could not effectively track important criteria. For instance, Citi's computer system could not stop a loan officer from moving forward with a loan application if he or she entered an applicant who did not meet a loan program's minimum credit score. The fact that this simple indicator could not be flagged was one among many reasons that Hunt and Bowen could not systematically prevent Citi from buying loans from correspondent lenders that did not meet Citi's requirements. Bowen recalled, "I would make presentations, capture people in the hallways, warn my superiors. No one could tell me that what I was finding wasn't true, but they would argue that it was just technical exceptions that I was finding. The real estate market was in a bubble phase, and there really were no delinquencies yet, so there was no hard evidence that the defects would translate into losses.

When Hunt sent another increasingly grave summary of her defect findings to Bowen in late 2007, he concluded that Citigroup was at dangerous risk. Hearing in the press that on Sunday, November 4, 2007, Robert Rubin would be named Citigroup's new chairman of the board, Bowen knew he needed to warn him. From his home on Saturday, he sent an email to Robert Rubin, copying Citi's chief auditor (who reported to the board of directors), Citi's chief financial officer, and Citi's senior risk officer in Manhattan. "The reason for this urgent email concerns breakdowns of internal controls and resulting in significant but possibly unrecognized financial losses existing within our organization," On Tuesday he received a call from one of Citigroup's top general counsels, who said, "We got your email, and we're taking this seriously." However, Bowen said, general counsel never called back despite the emails he sent in November and December, offering to share more details. Instead, soon thereafter Hunt was asked to meet with a group of Citi's lawyers, who had flown in from New York. After meeting with the attorneys and ruminating on the questions they had asked, she began to suspect they had something to do with Bowen. From that point forward, Hunt began keeping a detailed spread sheet on her home computer; recording every problematic encounter or email she had at work each day. In early 2008, Bowen was stripped of his underwriting responsibilities, and the number of people he managed was reduced from 220 people to 2. That April, Citi modified Hunt's responsibilities as well. She went from supervising 65 people to 1.

In July 2008, Bowen testified before the U.S. Securities and Exchange Commission (SEC), which had approached him, and was told the commission would pursue his case, but he never heard back. "Looking back, I think that the U.S. government couldn't pursue fraud charges and at the same time give Citi a $45 billion bailout. The public wouldn't have accepted that,"
While working for QC, Hunt continued to witness fraud. She discovered 1,000 loans that had been flagged by her team for not just defects but *fraud* and had been escalated to CitiMortgage's fraud prevention and investigation group. The fraud prevention and investigation group had not taken action on some of the loans in this group for over two years. "You know when they say people tend to have a fight or flight response? Ordinarily, I took flight. I'd leave a company each time I saw unethical behaviour. But this time I was trapped. I couldn't leave. Nobody was hiring during the economic crisis."
In January 2009, Bowen—who had continued to be employed by Citi but had been placed on paid administrative leave from the moment he had been stripped of his underwriting responsibilities—left the company. "I had to move on with my life. [All this] had taken a real toll

on my family and my health, and I had to end it," he said He was then asked to testify publicly in front of the commission on April 7, 2010, though in the final days leading up to his public testimony, the deputy general counsel of the commission—under pressure from Citigroup's lawyers—made him delete any mention of his concern that Citi had materially misrepresented its certifications of internal controls, delete the names of individuals within Citi, and delete information about his essential demotion after having sent the email to Robert Rubin. When reflecting on his journey, the word that came to mind was *devastating*. "It truly was," he said. "From my standpoint, the corruption extends to the highest levels of government. I feel absolutely, completely violated. Every principle that I grew up with just completely violated." In the months that followed, Hunt reported Citi's fraud anonymously on the FBI's website. I thought the FBI would certainly be interested in fraud, but I never heard back. It was so frustrating." She was ready to leave Citi and move in an instant, but there was nowhere to go. The time had finally come. She had to take a stand. But who should she go to, and what should she say?

Adapted from:
Adam Waytz, Vasilia Kilibarda, (2017) "Through the Eyes of a Whistle-Blower: How Sherry Hunt Spoke Up About Citibank's
Mortgage Fraud", Kellogg School of Management Cases, Vol. Issue: , pp.1-18,
https://doi.org/10.1108/case.kellogg.2016.000374
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Questions

(a) Identify and critically analyse the conflict between personal and business ethical values faced by Richard Bowen and Sherry Hunt (15 marks)
(b) Discuss the dilemmas of whistle blowing exposed in the case study. (15 marks)
(c) In your opinion, were the strategies used by Richard Bowen and Sherry Hunt adequate? Give reasons for your response. (10 marks)

SECTION B

Question 1

Ethics refers to a set of principles pertaining to what is good in the conduct or behaviour of an individual. Examine the meaning of "good" and the causes of bad behaviour in business. (20 marks)

Question 2

Investigate management's ethical and fiduciary responsibility to shareholders with a critical analysis of the conflict that may arise in pursuing other ethical responsibilities in a business. (20 marks)

Question 3

Discuss businesses ethical responsibilities towards creditors. (20 marks)

Question 4

The guiding principle to ethical competitive behaviour is not to harm the competitor but to serve the customer better. Use examples to discuss the likelihood and tendency of businesses to default on this principle in competitive practices. (20 marks)