The Curious Loan Approval
Teaching Notes

What Are the Relevant Facts?

1. Adam is a proficient financial analyst, as evidenced by his credit analysis exam scores and the praise he receives from his supervisor.
2. Adam's customer, Mitchell Foods, Inc., represents a large retail grocery chain requesting a $5 million short-term loan to finance inventory expansion.
3. Mitchell Foods finances its 35 retail outlets using operating leases to achieve off-balance-sheet financing.
4. Adam recognizes the need to adjust Mitchell Foods' leverage ratio to include the firm's significant operating lease liability. Given this adjustment, Mitchell Foods appears dangerously overleveraged; without the adjustment, the firm's balance sheet understates the true amount of leverage carried by the firm.
5. Mary dismisses Adam's concern regarding the recognition of Mitchell Foods' operating lease liability, and she instructs him to remove any explicit reference to this problem from the Mitchell Foods credit file.
6. Mary's directive to Adam contradicts the bank's credit policy regarding the treatment of operating lease liabilities.
7. The Mitchell Foods loan request is approved by the bank's credit committee with no discussion of the firm's operating lease liability.
8. After the loan is approved, Adam learns that Mary's personal mortgage loan request at Bay Street Savings has been approved with extremely favorable credit terms.
9. The president of Mitchell Foods is also the Chairman of the Board at Bay Street Savings.

What Are the Ethical Issues?

1. How can Adam reconcile his duty to his boss and his duty to complete his financial analysis of Mitchell Foods in conformity with the bank's credit policy?
2. Should Adam pursue this issue, even though the loan has already been approved by the bank?
3. Should Adam seek additional information from Mary, or should he discuss the matter with other senior officers within the corporate banking group?

What Are the Ethical Issues?

1. Does Adam have a fiduciary duty to reveal Mary's potential conflict of interest in this transaction to other officers within the bank?
2. Does Adam, as a junior financial analyst, have responsibility for improper documentation within the credit file, when the bank's senior loan committee members failed to notice Mitchell Foods' significant operating lease liability during the credit committee meeting?

Who Are the Primary Stakeholders?

- Adam
- Mary
- The members of Farmwood National's senior credit committee
- The depositors and shareholders of Farmwood National Bank
- The mortgage loan officers at Bay Street Savings and Loan
- The president of Bay Street Savings and Loan
- The depositors and shareholders at Bay Street Savings and Loan
- The FDIC and, ultimately, all American taxpayers

What Are the Possible Alternatives?

1. Adam could approach Mary, ask for more specific reasons why she instructed him to ignore Mitchell Foods' operating leases in his credit analysis, and ask her to explain why this issue was not mentioned during the credit committee meeting.
2. Given Mary's apparent conflict of interest in this transaction, Adam could discuss Mary's behavior with the head of the corporate banking group, the officer in charge of credit policy administration within the bank, or some other senior manager.
3. Adam could seek additional information before he takes any action, perhaps by reviewing the written minutes of the credit committee meeting at which the Mitchell Foods loan was approved.
4. Adam could accept Mary's explanation, ignore the apparent conflict of interest, and do nothing.

What Are the Ethics of the Alternatives?

- Questioning the class based on a "utilitarian" perspective (i.e., costs and benefits):
  1. Which possible alternative provides the greatest benefit to the greatest number of people? (Be sure to point out that because Farmwood National and Bay Street Savings are federally insured institutions, credit policy violations at either firm can have far-reaching effects on depositors, future loan customers, and taxpayers.)
  2. How can costs be measured in this case? Should this measure include the danger to Adam's career or Mary's career? How does the cost of a single violation of the bank's credit policy translate into the aggregate cost of increasing risk within Farmwood National Bank and/or the entire banking industry?
  3. Do the benefits associated with absolute conformity to the bank's credit policy offset the costs of inflexible, bureaucratic lending standards?
- Questioning the class based on a "rights" perspective:
  1. What does each stakeholder have the right to expect in this case? In particular, does Adam have the right to demand a clear explanation of the transaction from Mary? Does Mary have the right to demand loyalty and trust from her subordinate? Does she have the right to privacy in her personal life? Does the bank's credit committee have the right to expect that individual loan officers will reveal potential conflicts of interest when they bring a credit request to the committee?
  2. Are the rights of some of the stakeholders in this case more important than the rights of others? If so, whose rights are most important, and whose rights are least important? Why?
  3. Which alternative course of action violates the rights of the greatest number of stakeholders in this case? (Be sure to include taxpayers as stakeholders.) Which course of action violates the rights of the fewest number of stakeholders?
- Questioning the class based on a "justice" perspective (i.e., benefits and burdens):
  1. Which course of action distributes the benefits and burdens most fairly among the stakeholders? Which course of action results in the most inequitable distribution of benefits and burdens?
  2. What are the benefits and burdens associated with Adam's revelation of details concerning Mary's personal financial affairs with other officers at the bank? Does Adam (or Mary) share equally in the benefits and burdens associated with this course of action, or do these particular stakeholders have a disproportionate burden in exchange for minimal benefit?

What Are the Practical Constraints?

1. As a junior financial analyst, Adam knows very little about the details of the credit committee meeting at which the Mitchell Foods loan was approved. The firm's operating leases may be immaterial to the credit decision, because they are very short-term contracts or cancellable at the option of the lessee.
2. Mary is Adam's mentor. If he violates her trust at this juncture of his career, he may inadvertently sabotage his own career with the bank
3. The loan has already been approved. It may be impossible for the bank to limit its loss exposure at this late date, regardless of the particular course of action that Adam decides to take.

What Actions Should Be Taken?

1. What actions should Adam take?
2. Which alternative would you choose if you were in his position? Why would you make that choice?
3. Are there any additional facts you would like to know about the case before you make a particular decision? If so, what are these facts, and why are they important to your decision process?
4. Which ethical theories (utilitarian, rights, or justice) make the most sense to you as they relate to this situation? Why?

