

**Anthony S. Fell
Remarks to
King Bay Chaplaincy
Leadership and Character Breakfast Series
7:30 a.m., Wednesday, September 28, 2011**

Thank you Tom for your kind remarks and introduction which is very sincerely appreciated.

Good morning Ladies and Gentlemen.

First off, let me say how delighted I am to participate in this Leadership and Character Breakfast Series sponsored by King Bay Chaplaincy.

I would like to both thank and congratulate Tom Caldwell, Chairman of the Board of King Bay and Bruce Smith, Director of Chaplaincy on the outstanding work that King Bay does for our downtown community.

The chaplaincy has been in operation since 1977 offering daily non denominational services and providing help, counselling and, most importantly, hope to people in distress in this area - many from the financial business.

The financial business can be highly stressful for many and this is a valuable service to the community.

Now my focus this morning will be on character and leadership in the financial business.

Character is defined by the Oxford Dictionary as a “distinctive morale strength” or “good reputation”.

Leadership is defined as “guidance given by going in front”.

In other words you lead the troops over the hill – you don’t follow them.

Another definition of leadership, which I like is the ability to have people follow you where they don’t want to go.

In the corporate world leadership and character of top management is an essential ingredient in every successful business.

**I would add a further closely related dimension to leadership and character and that is
ethics and integrity.**

There have been hundreds of books written about leadership and character in the corporate world.

When you cut through it all, apart from overall management ability, it all gets down to top management having a total commitment to;

- **a strong focus on ethics and integrity**

and

- **an unwavering commitment to always placing the interests of their clients first**

In my own career, which has been investment banking over many years, I have observed globally that there has been a huge deficit of leadership, character, ethics and integrity in the investment industry.

Insider trading, front running clients, trades under the blotter, mispricing inventories and mispricing mutual funds and many other infractions, occur all too frequently – many to the detriment of clients.

Many investment firms have gone by the wayside over the years.

Some good examples are;

- **Baring Bros.**
 - **Morgan Grenfell**
 - **Warburg's**
 - **Kidder Peabody**
 - **Solomon Brothers**
 - **Drexel Burnham**
 - **Bear Stearns**
 - **Lehman Bros.**
 - **Merrill Lynch**
- and**
- **there are many more**

These firms were not destroyed by the competition or bad markets.

Rather these firms were destroyed by internal greed, corruption, infighting, wrongdoing and lawsuits – in other words, a lack of leadership, character, ethics and integrity – primarily at the top of the firm.

Just this past summer Roger Martin, Dean of the Rotman School of Business, published an outstanding book “Fixing The Game”.

This book documents the ethical breakdown of certain businesses due, in large measure, to greed at the top and the fanatical pursuit of shareholder value at all costs including pressing the regulatory envelope and taking advantage of your customers to maximize profits.

The book makes a convincing case that the best way to create shareholder value is to have a single minded corporate focus of always placing the interests of customers first which, of course, mandates high ethics and integrity.

Putting the customer first.

**That’s the way you build a reputation
and
that’s the way you build customer loyalty.**

What’s the difference between ethics and integrity.

Ethics is a set of personal principles, a moral code or rules of conduct if you like, which are adhered to and followed by an individual or a financial institution.

Integrity, on the other hand, is a matter of honesty or truthfulness – as interpreted by the laws of the land or, in the financial business, by the rules set out by the regulatory authorities.

You can legislate the law in business but, unfortunately, you cannot legislate ethics – you either have them or you don't.

When you look back at the record of the financial business in the U.S. and Europe these past several years, it is clear there has been a real deficit of leadership and character and definitely a deficit of high ethical standards and maybe even of integrity.

This should be of concern to all of us in the financial business because we all tend to be tarred with the same brush.

So let's reflect back on this most recent financial crisis in the U.S. and Europe.

In a nutshell we had a sub-prime mortgage crisis in the U.S. starting in 2007 which morphed into a banking crisis and a year later morphed once more into a sovereign debt crisis in Europe – still ongoing.

I'm not going to dwell on the causes of all of this because they have been incredibly well documented.

Suffice to say for the banking and investment business in the U.S. and Europe the end result of this crisis is carnage, destruction of wealth and vast reputational damage to the financial business.

As a result of all that has happened most of the big banks in the U.S. and Europe can be firmly categorized as the "walking dead".

What's really amazing is how long the CEOs of these banks lasted without being forced out – and a few are still there.

Just think of it.

**Barclays
Lloyds Bank
Royal Bank of Scotland
UBS
Deutsche Bank
Commerzbank
Societe Generale
Credit Agricole
Citigroup
Bank of America**

The shares of these ten giant banks are down an average of 88% from their all time high – some, like Royal Bank of Scotland are down 95%.

With proper mark to market accounting there is no equity left on the books of these banks.

The shares of these banks are trading at option value or a warrant on the future.

Shares of Morgan Stanley are down 85% from the high and Goldman Sachs by 60%.

Lehman of course is bankrupt, and deservedly so, and Bear Stearns and Merrill were bought out for a pittance.

The banking industry in the U.S. and Europe is in total disarray.

Just as important the U.S. banks are facing massive regulatory and civil lawsuits, tens and tens of billions, and regulatory problems coming at them from every point on the compass.

Every time you pick up the paper there seems to be a new suit against J.P. Morgan, Citigroup, Bank of America or Wells Fargo.

When you reflect on the damage in the European banking sector, I think most of it gets down to massive mismanagement and ego driven superstar CEOs who took far too much risk and went a deal too far.

In the U.S. there was not only massive mismanagement and ego driven CEOs, but you could add a further important dimension, which was a serious breakdown of ethical standards.

When you read all the books about Wall Street over the past few years it is clear the long bull market which ended in 2007 was accompanied by a steady and significant decline of ethical standards in the banking and financial business in the U.S.

Wall Street lost its moral compass.

In the euphoria of the boom, the industry forgot that there are many practices in the financial business which are legal but which are also totally and completely unethical.

A pervasive view developed on Wall Street that if a business practice or product was legal, it's okay and the ethics went out the window.

Banks and dealers have large highly paid legal departments to keep them on the right side of the law but who looks after the ethics of the bank and how they treat their customers.

Virtually every financial institution on Wall Street has a high sounding corporate mantra placing the interests of their clients first but the record shows what happened in actual practice in many firms was far different.

Problem is they didn't "walk the talk".

It is now clear, as this most recent financial bubble got bigger and bigger, that in many banking, investment and mortgage firms and credit rating agencies in the U.S. the partners and senior management and the bonus pool came first and the clients came last.

This latest crisis exposed a vast array of legal but unethical practices in the business.

These included;

- super aggressive marketing of financial products –especially in the mortgage business**
- hidden fees, and commissions and teaser rates on mortgages to mislead new homeowners**

- **conflicted rating agencies**
- **firms betting against their clients**
- **inadequate disclosure of many products**
- **robotic signing of mortgage foreclosure documents**
- and
- **marketing highly complex products to unsuspecting investors**

The list goes on.

Just this past week the SEC introduced a proposal which would restrict financial firms from betting against a bundle of financial products they created and sold to investors.

The SEC said the proposal under consideration is an important step forward to prohibit this practice.

Imagine an industry where the regulator has to introduce regulations to prohibit the firms from betting against their clients.

So over the past four years we have witnessed an incredible unravelling of the banking systems in the U.S. and Europe.

So, who or what was responsible for all of this?

Some would say the U.S. Congress was responsible for far too aggressive public and tax policy encouraging homeownership - and they would be right.

There are those who say it was central banks who kept interests far too low for too long encouraging governments, homeowners and consumers to borrow far too much – and they would be right.

Still others would say the regulators are responsible for permitting excessive leverage in financial institutions and for not exercising their existing right to regulate the mortgage market - - and they would be right.

But as far as shareholders and the financial industry is concerned, the real responsibility for the crisis in the banking and investment business rests squarely with top management.

These big banks are run basically by a CEO and three or four close associates at the top.

They are the ones who make the big decisions and they are the ones that set the tone for ethics and integrity down through the ranks and they are the ones responsible for governing the management and risk profile of the institution.

Most importantly, it's top management who is responsible for making sure that clients always come first.

The top executives of these big banks cannot exonerate or distance themselves from all that has happened by blaming the regulators or the Federal Reserve or the U.S. Congress.

Must huge banks with balance sheets of five hundred billion to a trillion dollars of assets rely on government regulators to control their risks.

I hope not.

Top bank management should understand the risk of excessive leverage, they should have recognized the mortgage bubble instead of trying to capitalize on it.

Also, they should have recognized that the risk management systems in their own bank were totally inadequate, or even non existent.

The sub-prime mortgages were shovelled in the back door, bundled up and sold out the front door to unsuspecting clients as quickly as possible to get them off their books before they went sour.

The top management of these big banks and dealers must accept responsibility for the incredible decline in ethical standards in the business.

They are ones who are supposed to lead on ethics, integrity, leadership and character.

The record shows they failed miserably and the consequences for the entire industry and the country have been disastrous.

(2001 tech and telecom meltdown (Enron/Worldcom))

It's of interest that the big banks in the U.S. and Europe are now fighting the maze of new regulations being imposed on the financial industry by regulators but they forget one thing.

They forget they brought this regulatory morass on themselves.

They have only themselves to blame.

Fortunately, the Canadian economy, financial industry and markets have come through the turmoil of the last four years not totally, but relatively, unscathed.

I attribute this to three factors.

The relatively strong fiscal position of our Federal Government.

Secondly, we have had a more conservative regulatory environment and a better regulated mortgage market.

Finally, I think it's fair to say that over the long term Canadian banks have been more conservatively and prudently managed than either U.S. or European banks.

In the five years leading up to the start of the crisis in 2007 a wild west atmosphere developed in the U.S. and Europe with huge M & A deals being done driven by so-called superstar CEOs.

(RBS & Barclay; ABM Amro \$100 billion)

Canadian banks were extremely fortunate in 1998 when the Minister of Finance turned down the proposed bank mergers.

As the industry evolved, these deals could have had a very unhappy ending.

To my mind, the major lesson of this past financial crisis is that;

- **leadership**
- **character**
- **ethics**
- **integrity**

and

- **a total focus on placing the interests of your clients first**

are the essential ingredients of long term success in the financial business.

When you are managing and looking after other people's money, your personal reputation and the collective reputation of the firm or bank for which you work is, by far, your most important asset.

Unfortunately, and regrettably, at least for the moment, Wall Street has lost its reputation.

I'm not sure it can ever be regained.

Fortunately, I believe circumstances in Canada are very materially better but, we too, have our challenges.

We cannot solve the problems of the U.S. and Europe but we should take note of what has happened and redouble our efforts to ensure the Canadian market maintains and strengthens its reputation for leadership, high ethical standards, prudent bank management and looking after clients first.

And there are issues.

A poll by Nano's Research about two years ago does not make good reading for stock brokers, business executives or bankers – in other words, for the entire financial business.

This random poll asked the question.

“Please state how you would rate the honesty and ethics of people in the following eighteen professions”.

In terms of ranking either high or very high, stock brokers ranked second to last out of eighteen, just above car salesmen but well below real estate agents, labour unions and building contractors.

The Banker and business executive segments were also well into the fourth quartile.

All in – a very disappointing and, I would say, disturbing result.

This should come as no surprise because polls and surveys have been telling us this for years – so there has to be a reason.

There is always a reason.

The key to achieving a high reputation and for placing the interests of our clients first is not in having a strong compliance department or rigorous regulatory and enforcement agencies.

The key is to have a Board of Directors and a top management team which has a total focus on ethics and integrity and ingraining that culture right throughout the firm.

It is my view that client trust and reputations are built over a long period of time in small steps by doing the right thing for your clients day-after-day, week-after-week.

Clients intuitively know if you are placing their interests first or if you are trying to take advantage of them.

In my experience in running a business, management is constantly confronted with a series of decisions, some big and some small

and

You either do the right thing for your customer or alternatively, you thread the need and rationalize a decision which favours the firm's short term interest.

I mentioned taking small steps to gradually improve our financial industry's reputation. Here are a few examples.

Excessive trading of retail investment accounts is an issue.

Most investment firms offer annual incentive award trips to their investment advisors. They take their top advisors or brokers and spouses to Hawaii or Europe or other exotic spots.

Qualification for these reward trips is based on total gross production or commission earned.

I am all in favour of these award trips but gross production is the wrong incentive and should be banned.

Often a firm's best and most professional advisors are not your top gross producers because they don't trade much.

The biggest grossing producers may well be trading far too much and churning their accounts and actually doing a very poor job for clients.

Stated simply – basing these award trips on gross production is a perverse incentive to churn accounts.

Qualification for incentive trips should be based;

- **on total assets under advisement**
 - **on customer satisfaction surveys**
 - **portfolio performance**
- and**
- **on an arbitrary judgment by sales management of which advisors are doing the best job for their clients.**

To ban award trips based on gross production and use other criteria should be an easy decision but the regulators won't impose the rule change.

Individual firms will not make the change because they say they will lose their top producers to another firm who does offer the trips.

It's pathetic.

When one buys a life insurance policy you pay a premium but there is no disclosure as to the commission.

If insurance buyers knew the commission, they would be shocked.

Buying life insurance is a major long term commitment.

When you buy a house, a new issue stock or pay a fee to have your money managed, you know exactly what the commission is.

Not so with life insurance – the commission is deliberately hidden in the premium.

Is hiding the commission on a life insurance policy placing the interests of the client first?

Of course not.

Why does not the insurance regulator require companies to disclose the commission.

The answer is the insurance regulator is beholden to its political masters and the insurance agents' lobby is very powerful and neither the Liberals or the Conservatives will stand up to it.

Again, it's pathetic.

The insurance lobby is more powerful than the Government of Ontario or Ottawa for that matter.

The global merger and acquisition business is an important source of advisory fees for investment banking firms.

For almost every M & A deal the Board of Directors of each company require a fairness opinion from their investment firm saying that this is a fair deal for their shareholders. A substantial fee is involved.

Virtually every study on this subject shows that perhaps two-thirds of M & A deals do not create value for shareholders and, in fact, many destroy value.

This raises the question why do investment banking firms so readily provide their fairness opinion and stamp of approval. How could they be wrong two-thirds of the time.

Could it be because of the fee?

I think the investment banking industry could improve its reputation and credibility by being more selective before they put their stamp of approval on any deal.

I think investment firms could do a better job of being more selective of what equities they bring to market through an IPO.

The performance record of IPOs has not been particularly good. There have been some spectacular successes but many major failures and overall performance is somewhat disappointing.

Too often when a firm is considering taking a company to the public market place, the test is “can it be sold” but the real test is “should it be sold”.

Corporate Boards have a huge responsibility.

I believe Board governance has improved in Canada due to investor and public backlash from the excesses of the technology and telecom bubble in 2001 (Nortel 2001) and the most recent sub-prime and banking crisis.

The Canadian Coalition for Good Governance has had a positive impact, highlighting shortcomings in some areas and bringing in guidelines to encourage “best practices”.

Nevertheless, I still think we have a ways to go and Boards should be a little more demanding of management.

If trouble comes, such as a takeover or whatever it might be, Boards have a strong tendency to circle the wagon and it’s all for one and one for all.

Boards and management like a Director who ask questions – but not too many questions.

Boards don’t want outliers and they don’t want a Director who might resign on a matter of principle because that would put the whole Board under the spotlight.

When did you last see a corporate Board member resign from a Board on a matter of principle. Hardly ever.

In assessing Boards high marks are given for having a majority of independent Directors.

An independent Director is not necessarily a good Director.

You can have a totally independent Board which is also totally ineffective because no one speaks up and everyone just goes with the flow.

It's important to have Directors who not only believe in what they stand for but, more, far more, importantly, stand up for what they believe in and say so.

I think company Chairmen and Governance Committees could do a much better job on Board renewal and weeding our Directors who are not making an appropriate contribution.

It's quite rare that a Chairman or a Governance Committee would ask a Director to stand down because it's not a comfortable conversation.

Rather they let them sit on the Board for another few years until they are forced to retire due to a mandatory retirement age limit.

Based on my experience of making presentations to Boards over many years, I would say on the average Board;

- one-third of the Directors speak up and are counted and make things happen
- one-third of the Board watch what happens
and
- the remaining third of Directors wonder what happened.

This is not good. Board Chairs and Governance Committees should aggressively weed out non-contributors.

I think Boards and the companies which they govern would be well served if the Governance Committee automatically eliminated the least effective Director every year.

Small Boards, say ten to twelve Directors, are best because there is no place to hide and non-contributors show up quickly.

A major ethical issue in the securities business right now facing the regulators in the U.S. and Canada is the whole subject of high frequency trading and what to do about it.

HFT is a business that relies on incredibly rapid computerized placement of orders, many of which are immediately updated or cancelled.

HFT strategies include momentum investing, but can also include predatory strategies that seek out large orders in the market place and may disadvantage long term investors.

HFT trading firms profit from high volume and high volatility by moving in and out of positions in a matter of milliseconds.

With the advent of HFT trading volumes on exchanges have gone parabolic.

High frequency trading now account for more than 50% of the total volume on the New York Stock Exchange and in the month of August it was estimated to account for as much as 75%.

The total dollar value of trading on the New York Stock Exchange in 1997 amounted to only 30% of GDP but, at the recent peak in 2007 – 2008, it was amounting to 160% of GDP – a 500% increase.

High frequency trading has nothing to do with investing. Regulators in the U.S. have even stated that it makes little sense to refer to someone as ‘investing’ in a company if they only hold the stock for a second.

Rather HFT is a business which makes large profits on millions of computerized trades each day with holding periods that can be less than a second.

By producing small profits on many individual trades, high frequency traders generate billions in revenues.

Tabb Group estimated that HFT revenues in 2009 were over \$7 billion. These revenues may have come at the detriment of the average investor.

There are some who say that high frequency trading has improved liquidity of the market but there are very knowledgeable people on the other side who say increased volume does not equate to increased liquidity.

It is unfortunate indeed that the regulators and the investment industry have not moved far faster to get a real handle on high frequency trading.

I think a very few are profiting at the expense of many.

The incredible volumes and volatility we are experiencing today on the markets give the general public the impression that markets have just turned into a giant gambling casino.

At a time when investor confidence is wavering, this is most unfortunate and it reflects badly on the financial and investment industry.

HFT is a major market integrity issue. My advice to regulators – get on it.

So in conclusion, just let me say, for all of us in the financial business, our major focus for the future has to be to work hard to upgrade the ethical standards in every facet of our business.

The best way to do this is to make absolutely certain that we always place the interests of our clients first and, if we do that, the rest will take care of itself.