Managing Organizational Integrity
In an Age of Texts, Tweets and WikiLeaks

April 2, 2012

Keith T. Darcy, Executive Director
Ethics & Compliance Officer Association (ECOA)
When bubbles burst...
<table>
<thead>
<tr>
<th>Company</th>
<th>Sector</th>
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<tbody>
<tr>
<td>Enron</td>
<td>Accounting</td>
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<td>Tyco</td>
<td>Wall St.</td>
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<td>Adelphia</td>
<td>Mutual Funds</td>
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<td>Xerox</td>
<td>Insurance</td>
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<td>Rite-Aid</td>
<td>Hospitals</td>
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<td>Martha Stewart</td>
<td>Pharmaceuticals</td>
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<td>ImClone</td>
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<td>Aurora Foods</td>
<td>Fannie Mae</td>
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<td>Computer Associates</td>
<td>Freddie Mac</td>
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<td>WorldCom</td>
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<td>Not Uniquely American</td>
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<td>- Mannesmann</td>
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<td>- ELF</td>
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<td>- Royal Dutch Shell</td>
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<td>- ABN-Ambro</td>
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<td>- Heidelberg Cement</td>
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<td>- Royal Ahold</td>
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<td>- Bank of Italy</td>
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<td>- Parmalat</td>
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<td>- Samsung</td>
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<td>- Bank of China</td>
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<td>- Hyundai</td>
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<td>- Nikko Cordial</td>
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<td>- United Nations</td>
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Settlements
(DPAs and Federal Monitors)

- HCA ($1.7B)
- AIG ($1.6B)
- Royal Ahold ($1.1B)
- Fannie Mae ($400M)
- Time Warner-AOL ($510M)
- KPMG ($465M)
- Adelphia ($715M)
- Tyco ($750M)
- Prudential ($600M)
- CA ($225M)
- Marsh McLennan ($850M)
Lessons Learned

1. Irrational exuberance + uninhibited self-interest
2. Arrogance
3. Fraud
4. Conflicts-of-interest
5. Preferential treatment
6. Accounting arbitrage
7. Failure of independent auditors
8. Failure of analysts
9. Failure of rating agencies
10. Failure of regulators
11. Failure of board oversight
12. Culture of greed
In Response?

- Sarbanes-Oxley Act (“SOX” - 2002)
- NYSE + Nasdaq
Sarbanes-Oxley Act

- CEO/CFO financial certifications
- Loan prohibitions
- Bonus forfeiture
- Blackout trading restrictions
- Internal control certifications
- Codes of ethics
- Whistleblower provisions

Audit committee
(Section 301) - Must establish procedures for:
- receipt, retention + treatment of accounting issues;
- confidential + anonymous tips regarding questionable accounting.
(Section 406) – Must:
- adopt code for financial officers, or explain why not
Thompson + McNulty

**Thompson Memo (2003)**
- Seriousness of the offense
- Pervasiveness of wrongdoing
- History of serious misconduct
- Timely and voluntary disclosure
- Existence and adequacy of compliance
- Corporate remedial actions
- Collateral consequences of conviction
- Adequacy of non-criminal remedies

**McNulty Memo (2006)**
- Adequacy of board oversight
- Did the board perform independent oversight, or merely “unquestioningly ratify officers’ recommendations?”
-Periodic risk assessments.

-There must be standards and procedures to prevent and detect criminal conduct.

-The board must be knowledgeable about and reasonably oversee the program.

-There must be a high-level person charged with oversight.

-That person must have appropriate authority and adequate resources and unfiltered access to the board.

-The firm must take reasonable steps to communicate and train...including the governing authority.

-Evaluate the effectiveness of the program.
Precondition to an effective program:

“...promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.”

“A good corporate citizen must first and foremost operate ethically.”

Judge Reuben Castillo, Vice Chairman
The Bubble Burst (again)

The Great Recession
Post 9-11

2001-2006
- Extraordinary growth in mortgages
- Accommodating conditions
- CDO’s
- AAA Rating

2007
- Teaser rates begin to expire
- Delinquencies rise
- Foreclosures rise
<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
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<tbody>
<tr>
<td>3/16/08</td>
<td>Bear Stearns sold to JPM Chase</td>
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<tr>
<td>7/11/08</td>
<td>IndyMac Bank (bankrupt)</td>
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<tr>
<td>9/7/08</td>
<td>Fannie Mae &amp; Freddie Mac (gov’t ownership)</td>
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<tr>
<td>9/15/08</td>
<td>Lehman Brothers (bankrupt)</td>
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<tr>
<td>9/16/08</td>
<td>Merrill Lynch sold to BofA</td>
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<tr>
<td>9/16/08</td>
<td>AIG (77.9% gov’t ownership)</td>
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<tr>
<td>9/18/09</td>
<td>Money market fund “breaks the buck”</td>
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The Meltdown

“We need the equivalent of war time powers.”
- Hank Paulson

“If you (congress) don’t act today there will be no economy tomorrow.”
- Ben Bernanke

9/19/08 - Treasury Secretary asks congress for $700 billion (TARP)
<table>
<thead>
<tr>
<th>Date</th>
<th>Headline</th>
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<tr>
<td>9/24/08</td>
<td>WAMU (bankrupt), to JPMorgan Chase</td>
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<td>9/29/08</td>
<td><strong>TARP bill voted down by congress</strong></td>
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<td>Fortis Bank nationalized</td>
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<td>HYPO Real estate bailed out</td>
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<td>Bradford &amp; Bingley nationalized</td>
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<td>Glitner Bank nationalized</td>
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<td>Ireland guarantees all deposits</td>
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<td>Italy guarantees all deposits</td>
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<td>10/1/08</td>
<td>Senate passes TARP</td>
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<td>10/4/08</td>
<td>Germany guarantees all deposits</td>
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<td>Russia discusses bail out of Iceland</td>
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<td>Date</td>
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<td>10/6/08</td>
<td>UK buys 70% RBS, 43% Lloyds Bank</td>
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<tr>
<td>10/7/08</td>
<td>UK announces $500B stimulus</td>
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<tr>
<td>10/17/08</td>
<td>Germany approves $750B stimulus</td>
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<tr>
<td>11/10/08</td>
<td>China announces $600B stimulus</td>
</tr>
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</table>
When the tide goes out...

- Mark Deier, $400 million
- Marcus Schrencker, $100 million
- Arthur Nadel, $300 million
- Joseph Forte, $100 million
- Nicholas Cosmo, $300 million
- Paul Greenwood, $900 million
- Danny Pang, $100 million
- Milowe Brost, $400 million
- Bernard Madoff, $65 billion

“Am I a sociopath?”
B. Madoff to his therapist
New York Magazine 3/7/11
When the tide goes out...

- Satyam Computer - $1 Billion
- Siemens - $1.6 billion settlement
- Halliburton - $599 million
- Stanford Financial Group - $8B
- Galleon Group - $1B
- BAE - $400+ million
- Daimler - $185 million
When the tide goes out...

- “Operation Broken Trust” (>500 prosecutions)
- “Deutsche Bank pays $554m to NYS for Tax Evasion”
- “BofA Pays $150 million Re Muni Bid Rigging”
- “UBS Fined $780 million in Tax Evasion”
- “Schwab Pays $119 million to Settle”
- “FDIC Seeks $2.5 Billion in Clawbacks”
- “BofA Pays $150 Million to Settle Merrill Lynch”
- “SAC Ex-Manager Set to Plead Guilty”
- “European Regulators Investigate Banks for Credit Swaps”
- “HSBC Accused of Helping Mubarak Regime Land Deals”
“Goldman Sachs Charged with Fraud”
Financial Times
April 17, 2010

“The whole building is about to collapse anytime now...Only potential survivor, the fabulous Fab...standing in the middle of all these complex, highly-leveraged, exotic trades he created.”

“Anyway, not feeling too guilty about this, the real purpose of my job is to make capital markets more efficient and ultimately provide the U.S. consumer with more efficient ways to leverage and finance himself, so there is a humble, noble and ethical reason for my job; amazing how good I am at convincing myself.”
When the tide goes out...

- “Raj Rajaratnum Sentenced to 11 ½ Years in Jail.”
- “U.S. Targets Insider Culture: Ex-Goldman Director Gupta Indicted”
- “News Corp Attorney Noted Hacking Culture in 2008”
- “Congressional Review Notes a Culture of Compartmentalization at Fukushima”
- “Culture of Complacency at BP”
- “Culture Kills: The Legacy of Massey Energy”
- “MF Global Collapses: $1 Billion Unaccounted For”
- “Goldman Sachs: A Culture of Recklessness and Greed”
- “Culture Was Corrupt at Olympus”
- “Closed Corporate Culture Blown Open”
- “Toyota: Secretive Culture”
- “TEPCO: Culture of Compartmentalization”
- “Korea Crippled by Culture of Corruption”
Corruption

- “Four Sama Dubai Employees Are Held In Corruption Probe”
- “Ex-Head of Bank of Italy to Go on Trial”
- “Bahrain Kickback Investigation Widens”
- “Siemens Excluded from World Bank Contracts for Two Years”
- “Control Components Admits to Violating FCPA in 36 Countries”
- “Ex-Sinopec Corporate Chairman Sentenced to Death for Bribery”
- “China Executes 2 For Role in Tainted Milk Scandal”
- “Chevron Offers Evidence of Bribery Scheme in Ecuador Lawsuit”
- “Maybey & Johnson To Be Sentenced in Bribery Case”
- “Postmaster General in India Held for Corruption”
- “UN Cuts Back on Investigating Fraud”
- “Rio Tinto Employees Admits to Taking Bribes in China”
- “Nine British Companies in US Bribe Inquiry”
- “Alstom UK Directors Arrested in SFO Bribery Investigation”
“Greece Condemned for Falsifying Data”
“Nortel Will Liquidate Assets”
“Italian Notables Feel Heat in Corruption Scandal”
“Ex-Gome Head is Sentenced”
“How German Companies Bribed Their Way to Greek deals”
“Avon Bribery Probe”
“BHP Billiton in US Anti-Corruption probe”
“Alcatel Agrees to Pay $137 Million to Avoid U.S. Prosecution”
“Russia’s Two Top IKEA Execs Sacked Over Suspected Bribery”
“Nexus Technologies and Three Employees Plead Guilty to Paying Bribes to Vietnamese Officials”
“Bribe Case Focuses on Negotiator for Alcoa”
“Total Indicted for Alleged Corruption in Iraq”
“Johnson & Johnson Settles Bribery Case”
“Russia Leads the World in Economic Crime, Report Says”
Anti-Corruption

- “Brazil’s Lula Sends Anti-Fraud Bill to Congress”
- “Peru Government Announces Creation of Anti Corruption Commission”
- “Australia Introduces New Laws to Fight Cartels and Corporate Corruption”
- “Anti-Corruption Candidate Wins Croatia Election”
- “Italian Cabinet Approves Corruption Crackdown”
- “China Premier Calls for Intensified Fight Against Corruption”
Anti-Corruption

- Foreign Corrupt Practices Act
- UN Convention Against Corruption
- UN Global Compact
- OECD Working Group – “Good Practice Guidance”
- UK Bribery Bill
- G-20
New Risks for the 21st Century

WikiLeaks
Whistleblowing
Social Media
Hacking/Cyber crime
Transparency
“Whistleblowing Now Just a Click Away”
Corporate Secretary
8-15-11

www.sec.gov/whistleblower

“SEC adopts final rules to implement Dodd-Frank provisions.”
When the tide goes out...?

- Pfizer - $2.3 billion
- GSK - $750 million
- Novartis - $422.5 million
- Eli Lilly - $1.4 billion
“New App Lets People to Check-In When Bribes Are Paid”

Wall Street Journal
5-17-11

“BRIBESPOT, a new app for android smartphones and soon for iPhones allows users to send in reports of bribes being taken.”
“Transparency International Launches New Whistleblower Hotline Called SPEAK UP”

Irish Times
5-26-11
“China Launches Whistleblower Websites”
Sify.com India Ltd.
February 15, 2011
“I intend to take down an American Bank and expose an ecosystem of corruption”

Julian Assange
November 29, 2010
“News of the World Hacking Scandal Exposed”

“Australian PM: Murdoch Has Questions to Answer”

“Wall Street Journal Head Resigns”

“Piers Morgan Denies Phone Hacking”

“Head of Scotland Yard Resigns”

“DOJ Preparing Subpoenas”

“PM Cameron Grilled by Parliament”
Cyber Threats

- “FBI Directors Warns of Growing Cyber Threat”
- “Internal Sabotage Security Risks Rising”
- “Mass Leak of Client Data Rattles Swiss Banking”
- “Social Media Use Puts Companies At Risk”
- “Unseen Security Risks Lurk in the Copy Room”
- “Data Breaches Are Heaviest At Hotels”
- “White House Focus on Nuclear Terrorism Gets Scrutiny”
- “Senators Seek Documents on Fort Hood Suspect”
- “Terror Attack on US Flight to Detroit Investigated”
- “Deloitte Poll: respondents Lack Confidence in Ability of Private Enterprises to Reduce the Occurrence of Cyber Crimes”
“The Web’s New Goldmine: Your Secrets”
Wall Street Journal
7-30-11

“Journal reporter finds that one of the fastest growing businesses on the internet is the business of spying on consumers."
“Code of Ethics in Mississippi Restricts Social Media Interaction Between Teachers and Students”

Mississippi Teachers Code
8-9-11
“Facebook Hired Firm to Target Google on Privacy”
Wall Street Journal
5-13-11
“Online Monitoring of Jobs Candidates Raises Disturbing Questions”

Ethikos
8-10-11
Changing times...

“Twitter Revolution” launched the Arab Spring

- Tunisia
- Egypt
- Yemen
- Syria
- Bahrain
Changing times...

74 year old farmer launched the Indian Summer

- Anna Hazare
- Lukpal bill
Changing times...

"Occupy Targets Banks, Corporate Campaign Spending"

- New York
- London
- Ontario
- Dublin
- Geneva
- Halifax
- Zurich
- Berlin
- Sydney
- Kuala Lumpur
- Bogota
- Brussels
- Paris
- Hong Kong
- Tel Aviv
- Rome
- Cape Town
- Mexico City
Lessons of the Great Recession

1. Arrogance
2. Fraud
3. Corruption
4. Conflicts-of-interest
5. Preferential treatment
6. Executive excess
7. Failure of all the gatekeepers
8. Culture of greed
“Why I Am Leaving Goldman Sachs”
Greg Smith, March 14, 2012

“...culture...revolved around teamwork, integrity, a spirit of humility, and always doing right by our clients.”

“...the environment is now as toxic and destructive as I have ever seen it.”

“...not one single minute is spent asking questions about how we can help our clients. It’s purely about how we can make the most money off them.”

“managing directors refer to their clients as “muppets.”

“Even after the S.E.C., Fabulous Fab, Abacus, God’s work, Carl Levin, Vampire Squids? ...Integrity?”
There has been a profound loss of trust in every part of society, including our:
- markets
- financial institutions
- organizations
- government
- leaders
You can’t legislate trust.
What is trust?
How do you build trust?
Culture

“A system of shared values”

“The underlying assumptions, beliefs, attitudes and expectations shared by an organization.”

“It’s the way things really get done around here.”
Central Concepts of Corporate Culture

1. They’re **collective**.
2. It’s what members agree about.
3. They’re **emotionally** charged
4. They’re **historically** based
5. They’re inherently **symbolic**
6. They’re **dynamic**
7. They’re vague, at times contradictory
8. They’re paradoxical
Corporate Culture

Strong cultures have two primary characteristics:

- High level of agreement on what’s valued.
- High level of intensity about these values.
Corporate Culture and Performance

- Ikea
- Starbucks
- Dannon
- Michelin
- FedEx
- Southwest Airlines
- Google
Culture trumps compliance!
Strong cultures self-regulate
Self-regulate or.......?
The University of Illinois will transform lives and serve society by educating, creating knowledge and putting knowledge to work on a large scale and with excellence.

**Guiding Values:**
- Aim high
- Strive to control our destiny
- Be accountable for our actions and exercise responsible stewardship
- Be inclusive, treat each other with dignity and respect and promote citizenship
- Value excellence, quality and service
- Foster innovation and creativity
The Center for Professional Responsibility in Business and Society

The mission of the inter-disciplinary Center is to develop a national vision that articulates societal expectations of a professional’s responsibility and accountability at both an individual and organizational level.