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WHITE PAPER

CHARACTER'S CRITICAL ROLE IN STRENGTHENING JUDGMENT IN FINANCIAL INSTITUTIONS

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EXECUTIVE SUMMARY[1]

This White Paper examines the essential source of misconduct that has persisted in the financial services industry despite the warning flags raised from the Financial Crisis of 2008-09 and the very public shaming of major financial institutions that have violated various regulatory regimes. We argue that the primary source is not, as commonly believed, a failure of subjective morality due to "bad" character but rather a failure of business judgment due to objective character weaknesses.

We introduce the Ivey Leader Character Framework which provides an objective approach to assess and develop leader character. When the framework is: (i) used to identify and address underdeveloped areas of Leader Character and (ii) integrated into an organization's Human Resources systems and practices (from recruitment, through development, performance management, to selection for senior leadership roles) it not only substantially reduces the probability and impact of the catastrophic consequences of poor conduct, it also creates the foundation for the development of strong character to imbue strong judgment, which in turn will drive a robust culture of sustainable excellence. We pursue this discussion in the following manner:

- Briefly review, through the use of examples, the types of poor conduct that continue to plague the financial industry since the onset of the Financial Crisis;

- Briefly review the media coverage and academic literature analyzing the aforementioned poor conduct: framing it as an issue of poor "moral" character;

- Consider how this framing assumption has guided the programs designed by regulators, boards and managements to address it and why these actions have only met with limited success;

- Introduce amore complete interpretation of the sources of poor conduct and misbehavior in the financial industry using the Ivey Leader Character Framework;

- Discuss the implications of focusing on "judgment" rather than "moral behavior" as a more insightful, complete and pragmatic approach to the misconduct issue,

- Review the critical perspectives and key principles underlying the successful implementation of Leader Character that will strengthen the business judgment of the leadership throughout any financial services organization, concluding with six critical "takeaways."

Throughout this discussion we acknowledge the important (perhaps even primary) impact that context and culture have on the actions of individuals. We highlight Leader Character's capacity to not only create awareness of context, but to also neutralize the effects of negative context, and to shape positive culture. We view Leader Character as a vital addition to the discussion that will fully activate and animate the initiatives pursued to date by regulators, boards, and management allowing these programs to achieve their maximum effectiveness.

[1] This White Paper is based on the substantial body of research by a team of researchers (referenced throughout) under the auspices of the Ivey Ian O. Ihnatowycz Institute for Leadership.

POOR CONDUCT PERSISTS IN THE FINANCIAL SERVICES INDUSTRY

Since the Financial Crisis there have been numerous and widespread instances of poor conduct continuing to take place within Financial Institutions across the globe. Some of the more egregious, recent examples include:

- Forex Market Manipulations Scandal: Global banks will pay more than US$10bn to settle allegations that they rigged the US$5TN daily forex markets. A notable quote from an unnamed trader as written in a November 5, 2010 chat: "If you ain't cheating, you ain't trying".[2]
- Money Laundering: In December 2012 HSBC Holdings Plc reached a US$1.9 billion settlement agreement with the U.S. Department of Justice to resolve charges it enabled Latin American drug cartels to launder billions of dollars from the mid-1990's to 2010.[3] Yet despite HSBC spending nearly US$3BN annually and tripling the number of compliance staff to around nine thousand people, a monitor overseeing HSBC's compliance with this settlement has uncovered a range of lapses. "The monitor's findings, which date from 2015, suggest that despite three years of efforts to bring compliance up to U.S. standards, HSBC is still struggling to meet the terms of the deal."[4]
- Rogue Trading Scandals: There have been numerous rogue trading scandals uncovered in recent years, the larger ones including: J.P. Morgan Chase's "London Whale" (2012, ~US$5.8BN loss) and UBS's Kweku Adoboli Equities Trading (2011, ~US$1.8BN loss).

In aggregate it is estimated that by mid-2015 the 16 largest global financial institutions alone had paid fines, settlements and provisions in excess of US$300 Billion since the onset of the Financial Crisis[5], representing on average 7.5% of the operating cost base of banks[6].

What makes these examples all the more remarkable is that these egregious breaches of conduct occurred or continued to occur *after* the Financial Crisis. *After* the multi-billion dollar bailouts

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[2] "Serious Fraud Office drops UK criminal forex probe", Lindsay Fortado and Katie Martin, *The Financial Times*, March 15, 2016

[3] "HSBC Holdings et al Admit to Anti-Money Laundering and Sanctions Violations, Forfeit $1.256 Billion in Deferred Prosecution Agreement", U.S. Department of Justice, December 11, 2012

[4] "Iranian Miniskirts, Bags of Cash Raise Doubts Over Controls at HSBC", Ese Erheriene and Margot Patrick, *Wall Street Journal*, March 30, 2016

[5] "Banks' Post Crisis Legal costs Hit $300bn", Ben McLannahan, *The Financial Times*, June 8, 2015 citing a study undertaken by UK-based CCP Research Foundation.

[6] *Banking Conduct and Culture, A Call for Sustained and Comprehensive Reform*, Group of Thirty, July 2015, p. 21.

of the financial services industry funded by taxpayers across the globe. *After* the extraordinary measures taken by international banking regulators to increase their oversight of financial institutions, including the hiring and placing of staff within the financial institutions, and the creation and passage of thousands of new pages of legislation. *After* these financial institutions themselves have committed billions of dollars to the implementation of new governance and oversight programs, hiring tens of thousands of new Audit, Compliance and Control personnel across the industry.

> *Banking is at a low point in terms of customer trust and reputation…The management challenge of embedding values and desired conduct cannot be overestimated, but it needs urgent action, from the banks and their leadership, as an ongoing task*[7].

David Wright, who recently stepped down as secretary-general of IOSCO, was quoted as saying that he has "no confidence that corporate governance and behavior is improving". He added, "My view is that there will be more discoveries of anti-competitive behavior, price fixing and collusion. I hope that I am wrong but I fear that I am not."[8]

This lack of progress at improving conduct has been a source of frustration for regulators, boards, management, industry stakeholders and the public at large. This frustration is real and it is intense. In the U.S. it has been publicly stated by regulators that if bad behavior were to persist then "the inevitable conclusion will be reached that your firms are too big and too complex to manage effectively. In that case, financial stability concerns would dictate that your firms need to be dramatically downsized and simplified so that they could be managed effectively."[9]

While in Canada the situation is not nearly as dire, this is not to claim that Canadian regulators are complacent or unaware of the risks that misconduct can present. In remarks made in June, 2015 to the C.D. Howe Institute, OSFI Superintendent Jeremy Rudin stated that OSFI has "come to see conduct as a prudential issue"[10]. This position was reinforced by Rudin in a recent article where he was quoted as saying, "Regulators need to make sure harder-to-

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[7] Ibid, p. 22

[8] "Cracking down on 'megalomaniacs and bullies'", Chris Flood, *The Financial Times*, March 24, 2016

[9] "*Enhancing Financial Stability by Improving Culture in the Financial Services Industry*", William C. Dudley, President and CEO of Federal Reserve Bank of New York; Workshop on Reforming Culture and Behavior in the Financial Services Industry, October 20, 2014

[10] *Away from the Lamppost: Culture, Conduct and the Effectiveness of Prudential Regulation*, Remarks by Superintendent Jeremy Rudin to the C.D. Howe Institute, June 17, 2015.

measure aspects of culture – norms and expectations for behavior – are in place to keep the risk-reward balance in check throughout the financial institution."[11]

POOR CONDUCT INADEQUATELY FRAMED AS A MORAL ISSUE[12]

The media, and the public at large, have not unreasonably framed the persistent misconduct issues in the financial services business as a moral problem. Numerous documentaries (Frontline: Money, Power and Wall Street, aired April 24, 2012) and Hollywood films ("The Big Short", 2015) have richly portrayed the excesses of the financial services business.

Articles from leading periodicals and newspapers support the framing of the misbehavior as a moral issue. The Atlantic Magazine's cover story in its May 2015 issue featured the article "Can Bankers Behave?"[13]. The author cites his own personal experience as an investment banker, interviews other banking professionals, and quotes prominent academics and banking regulators. His concern – "could Wall Street's deepest flaws be cultural, promulgated over generations by leaders who have chosen to reward those who cut corners, stab colleagues in the back and engage in otherwise unethical behavior?"[14].

Similarly an article by John Plender in the Financial Times invokes John Kenneth Galbraith's concept of a "stock of moral capital" present in the financial system at any given time, which rises and falls with market prosperity[15]. However, the author asserts that in addition we are witnessing a structural, secular change in this stock of moral capital brought about by an adverse change in ethical values.

There are recent academic studies of human behavior that strongly support the premise that one's moral fiber is eroded with even minimal exposure to the context of money, financial markets and even banking. According to a study published in the journal Nature, people

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[11] "Canada's bank regulator probing links between risks and 'culture' at financial institutions", Barbara Shecter, *National Post*, December 7, 2015

[12] There appears be a broad-based call for improved ethics in all walks of life, including business. Noted columnist and author David Brooks' book "*The Road to Character*" has been on the *New York Times* Bestseller list since its publication in April, 2015. And in the Harvard Business Review's April, 2015 edition, its *Idea Watch* section featured the article "Measuring the Return on Character", summarizing the results of a study that demonstrated that CEO's who rated highly on four moral principles delivered better financial results than those that didn't.

[13] "Can Bankers Behave?", William D. Cohan, *The Atlantic*, May, 2015

[14] Ibid.

[15] "*The crisis shows moral capital is in secular decline*", John Plender, Financial times, June 9, 2014

primed to remember that they worked for a bank ("identity-primed") were more likely to cheat on a coin toss[16]. This study is consistent with previous landmark studies about "money priming" which demonstrated that people even only subtly reminded of money were less helpful, preferred solitary activities and more physical space between themselves and a new acquaintance (although apparently ready to work harder and longer!)[17].

The inescapable (and not unreasonable) conclusion for many is that the Financial Services industry is riddled with "bad" people, attracted and empowered by an industry wide culture that allows and encourages them to exploit the weaknesses and loopholes for their own benefit. Zimbardo captured this dynamic in his description of bad apples, bad barrels (contexts / cultures) and bad barrel makers (managements / boards / regulators), with his classic and unsettling "Stanford Prisoner Experiment" revealing that good people placed in bad cultures end up doing bad things.[18] It is not a stretch for many to conclude that the nature of the financial industry itself creates its own moral erosion – even affecting "good" people - and efforts to impose rules to codify "good" morals, conduct and behavior are doomed to fail. Yet the financial industry has been under intense pressure to try.

SOLUTIONS BASED ON ADDRESSING MORAL BEHAVIOR

Certainly regulators, boards and managements have a much more nuanced view than the general public of the conditions and causes that have led to persistent misconduct and misbehavior in the financial sector. There is an awareness of the "bad apples" that need to be removed before they do more damage to their organizations. There is an awareness of the "bad barrels" that need to be rehabilitated before they inflict more damage on their stakeholders and the system in general. There is an awareness among the barrel-makers of the need to create policy and governance frameworks that also serve the long terms interests of the societies in which they operate who rely on a stable, fair, and resilient financial system. No one seriously advances the belief that morality, although clearly a problem, can be regulated, and even if it could, that it would be a panacea.

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[16] "Business, culture and dishonesty in the banking industry", Alain Cohn et al, *Nature*, Volume 516, December 4, 2014

[17] "The Psychological Consequences of Money", Kathleen D. Vohs et al, *Science*, Volume 314, November 17, 2006

[18] *The Lucifer Effect: Understanding How Good People Turn Evil*, Philip Zimbardo, 2008

"Virtue cannot be regulated. Even the strongest supervision cannot guarantee good conduct" - Mark Carney, governor of the Bank of England in a speech in London, Ontario, 2013[19].

However, the solutions proposed and imposed to date – with varying degrees of effectiveness – do have at their core an intent to install and strengthen moral sensibilities for the purpose of positive behavior modification. Examples include programs that have introduced codes of conduct, ethics and value statements which explicitly include moral considerations as a baseline standard for behavior. Compensation systems have been substantially adjusted through payout reductions, deferrals and claw-backs in an effort to reduce the incentives that induce or encourage immoral behavior. Complex and comprehensive compliance programs have been designed and rolled out which monitor and report key metrics in dashboard formats throughout all levels of an organization, up to and including the board. There is the reasonable expectation that sensitizing people to a moral code of conduct, redesigning incentive systems to support this moral code, and implementing compliance systems that check key performance indicators will lead to more responsible decision making and less instances of misconduct.

However, as laudable as these changes are, they have encountered various forms of resistance. Many in the financial services industry object (understandably) to the notion that they are morally inferior or flawed, and programs that seek to teach morals and ethics are often seen as condescending and met with "flavor-of-the-month" derision[20]. Changes in compensation systems have certainly created better alignment between bonus-able employees and their institutions, yet egregious instances of bad behavior to preserve bonuses (perhaps not as rich as before, but still substantial by any other measure) are not uncommon. Many compliance systems have devolved into "tick the box" exercises where efficiency is more prized than judgment, undermining the effectiveness of the process, and perhaps even engendering a dangerous false sense of security. Given the ongoing instances of misconduct it is clearer than ever that simply changing the rules and implementing new processes do not go far

[19] "Can Bankers Behave?", William D. Cohan, *The Atlantic*, May, 2015

[20] It is clear that people within the financial industry do not perceive themselves as morally "bad". Tom Hayes, recently convicted in the UK and sentenced to 14 years in prison for his role in the LIBOR scandal was the subject of an in-depth article in the Wall Street Journal. In the article the author writes: "He was 'getting angrier and angrier' his father, Nick Hayes, later told me. 'The more he gave the interviews to the SFO, the more convinced he was of his innocence.' And the more he became obsessed with the notion that his planned guilty plea would haunt him for the rest of his life.", "The Unraveling of Tom Hayes", by David Enrich, *The Wall Street Journal*, September 13, 2015.

enough, and will not by themselves sustainably change culture, and the frame of reference within which people make decisions.

The frustration that these approaches have not gone far enough is evident in the more radical solutions that continue to be implemented. In the UK the "Senior Manager's Regime" came into force in March, 2016. This regime makes a "reckless" decision that causes a bank to fail a *criminal* offence carrying a maximum of seven years in prison and an unlimited fine. The rules apply to individuals and banks who fulfill 17 designated senior management functions, ranging from the chief executive and heads of risk and finance to the chairs of the risk, audit and remuneration committees[21]. Perhaps the biggest issue faced by these deterrence based solutions is that most unethical and improper behavior can take a very long period of time before it is actually discovered. However, by then the damage has been done.

What is needed instead is an approach that impacts the conduct at the time when conversations are taking place or when choices are being made to either act morally or not, and in particular to activate and exercise the quality of judgment, strengthened by character that anticipates the consequences. This enhanced level of judgment will be fully aware of the contextual and cultural influences acting on the decision at hand, and is robust enough to not only resist poor judgments, but indeed to exert leadership in positively shaping the culture within which future decisions will be made by themselves and others.

We argue in the following section that these choices and decisions are not optimally or primarily framed as ethical or moral decisions, but rather as business judgments. There are ways to improve an individual's business judgment through the development of character, that when added to and augmented by the many process, organizational and regulatory changes described earlier , will not only fully animate those processes, but reduce the likelihood of catastrophic outcomes, and lead to substantial, sustainable and indispensable improvements in both individual and organizational performance.

POOR CONDUCT FRAMED AS A JUDGMENT ISSUE

We believe that framing the conduct issue as a moral behavior problem, although not without merit, is ultimately incomplete and may indeed create obstacles to identifying the core issues of this misconduct, and the effective approaches to resolution we have noted above.

[21] "Leeson: risk managers should be personally liable for trades", Tom Osborn, Risk.net, March 14, 2016

> *"A prime element of leadership, within a firm and across the industry, is character – behavior anchored in values consistent with the public's legitimate expectation of trustworthiness" - William C. Dudley from a speech in November 2015* [22].

We believe that it would be more insightful and more precise to interpret misconduct and misbehavior in the business sphere as being a failure of judgment, caused by weakness in some dimension(s) of character. The underlying rationale is two-fold. First, focusing on the quality of judgment not only deals with issues of poor judgment but importantly extends to excellent judgment leading to sustained excellent performance.[23] Essentially, by understanding the micro-foundations of excellent judgment the underpinnings of poor judgment are addressed. Second, while few people self-assess as having issues of morality, strengthening judgment is something most people aspire to. Viewing character weakness as a judgment issue instead of a moral issue engages audiences who want to improve judgment but without the judging that is typically associated with moral agendas. The discussion can be had much more dispassionately and rationally, and the audience does not feel themselves either under attack or being judged in a very personal sense. Further, a discerning audience will quickly sense an opportunity to improve their own decision-making and performance, making engagement very much in their own self-interest. Indeed, simply by explicitly framing the discussion in the self-interest of the listener we can substantially reduce barriers to engagement.

[22] "Opening Remarks", William C. Dudley, President and CEO of Federal Reserve Bank of New York; Reforming Culture and Behavior in the Financial Services Industry, November 5, 2015

[23] "In the case of the effects of character, Cameron, Bright, and Caza (2004) found that firms whose members possessed more character dimensions outperformed those whose members possessed fewer character dimensions, and in Wang and Hackett's (2016) work, character-based leadership predicted the well-being of both leaders and their followers, along with the performance and citizenship behaviors of employees even after other leadership styles were controlled for. Character dimensions have also been associated with performance on creative tasks (Avey, Luthans, Hannah, Sweetman, & Peterson, 2012), job performance (Hannah, Lester, & Volgelgesang, 2005; Seijts et al., 2015), executive leadership and performance (Sosik, 2006; Sosik, Gentry, & Chun, 2012), executive selection criteria for top-level positions (Hollenbeck, 2009), trust and commitment (Thun & Kelloway, 2011), psychological safety (Palanski & Vogelgesang, 2011), citizenship behaviors (Cohen et al., 2014; Thun & Kelloway, 2011), life satisfaction and well-being (Park, Peterson, & Seligman, 2004; Thun & Kelloway, 2011) and ethical behavior and reduced counterproductive behavior (Cohen et al., 2014). In addition, in his book on "Return on Character", Kiel (2015) shows firms of "High Virtuoso" CEOs averaging five times the ROA over a 2-year period, compared to their "self-focused" CEO counterparts, and having 26 percent higher work engagement, and fewer audit problems and lawsuits. In sum, there is evidence to suggest that character enables human excellence and social betterment." - "The Entanglement of Leader Character and Leader Competence and its Impact on Performance" by Sturm, Vera and Crossan (working paper)

This latter point is not to be under-estimated. Perhaps one of the most significant challenges to changing organizational culture is that of sustainability. Regulators, boards and management are in agreement that meaningful and sustainable cultural change within large financial institutions has been extremely difficult, and that "accountability must be seen as a new way of doing business, not as a compliance fad"[24]. To emphasize, improving the character related aspects of judgment achieves sustainability in two separate, but self-reinforcing ways. First, measures that enhance individual and organizational performance create their own "indispensability". Second, the aggregate effect of improved judgments by individuals (in particular those with *positional* leadership) positively influence the culture of the organization, solidifying the improvements and making it more difficult and less likely that the culture will regress (i.e. preserving the "good barrel"). Working with an NHL team, a player recounted the importance of character to their performance, describing that when the team had won the Stanley Cup, they could have brought a criminal into the room and he would have become a better player.

> *"Banks should look at culture, and achieving consistent behavior and conduct aligned with firm values, as key to strategic success, rather than as a separate work stream or add-on process to respond to short-term public, regulatory or enforcement priorities" - Banking Conduct and Culture, Group of Thirty, p.12, July, 2015*

The Leader Character Framework is intended to create superior performance for both individuals and organizations through sustainably improving judgment and decision making at all levels throughout an organization, in particular by focusing on those in leadership roles. Once embedded in an organization it becomes not only a core strategic value driving superior performance, but also raises the standards and expectations for behavior and conduct, enhancing and developing a robust culture that substantially reduces the risk of catastrophic misconduct. A robust character-infused culture also provides a degree of protection from the truly incorrigible "bad apples" that inevitably crop up in any large organization by making their deviant behavior easier to identify and more clearly unacceptable, which limits their potential for leadership and organizational influence.

In the past, re-framing a discussion on character as a judgment issue has been very challenging because character:

[24] "Summary Notes: Reforming Culture and Behavior in the Financial Services Industry", p.8, published by the Federal Reserve Bank of New York, November 5, 2015

1. has always been considered a subjective, individual concept, eluding objective definition;
2. cannot be readily measured; and
3. is regarded by many as an unchangeable physical trait, like the color of one's eyes.

However, where there is an accessible, convincing, measureable and developable definition of and framework for character (in the judgment sense) this could be an extremely useful business tool, not only in the Financial Services industry, but in any organizational / industrial context. This is because although character has resisted many attempts to objectively define it, virtually everyone agrees that it is an extremely important element in leadership.

Recently, with the development of the Ivey Leader Character model, an award-winning[25] framework that is being deployed across a wide variety of organizations, such a framework is now available.

IVEY LEADER CHARACTER FRAMEWORK

The fundamental premise is that organizations need to elevate character alongside competence for sustained excellence[26]. Doing so requires a rigorous, robust and practical approach to identifying, measuring, developing and applying character in organizations. Research establishes that character is revealed through a set of observable behaviors that support sustained excellence in organizations.[27] Figure 1 depicts the dimensions and elements of Leader Character.

Dimensions are the 11 high level constructs, and elements are the behaviors that capture the dimension. For example, Integrity is a dimension that comprises more than being principled, but also more challenging elements such as candor and authenticity that make the practice of Integrity difficult. Many organizations identify Integrity as an important value but fail to recognize that simply stating it is important does not deliver it. The equivalent is

[25] "*Developing Leadership Character in Business Programs*" by Professors Mary Crossan (Ivey), Daina Mazutis (IMD), Jeffrey Gandz (Ivey) and Gerard Seijts (Ivey) and was awarded the prestigious Academy of Management Learning and Education's Article of the Year (2013).

[26] Gandz, J.; Crossan, M.; Seijts, G.; Stephenson, C. (with research assistance from Daina Mazutis) Leadership on Trial: A Manifesto for Leadership Development. 2010. See also Appendix 1.

[27] Refer to footnote 23

indicating someone wants to run a marathon without ever training to do it. Judgment at the centre of the framework reveals that the decisions and actions are predicated on more than competence but also the strength of character. For example, Judgment that is underweighted on dimensions such as Humility or Temperance runs the risk that decisions will be ego-driven and short-sighted if drive or lack of temperance are driving forces. Table 1 describes key implications when each dimension of character is present or absent in organizations.

Figure 1 – Leader Character Framework

All dimensions can become vices in excess or deficiency. Excess arises in cases where other dimensions are underdeveloped. For example, Humanity without Courage leaves leaders with a great deal of empathy but limited in their capacity to exercise Humanity. A high level of Drive without corresponding capacity for Temperance risks reckless and manic behaviors. Unlike personality traits and associated theory that suggests individuals are born with traits such as extroversion and introversion and need to find other people to complement their innate tendencies, the dimensions of character comprise learned behaviors, and all matter given their inter-relationship. It is important to emphasize that character is a set of learned behaviors and therefore can be developed. Unfortunately, many financial institutions (and other organizations as well) have inappropriately over-weighted some dimensions relative to others, creating a context and culture that over-weights dimensions such as Drive and Courage and underweights dimensions such as Temperance and Humility, resulting in virtues becoming vices, with the ultimate implication that Judgment is impaired.

Table 1: Impact of Character on Organizations

	PRESENT	ABSENT
Courage	- Decisions are made in spite of uncertainty - There is opposition to bad decisions - Innovation thrives	- There is agreement with poor decisions - Satisficing rather than maximizing is the norm - Moral muteness prevails
Drive	- There is sustained momentum around focused priorities and high productivity	- There is widespread lethargy and low productivity
Collaboration	- Effective teamwork enhances productivity - There is diversity in teams that contributes to innovation, understanding, and appreciation for others' ideas	- An "every man for himself" mentality breeds a hostile competitive climate that alienates potential allies - Lack of information sharing leads to poor understanding of decisions, resulting in friction and conflict
Integrity	- There is trust, transparency, and effective communication	- People operate from a position of self-interest and mistrust which impairs their ability to make good business decisions.
Temperance	- There is effective risk management governed by reasoned decision-making - There is thoughtful consideration (versus impulsive over-reaction) to events that impact the business	- Short term gains dictate strategy - Desire for instant gratification trumps a more measured "what is best over the long term" approach
Accountability	- There is ownership of issues and commitment to decisions and their execution	- There is failure to deliver results and take responsibility for poor decisions and outcomes
Justice	- There is perception of fairness that fosters trust - People go above and beyond what is required	- Inequities exist that erode trust - Widespread favoritism and nepotism exist
Humility	- There is a willingness to identify and discuss mistakes - The organization supports continuous learning	- Interactions are ruled by arrogance and overconfidence - Problems and projects are approached with complacency
Humanity	- There is a deep understanding of what is important to stakeholders that fosters unique insights and competitive advantage	- There is a failure to acknowledge critical social implications of decisions and actions
Transcendence	- There is commitment to excellence - There is clarity on superordinate goals and a focus on big picture thinking - Inspiration motivates innovation	- Strategy is dictated by narrow goals and objectives - There is failure to acknowledge, appreciate, or strive for excellence - People are not inspired to create and contribute
Judgment	- There is recognition of key issues relevant to situations - Decisions are predicated on excellent understanding, analysis, and insight	- Lack of comprehensive and balanced assessment of issues leads to poor decisions, confusion, and resistance to change.

Leader Character is essential for sustained excellence as it provides the foundation leaders need to operate positive two to three standard deviations from the norm as depicted in Figure 2a. Character works in at least three important ways over and above competence. First, anchored in Judgment and supported by the other dimensions of character it provides the foundation to reason through complex, ambiguous and difficult issues. Second, and often associated with such issues, is having the personal strength, founded in character, to withstand difficult or challenging situations over extended periods of time. Finally, it is instrumental in the inspiration and aspiration needed for sustained excellence.

Character enables leaders to resist the gravitational pull to the norm (or worse) as shown in Figure 2b. The organization, industry and societal cultures (barrels) within which individuals operate both define and challenge Judgment. Speaking at a convention for Fraud Examiners, Andrew Fastow, the former CFO of Enron, stated that "Accounting rules and regulations and securities laws and regulation are vague…They're complex … What I did at Enron and what we tended to do as a company [was] to view that complexity, that vagueness … not as a problem, but as an opportunity." The only question was "do the rules allow it — or do the rules allow an interpretation that will allow it?" Fastow insisted he got approval for every single deal — from lawyers, accountants, management, and directors — yet noted that Enron is still considered "the largest accounting fraud in history." He asked rhetorically, "How can it be that you get approvals … and it's still fraud?".[28]

Consider that rules and regulations are often interpreted as defining "how the game is played" and often people are rewarded for creative application of the rules. Fastow claimed he should have been called the "Chief Loop-Hole Officer".[29] As well, the rules and regulations typically seek to prevent the negative deviation shown in Figure 2a, while values and ethics tend to define the norm. However, they are insufficient to develop the strength of character that withstands the many forces that undermine sustained excellence. Forces that typically undermine sustained excellence are basic psych/social forces such as social comparison, bystander effect and money priming, but also organizational culture forces such as compensation and reward systems that are often quite transactional and focused solely on results without regard for the quality of the results. Unfortunately, many results have embedded within them toxic elements or "ticking time bombs" that go undetected for often

[28] "The Confessions of Andy Fastow", Peter Elkind, *Fortune.com*, July 1, 2013
[29] "Here's a Simple Lesson in Ethics From the Former CFO of Enron", Tracy Alloway, *Bloomberg.com*, July 2, 2015

long periods of time as evidenced in many bank failures. We assert that while currently there are few ways to test the quality of the results, weaknesses in character are usually implicated. Furthermore, where organizations seek to develop strength of character and its associated culture, it is less likely that those who habitually operate in deviant ways will go undetected as they will be more clearly identifiable as outliers (i.e. "bad apples") and be forced to either modify their behaviour or exit the organization.

Figure 2a

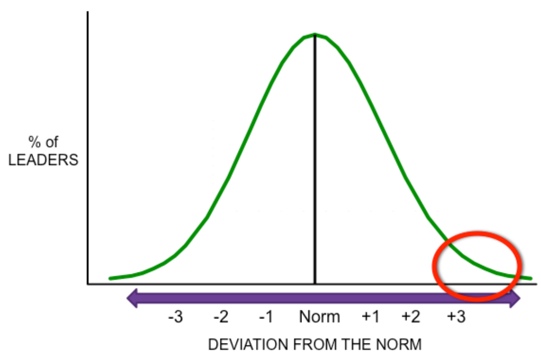
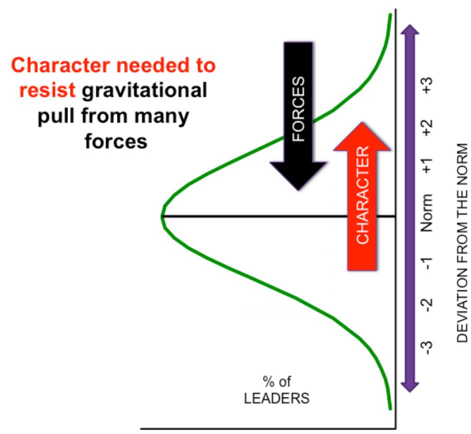


Figure 2b



Taken together, the implications for the financial services industry are significant. First, character needs to be elevated alongside competence to avert negative deviance and reap the benefits of positive performance. This is an important pivot away from character viewed as associated with being a good or bad person, but rather as foundational for sustained excellence. Second, many organizations (such as the Enron example cited earlier) have fallen into the trap of overweighting some dimensions and underweighting others leading to toxic cultures that undermine judgment. The dimensions of character need to work together to support Judgment, which acts like an air traffic controller drawing on the dimensions as needed.

Organizations are already assessing character using the Leader Character Insight Assessment (LCIA) offered through Sigma Assessment[30] It is a reliable and valid instrument that can be used in self-assessment or 360 format. The results enable individuals and organizations to identify areas of development. Since the Leader Character Framework is behaviorally based, it can be used to select on character, develop character, reward and promote on the basis of

[30] See Appendix 2 for sample Leader Character Inventory Assessment report excerpts.

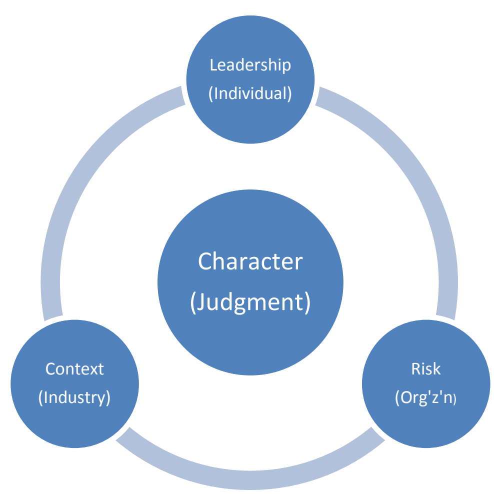
character and infuse culture with character. Elevating character alongside competence for sustained excellence is in the best interests of organizations and the regulators who provide stewardship.

IMPLEMENTING THE LEADER CHARACTER FRAMEWORK

Implementing the Leader Character Framework in any organization requires giving consideration to: (i) the multiple perspectives within the environment and (ii) the process of developing character within leaders and embedding character in the organization. Actual implementation programs need to be customized for each organization. This section will provide a brief discussion of these perspectives and three basic principles underlying the embedding of the Leader Character Framework, with some specific thoughts on this implementation process as it applies to financial services organizations.

The process of implementation needs to take into account three different perspectives: the Individual, the Organization and the Industry. In the context of the financial services industry these three perspectives equate to: Leadership, Risk and Context. (See Fig. 3). Each perspective is briefly described below:

Figure 3 – Implementation Perspectives



- **Leadership / Individual Perspective:** This perspective considers the application of Leader Character to enhance, and potentially transform, the decision-making abilities of individuals to drive sustained, superior performance. As discussed earlier, the Leader Character dimensions are learned behaviors, and can be strengthened through individual development plans.[31] Although the Leader Character Framework targets organizational leaders, it regards leadership as being *dispositional*, not simply *positional,* and is intended to engage every person in the organization. This is particularly important since many derailments in financial services arise from poor judgment by experts who do not have supervisory responsibilities. As a result, regulators will be interested in Leader Character initiatives that extend beyond persons in the leadership ranks. For example, one large integrated financial services organization that has pioneered this approach included exposure to the Leader Character Framework as part of its onboarding of new recruits in capital markets.

- **Context / Industry Perspective:** This perspective considers the effects of industry-specific context on character to impair, distort or otherwise erode decision-making capabilities. For the financial services industry there are specific challenges that have been identified including Identity Priming and Money Priming. Complications to consider here are the incentives created by the potentially lucrative compensation programs typical for the industry. For the financial services industry the impact of this specific context needs to be taken into account as a unique downward "gravitational pull" effect on decision-making as discussed earlier (see Figure 2). As has been demonstrated by the persistent issues of misconduct, the specific implication for regulators is that rules and regulations on their own have been insufficient to address the gravitational pull toward negative deviance and hence investment in character is a critical leverage point.
- **Risk / Organization Perspective:** This perspective connects the two previous perspectives (individual, industry) by considering the perspective of each individual within a specific financial services organization. Each organization will have a unique mission, value proposition, actual / aspirational culture and stakeholder set that will inform the language, pace and approach to implementation. However, for financial services in particular, as the risk / reward tradeoff is central to organizational performance, there is the opportunity for Leader Character to focus on risk / reward decision-making as the activity of highest potential impact, across all types of risk (credit, market, operational, reputation and conduct). From a regulatory, board and executive

[31] Both the LCIA and the Developing Leadership Character book by Crossan, Seijts and Gandz, Routledge 2016, are designed to develop leader character. Ivey also has an MBA course devoted to the development of leader character called "Transformational Leadership". The AMLE article referenced in footnote 25 makes the case for developing character alongside competence in business schools.

perspective, conduct risk has specifically proven to be persistent and resistant to sustainable improvement, and offers a natural "leverage" point to introduce Leader Character. In addition, it is important that the improved judgment developed by stronger Leader Character permeate the entire organization as hindsight often shows that misconduct was first detected, but not escalated, in less accessible "corners" of a financial institution.

The process of embedding is extremely important and needs considerable and conscientious forethought in order to properly implement Leader Character and avoid organizational disharmony and / or harm. For example, it would be very prejudicial to the implementation of the Leader Character Framework if middle management were to judge that the Board, CEO, or executive management were disingenuous in their support of Leader Character, hypocritical in its implementation or not personally striving to achieve great Leader Character in their day-to-day actions. Importantly, the "barrel makers" themselves (management, boards and regulators) need strong character and competence to design, build and embody a character-aligned culture within their organization and industry. Individuals with strong character have a developed capacity for accountability, justice and integrity, to name a few character dimensions, that enable them to stand outside the "barrel" and consider what is in the best long term interests of all stakeholders while their character-infused judgment helps them to navigate the complexity and ambiguity inherent in the financial services context.

Embedding Leader Character is very dependent upon the perspectives discussed earlier and is therefore unique to each organization. Instead of providing a detailed and rigid formulation, we present three "Principles" to be followed in the design and execution of an implementation program. These principles, when adhered to, provide a firm foundation upon which an implementation program can be initiated and sustained, and are also useful in proactively addressing some of the forms of resistance other organizations have encountered when embedding Leader Character.

1. Leader Character is a core strategy, to be fully and permanently integrated into an organization's overall strategy:
    a. Leader Character is intended to permanently improve judgment and decision making in all situations, sustainably and permanently elevating a positive organizational culture; it is not a "flavor-of-the-month" reaction to regulatory / stakeholder conduct issues;

    b. Leader Character provides a framework that (i) creates a common definition of character (ii) can objectively measure character and (iii) informs the approaches to activate and substantially develop character through the application of individual development plans[32];
    c. Leader Character terminology becomes ingrained in a common language to discuss matters of character, decision making and performance, and is incorporated into internal and external stakeholder communications.
2. Where high Competency resides, strong Leader Character must also reside:
    a. High competency exercised in the absence of strong Leader Character will lead to catastrophic outcomes (as evidenced by the many egregious examples of complex financial products improperly sold to unsophisticated investors);
    b. As such, wherever high competency is required, measured and developed, strong Leader Character should be required, measured and developed. The LCIA is a behavior-based assessment that can be employed to do this;
    c. This principle has many implications, perhaps the most substantial of which is that Leader Character needs to be incorporated into all aspects of an organization's HR program cycle (recruiting, development, evaluation, compensation, promotion, and termination).
3. Seek impactful "leverage" points to introduce Leader Character:
    a. Take advantage of significant organizational initiatives and issues, such as conduct risk management, organizational transformation, or values and ethics to frame the introduction of Leader Character to all stakeholders (including regulators) as an opportunity to enhance decision making and performance;
    b. Persistent misconduct in the financial services industry provides a natural and impactful leverage point to introduce Leader Character;
    c. Other financial industry leverage points include (i) Risk Management (credit, market, operational and reputational, and the "Three Lines of Defense" risk management framework commonly employed in the industry) and (ii) Wealth Management / Investor Advice.

These three principles follow two basic themes that are present and evident throughout this paper, namely: (i) character in an organizational context can be objectively defined, measured

[32] Ibid

and developed and (ii) the business purpose for improving character is to improve judgment, decision-making and performance, not impose some form of moral code.

CONCLUSIONS

We conclude our discussion with six main points:

1. **The continuing issues of misconduct in the financial services industry indicate that the approaches and remedies employed to date have met with limited success.** It is also clear that the financial services sector is too important to the overall functioning of the economy for this misconduct to persist. Indeed, key regulatory bodies have signaled that the *status quo* is simply not acceptable. New approaches, perspectives and initiatives are required.

2. **Reframing misconduct in the financial services sector to add business judgment to the moral issue represents a more complete formulation of the problem.** This reframing has two very significant practical advantages. First, formulating the issue as primarily one of judgment does not meet the same emotional resistance that a "moral" framing will encounter. Further, initiatives to improve judgment, decision making and performance are widely shared, non-controversial aspirations that allow for a strong alignment of interests among all stakeholders. Secondly, the improved judgment, decision making and performance that results from stronger Leader Character places this initiative at the core of corporate strategy, leading to sustained and permanent change. In turn, improved character-based judgment will positively impact the context and culture within which decisions are made, fully activating and animating the many measures already put into place, while further improving sustainability and limiting the risk of an incorrigible individual and / or cultural regression.

3. **Leader Character must be present wherever there is a competitive / strategic requirement for strong competency.** Warren Buffet has been quoted as saying, "Somebody once said that in looking for people to hire, you look for three qualities: integrity, intelligence, and energy. And if you don't have the first, the other two will kill you." Using the language of Ivey's 3C's of Leadership, the three qualities would be Character, Competency and Commitment. The Financial Crisis was an excellent demonstration of the adverse consequences that can prevail when judgment (Character) is overwhelmed by technical expertise (Competency) and intense effort (Commitment).

It is Leader Character that harnesses strong Competency and Commitment to produce sustainable excellence while simultaneously avoiding catastrophic outcomes.

4. **The dimensions in the Leader Character Framework are habits of behavior that can change over time, for better or for worse.** Unlike physical or personality traits they can, through patient and thoughtful application, be consciously strengthened. And given their interdependence, strengthening underdeveloped dimensions has the effect of increasing the capacity and effectiveness of all other dimensions. Indeed the imbalance of underweighted and over-weighted dimensions risks over-weighted dimensions becoming vices. Furthermore, if the dimensions are neglected then due to contextual pressures an individual's character will atrophy with potentially disastrous results, in particular for those who occupy senior level roles of leadership and responsibility.

5. **Strengthening Leader Character will positively influence and change an organization's culture and (potentially) industry context.** It does this in three ways:

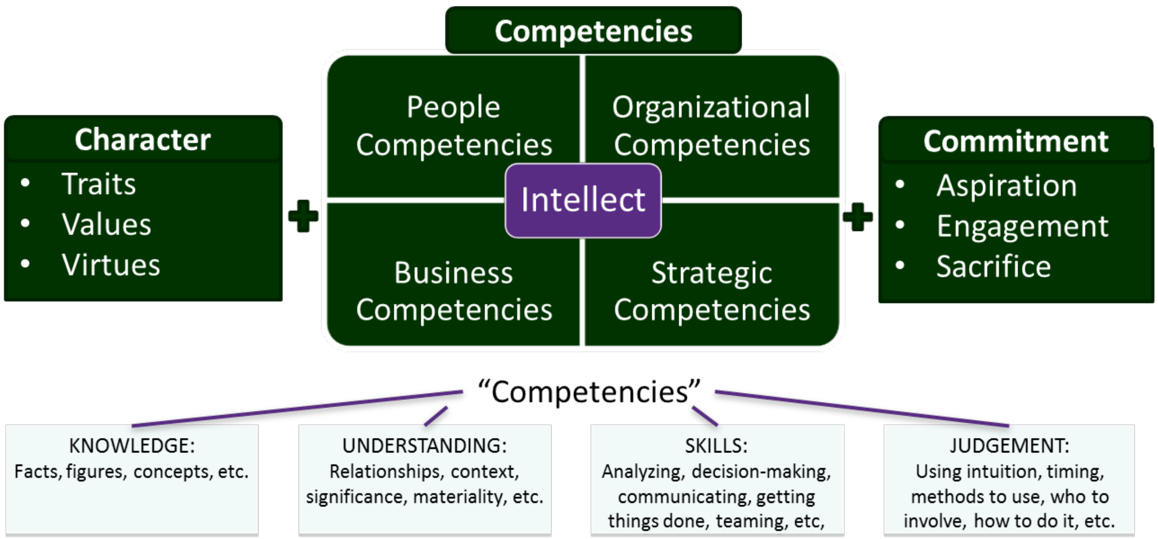
    a. Decision making and judgments will incorporate an awareness of context, in particular negative context, that can create the downward gravitational pull that undermines judgment;

    b. Decision makers will possess more resources and strength which are needed to resist the powerful forces of negative context and "informal" culture;

    c. Positional leaders (management, boards and regulators) will possess greater judgment and insight to design, create and sustain holistic, positive and self-reinforcing cultures ("good barrels") for their teams, organizations and industry.

6. **Embracing and implementing Leader Character represents an opportunity and a challenge to the Financial Services sector.** Significant sustainable advantages can potentially accrue to the "first movers" for the leaders in financial institutions who instinctively understand the value that character provides in any enterprise that aspires to excellence. Although the challenges of implementing Leader Character may at times appear formidable, the costs and risks of inaction (or simply staying the course) in the current environment seem unacceptable. We strongly encourage leadership across the Financial Services sector to consider plans, approaches and initiatives directed at embedding Leader Character as a core strategy for the long term prosperity of their organizations.

Appendix 1: The 3 C's of Leadership



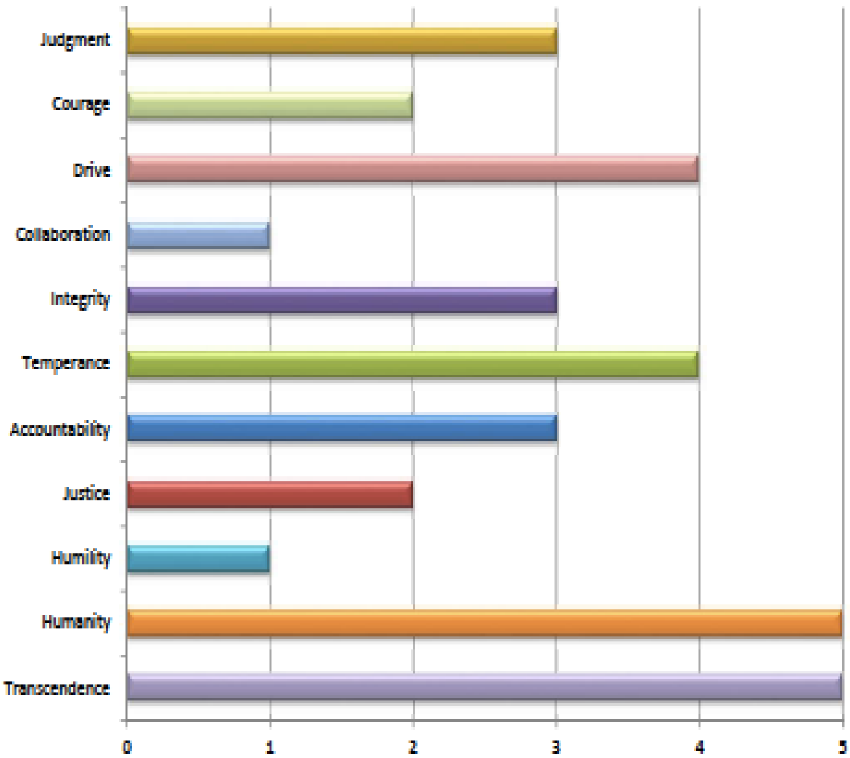
Gandz, J., Crossan, M., Seijts, G. and Stephenson, C. (2010). Leadership on trial: A manifesto for leadership development. London, Ontario: Ivey Business School.

Appendix 2a: Sample LCIA Report - Summary

LCIA Results Overview

Dimension Scores

In responding to the LCIA items you were asked to identify how likely you would be to engage in various behaviours that reflect the character dimensions and elements described in this report. You responded using the following scale: 1=Extremely Unlikely, 2=Unlikely, 3=Unsure, 4=Likely, 5=Extremely Likely. The graph below shows your score on each character dimension.



Appendix 2b: Sample LCIA Report - Judgment

JUDGMENT

Makes sound decisions in a timely manner based on relevant information and critical analysis of facts. Appreciates the broader context when reaching decisions. Shows flexibility when confronted with new information or situations. Has an implicit sense of the best way to proceed. Can see into the heart of challenging issues. Can reason effectively in uncertain or ambiguous situations.

ELEMENTS

Situationally Aware: Demonstrates an appreciation for unique circumstances that may dictate unique approaches.

Cognitively Complex: Analyzes, makes clear sense, and draws sound conclusions in uncertain, complex and ambiguous circumstances.

Analytical: Skilfully analyzes and employs logical reasoning.

Decisive: Promptly makes astute, level-headed decisions. Shows clear-sighted discernment of what is required.

Critical Thinker: Applies sound analysis and logical reasoning to evaluate ideas, decisions, and outcomes.

Intuitive: Understands things without an apparent need for conscious reasoning.

Insightful: Grasps the essence of situations. Sees into the heart of challenging issues.

Pragmatic: Understands, develops, and implements workable solutions under varied circumstances.

Adaptable: Modifies plans, decisions and actions to adjust to new conditions.

The chart below displays your ratings for Judgment and its key elements.