REPRINTED FROM
CREDIT UNION JOURNAL
THE NATION'S LEADING INDEPENDENT CREDIT UNION NEWSWEEKLY

A Tale of Two Financial Institutions: Why We All Need To Review Ethics

SECOND IN A SERIES ON ETHICS

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January 27, 2014

If you've just returned from your year-long trip to Mars, you'll be comforted to find that Twitter is making an offering of stock to the public and Jamie Dimon of Chase is making a sacrificial offering to the regulators in the form of $13 billion plus of shareholders' money, while holding a reserve pot of $23 billion for all settlements.

Dimon decided to cloak his tough-guy image and admit to his forced errors, such as the 4,208 mortgages he bought from New Century Financial Corp in 2006, repackaged and sold to investors like Freddie Mac and our corporate CUs. Within a year, 15% of the borrowers were delinquent and two years later these bundled investments were threatening the viability of our industry.

It's worth noting that CUs paid for these blunders. For example, a $20 million CU was assessed $142,000, or 4.3% of its capital, over a five-year period, while a $225 million CU paid $1.6 million, or 4.8% of its capital.

And the ethics of the once-mighty-and-still-powerful banking world continues to play out in the press while fines and losses add up and criminal charges are threatened. But as a society, we fail to know why people behave as they do; for example, why Bernie Madoff professed to "take care of people" while he "took advantage of them." But we do know that these extreme examples provide insight from which we can learn.

To better understand this, let's illustrate the past failures of two financial institutions.

Facts for Institution A

- Bought a subprime mortgage originator in 1999 which added $1billion to the bottom line.
- The chief economist issued a report in June 2006 that the housing market was ready to implode and companies deep into mortgages were heading into trouble. The CEO, adverse to challenging news, fired the chief economist on the spot.
- Sells mortgage originator for a healthy profit, but buyer insists that $10 billiion of risky loans be kept by seller. With little communication within the institution, these loans were still in the pipeline when it collapsed.

A little known regulator from the OCC, John Dugan, was well aware of the CEO's abusive behavior not only to employees but to regulators. In the waning months of 2008, after the fall of Bear Stearns and Lehmann Brothers, Dugan held the cards and the money.

Would Dugan bail it out? Maybe it was lessons learned from the playground. Dugan denied the bailout and the institution was later acquired by a rival.

Facts for Institution B

- Lack of discussion by management of real problems within investment portfolio; paid little attention to its own internal warning signs as a far back as 2007.
- CEO did not heed persistent advice of its chief economist, who sold his California home in 2004 fearing the collapse.
- CEO stated we are "solid as a rock" while knowing the underlying collateral of its investments was comprised largely of subprime mortgages.
- CEO noted he was doing a lot of speaking at meetings and receiving strong support and feedback; "2008 should be a banner year."
- By 2009, estimate of losses was $2 billion and $5 billion, and just hours before regulators took over, the CEO stated "We continue to be safe and sound...We don't expect the credit losses to exceed our capital."

These are very different institutions but with a similar story and similar outcome; A is a bank and B is a CU. Before you learn more about them, let's define our core concerns: the ethics of the institutions and its leaders. Ethics: (1) the discipline dealing with what is good and bad, and with moral duty and obligation. It derives from the Greek word: ethos, which means character. Character: (1) the combination of mental and ethical traits marking and individualizing a person, group, or nation.

And with regard to these cases, what can we say about traits and characteristics? Traits and characteristics for A: pompous and abusive to regulators and employees; one-way communication; addiction to profits; lack of accountability. Traits and characteristics of B: strained relationships; lying and denying; one-way communication; arrogance; lack of accountability.

And the Losers Are.....

Financial Institution A was National City Bank of Cleveland, which was acquired by PNC of Pittsburgh. Financial Institution B was WesCorp, which cost us dearly.

Are any of these traits and characteristics in play at your credit union? It has happened and continues to happen behind our doors. NCUA reports that since 2010, 39 credit unions were liquidated, costing the insurance fund dearly.

For example two credit unions with assets totaling $560 million cost the insurance fund $153 million. The report identifies lapses of ethics and mismanagement. Could fraud or mismanagement be taking place in the office across the hall?

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