GOVERNANCE AND CULTURE REFORM
FEDERAL RESERVE BANK *of* NEW YORK

Case Study

<u>The Case: Gotham Financial Services, Inc.</u>

Ten years ago, in the wake of the financial crisis, Gotham Financial Services, Inc. (GFSI) acquired Lake Erie Bancorp (LEB). Once known as the banker to America's leading manufacturing firms, LEB's business followed its customers down the Interstate Highway 75 from Michigan and Ohio to Florida. As the population of the Gulf Coast grew, LEB reinvented itself as a full-service retail bank headquartered in Tampa, Florida. It retained its name to remind customers of its long history and Midwestern values. Its balance sheet, however, was long on Florida's real estate market. When the crisis hit and mortgage defaults spiked, LEB fared worse than many. (A 2009 *New Yorker* article about LEB began, "The financial crisis started here.") GFSI, by contrast, had skillfully hedged its real estate exposures and found in the crisis great opportunity. From his New York headquarters, CEO John Smith saw an opportunity to acquire Gulf Coast customers and office space at a good price, while expanding the firm's brand in one of the country's fastest-growing regions. Regulators, running short of fingers to plug the dam of the crisis, quickly approved the takeover.

Variation 1

Five years after the takeover, GFSI investors enjoyed a record high share price. Smith eyed retirement and had in mind a perfect successor—Joseph Frank, recently named Head of Retail Banking. A GFSI man, Frank had built a remarkable record of success in seemingly every business line in the firm. He saw himself not so much in the business of banking, as in the business of solutions.

Frank's tenure in retail was likely to be a short one, but long enough to help him earn some consumer bona fides. When he eventually took the helm as CEO, GFSI—known more for its wholesale business—would be able to proudly state that it had promoted to CEO the Head of its Retail Bank. "I want the motto of the whole organization to be 'The Customer Comes First,'" Frank said. "That's the message on Main Street. It should be the message on Wall Street."

Though he knew his ascent to CEO was near, Frank was not one to rest. He undertook his new assignment at GFSI's Retail Bank with characteristic acumen and vigor. A few weeks after arriving, Frank found a problem that needed his solution. Retail banking was not an especially profitable business—at least, not by the standards to which Frank was accustomed. Still, there was opportunity in a traditionally "sticky" customer base. Customers simply needed to buy more. Frank rolled out new cross-selling objectives and conditioned compensation on meeting those benchmarks. He also unveiled a new system that would collect and analyze performance in real time. Soon after the successful implementation of the new system, Smith retired and Frank became CEO.

At the Tampa regional office, the message from New York was clear: Grow and grow some more. The more products, the better. Terri Bergin, the regional manager, worked with her branch managers to create and pioneer a new Tampa program: "Everyone's a salesperson." The initiative aimed to cut across silos and hierarchies at the branch, and make the job of selling GFSI's services the responsibility of each employee. All branch employees were offered webinars on the many financial products and services that GFSI could offer. Greeters were trained to welcome customers with a friendly hello and a question: "Are you here to check on your investments?" Tellers were given complementary brokerage accounts and encouraged to mention to customers the new service that they had just tried themselves. "I'm telling ya, you gotta try this mutual fund. I love it! Why should you leave your money sitting in a savings account when it could be earning for you?"

As it turned out, Frank's first Senate Banking Committee hearing as CEO was almost entirely about retail banking. A consumer watchdog had reported that staff in GFSI's Tampa Bay Area branches were giving financial advice without a license and directing customers into investments that earned big fees for GFSI when comparable products from Vanguard could have saved the customers money. Frank knew of the watchdog report and is pondering the right next step.

Variation 2

The 2009 takeover included LEB's back-office operations, based in Springville, Florida, a small town about an hour outside of Tampa. The office processed transactions for legacy LEB clients. Springville management was constantly concerned that GFSI might centralize all back-office services at their New Jersey operations center in order to cut costs.

From the time of the takeover, GFSI focused on profit growth while management in Springville focused on retaining jobs. The Springville employees had worked at LEB for decades, and were very loyal to the company. The LEB office supported many ancillary businesses in the town and had even started building a small clinic for children with cancer. Many of the employees' spouses were helping to get the clinic off the ground. At the time of the acquisition, LEB's Springville management made it clear to GFSI management that the town would be devastated if operations were moved to New Jersey. That seemed to keep the jobs safe for a while, but the specter of cuts was never far away.

Then, last year, LEB client activity started picking up. Year on year, profits doubled on business routed through the Springville office. LEB clients were using the firm for many more transactions than in the past. The Springville office reaped the financial benefits, and it looked like management there had secured the unit's survival (and their staff's livelihoods).

Maria Middleton, an analyst at the New Jersey operation, had noticed that more and more client activity was moving to Florida and that transaction speeds in Springville were 30% faster than what her colleagues in New Jersey were able to manage. "Impressive," she thought. "No wonder clients were sending more business their way!" She wondered how they were achieving this success.

Maria learned that the Springville office had implemented a streamlined straight-through-processing procedure that bypassed time-consuming manual compliance reviews. She wasn't able to get much information about how, but she knew that several members of the compliance team there had recently left the firm. Concerned that things in Springville might not be fully above board, Maria went to her manager, Bob Hesser. She shared her concerns that the improvements in processing times might be related to the compliance departures, and Bob assured her that he would escalate the issue, after joking about how the organization was better off with a few less compliance cops.

Bob didn't mention it to his boss. Springville management had seemed so happy and relieved at their golf outings during Bob's visits this past year. They were so much less stressed than before. Bob was happy for them. Besides, he reasoned, the team's customers were thrilled with faster processing speeds. If customers were getting better service from Springville, that is ultimately good for the firm, since the customer is #1. Anyway, Maria had a history of being a bit hysterical. Ever since she took an online course on speaking up, she'd been raising issues with some regularity.

Maria discovered that Bob never mentioned this issue to his boss. She needs to decide whether to let sleeping dogs lie.

<u>Please select the 3-4 questions that you would find most interesting to discuss at your table.</u>

1) Are there any blind spots in the case where the decision-makers weren't seeing the ethical relevance? Or, was it mostly a case of intentional trade-offs (e.g., commercial success versus ethical relevance)?

2) Did decision-makers feel supported by the norms and processes of the firm in making the more ethical decision? Did the decision-maker know what the more ethical choice was?

3) How important is "trust that you have my back" in understanding the central dilemma?

4) Have the choices been framed by the decision-makers as ethical ones? Is there some reframing happening?

5) Is language choice playing a role in the framing?

6) What role does compliance have in these types of issues?

7) Are there any risk-management blind spots in the case?

8) What would you change (e.g., processes, communications from managers, incentives, etc.) to diminish the risk of bad choices in settings such as these?

9) If this dilemma were to surface in a firm today, how would it be handled?

10) What three new actions could you take in the week following this conference to make your firm even stronger at uncovering ethical blind spots?