

Wall Street in Crisis: A Perfect Storm Looming

Labaton Sucharow's U.S. Financial Services Industry Survey

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Executive Summary

As we share the results of our second annual survey of the US financial services sector, and approach the third anniversary of the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, we are mindful that much has changed on 'The Street.'

A particularly troubling and consistent finding from our survey is what the future holds for Wall Street. Many of the young professionals who will one day assume control of the trillions of dollars that the industry manages have lost their moral compass, accepted corporate wrongdoing as a necessary evil and fear reporting misconduct. This is a ticking economic time bomb that responsible organizations must immediately defuse.

To be sure, over the last decade, scandal and corruption have eroded public faith in the markets. We have witnessed the global economy in precipitous decline, leaving a casualty trail from seemingly impenetrable institutions like Lehman Brothers, to small businesses and everyday individuals who have lost jobs, homes and retirement savings.

We have hoped for, and worked toward, a better future. Governments around the world have enacted aggressive reforms to ensure greater transparency and accountability. Corporate behemoths and financial institutions have taken a more judicious approach to risk management. Industry leaders have made promises to employees and the public at large—promises about ethics and responsibility. But the reality is, we now face a moment of unparalleled crisis; many of these promises have gone unfulfilled and if we don't take swift collective action, the battle cry *this can't happen again* will be nothing more than background music to the next, more potent economic tsunami.

In this second annual survey of the US financial services sector, we uncovered astonishing data about the state of our markets and, notably, an abject decline in the three forces that, individually and together, have the power to serve as safety nets for the economy: individual integrity,

leadership and corporate culture. A particularly troubling and consistent finding throughout the survey is that Wall Street's future leaders—the young professionals who will one day assume control of the trillions of dollars that the industry manages—have lost their moral compass, accept corporate wrongdoing as a necessary evil and fear reporting this misconduct. This is a ticking economic time bomb that responsible organizations must immediately defuse or pay a heavy price.

One sign of hope was the heightened confidence in the regulatory authorities that oversee the financial marketplace. For several years, it has become popular to criticize financial regulators. Now, as a result of leadership changes, organizational reforms and a more aggressive enforcement approach, financial services professionals have greater confidence in these organizations' ability to effectively and efficiently police the marketplace. We predict that industry confidence will continue to grow as awareness of the SEC Whistleblower Program grows and the program's successes are made public. Ironically, for an industry that almost universally calls for less government, financial regulators appear to be the only place where Wall Street professionals place real faith.

As the first law firm to establish a national practice exclusively focused on protecting and advocating for SEC whistleblowers, and with five decades of experience successfully prosecuting high-profile and high-stakes corporate wrongdoing for prominent institutional investors around the world, we at Labaton Sucharow are certain of one thing: Wall Street is facing an ethical crisis. Our survey revealed that wrongdoing is widespread, misconduct is accepted and there is a fundamental breakdown in trust between employers and their employees.

Ultimately, we believe that the best way to ensure that the marketplace operates with greater transparency, fairness and accountability is to recognize the powerful troika—regulators, corporations and individuals—that has the ability to establish and strengthen a culture of integrity that will create lasting change in the financial markets. There is no question that we have the power to change course but first we must admit that Wall Street has a significant and growing ethical crisis and act now to address the problem.

Key Findings:

- Despite the many reforms put in place in the wake of the financial crisis, only 36% of respondents felt that Wall Street has changed for the better since Dodd-Frank's passage in 2010.
- More than half of respondents—52%—felt it was likely that their competitors have engaged in unethical or illegal activity to gain an edge in the market; 24% felt employees at their own company likely have engaged in misconduct to get ahead.
- Misconduct is still widespread in the financial services industry; 23% of respondents indicated that they had observed or had firsthand knowledge of wrongdoing in the workplace.
- 29% of respondents believed that financial services professionals may need to engage in unethical or illegal activity in order to be successful.
- More than one-quarter of all financial services professionals—26%—believed the compensation plans or bonus structures in place at their companies incentivize employees to compromise ethical standards or violate the law.
- An alarming number of financial services professionals, 24% of respondents, likely would engage in insider trading to make \$10 million if they could get away with it.
- Shockingly, and consistent with recent and high-profile criticism of the culture within the financial services industry, a full 28% of respondents felt that the financial services industry *does not* put the interests of clients first.
- Building on this seemingly endemic culture problem, a concerning number of financial services professionals indicated that their leadership may put profits above ethics; 17% felt their leaders were likely to look the other way if they *suspected* a top performer engaged in insider trading. Equally concerning, 15% doubted that their leadership, upon *learning* of a top performer's crime, would report it to the authorities.
- As enforcement actions are on the rise and new reforms have strengthened financial regulators and law enforcement authorities, the court of public opinion is following suit; 62% of financial services professionals felt the SEC is an effective watchdog and 57% felt that FINRA is effective.
- Despite the encouraging 89% of financial services professionals who indicated a willingness to report wrongdoing given the protections and incentives such as those offered by the SEC Whistleblower Program, 40% of respondents were still unaware of the SEC's Whistleblower Program.

The Perfect Storm

No matter what commercial crisis we examine, there are, almost without exception, three factors that form a perfect storm: greed, weak leadership and fear. In the end, it's not about arcane derivative instruments, sophisticated computer algorithms or law enforcement. The root problem is just not that complex. Bad things happen when bad actors are able to run wild and good people who might "out" them turn away in fear. We saw these issues at play in Enron, WorldCom, Madoff, Galleon, SAC, Tyco... any number of corporate scandals. Our recent survey points to signs that these destructive forces are present and growing.

Success Drivers: An Industry Pandemic

Given the difficult financial times we live in, when jobs are scarce and bonuses hang in the balance, we asked respondents whether financial services professionals have to engage in unethical or illegal activity in order to be successful. The results were disheartening:

- 29% of those surveyed believed that the rules may have to be broken in order to be successful, a 17 percentage point increase over last year's survey.
 - Looking at seniority, 36% of respondents with 10 years or less experience in the industry believed financial services professionals may have to engage in misconduct to get ahead; twice as many as the 18% of professionals with more than 20 years in the field.
- 24% of respondents believed it was likely that that staff in their company have engaged in illegal or unethical activity in order to be successful. This is a 14 percentage point increase over the prior year.
 - We noted a 10-point spread based on gender, with 20% of men and 30% of women feeling it likely that employees at their company have engaged in misconduct to gain an edge.
 - We noted a 19-point spread based on seniority; 35% of those with 10 years or less experience believed it was likely that their fellow co-workers have engaged in misconduct, compared to 16% of professionals with more than 20 years' experience.

24% of financial services professionals likely would engage in insider trading to make \$10 million... if they wouldn't get arrested.

That figure surges to **38%** for individuals with 10 years or less in the industry.

- When assessing their competitors' integrity, respondents reported a much stronger causal connection between unethical or illegal activity and success: 52% of respondents believed it was likely that their competitors have engaged in illegal or unethical activity in order to be successful, which represents an 11 percentage point increase over the prior year.
 - There was a 10-point spread based on gender, with 49% of men and 59% of women believing their competitors likely have engaged in illegal or unethical activity to be successful.
 - We noted a 12-point spread based on seniority, with 57% of professionals with 10 years or less experience believing their competitors likely have engaged in misconduct to gain advantage, as compared to 45% of professionals with more than 20 years of experience.
- 28% of survey respondents felt that the financial services industry doesn't really put the best interests of clients first. Not only was this a sharp increase from last year, but also the significant percentage of respondents who believed that the financial services industry does not put clients' interests first is an area of great concern and warrants additional regulatory inquiry.

Clients Beware:
28% of financial services professionals feel that the financial services industry does not put clients' interests first.

Misconduct in Perspective

- Given that nearly three in ten respondents reported that misconduct may be a necessary factor for success, we were curious whether 'getting caught' factored into financial professionals' decision-making. Accordingly, we asked financial services professionals how likely they were to engage in insider trading in order to make \$10 million...if there was no chance of getting arrested. A shocking 24% of respondents indicated that were likely to engage in insider trading if they could get away with it. This reflects a 9 percentage point increase over last year's survey results.
 - We discovered an alarming differential based on seniority. When probing the willingness to commit the crime of insider trading, if they could get away with it, 38% of financial services professionals with 10 years or less experience were likely to do so. This figure stands at 9% for those with more than 20 years of experience.
- We can no longer hold fast to the idea that bad actors act in isolation. Our survey findings support the premise that there are always witnesses. Indeed, 23%—more than one in five professionals—have personally observed or have first-hand knowledge of wrongdoing in the workplace.
 - The data suggests that the longer you work in the financial services sector, the more you'll see: 29% of professionals with more than 20 years' experience have observed or have firsthand knowledge of misconduct, a full 9 percentage points higher than those with 10 years or less in the field.

Performance & Pressure

- 26% of financial services professionals believed the compensation plans or bonus structures in place at their companies incentivize employees to compromise ethical standards or violate the law.
 - There was a significant gender-based differential, with 10% more women—a full one-third of all surveyed—feeling that compensation could incentivize misconduct.
 - Tenure, too, was a factor here. 31% of professionals with 10 years or less in the field believed compensation plans are in place that could incentivize misconduct, a full 10 percentage points higher than professionals with than 20 years' experience.
- 17% of respondents felt that if leaders of their organization **suspected** that a top performer was earning large profits from insider trading, they likely would ignore the problem.
 - Female respondents indicated less faith in their leadership. 21% reported it likely that their leaders would ignore suspicions of misconduct involving a top performer, as compared to 15% of males surveyed.
 - 24% of respondents with 10 years or less experience felt it likely that their organization's leadership would cast aside suspicions of a top performer's misconduct, a full 13 percentage points higher than those with more than 20 years' experience.
- More alarming, 15% of professionals in the industry believed that if leaders of their organization **learned** that a top performer had engaged in insider trading, they were unlikely to report that crime to law enforcement or regulatory authorities.
 - Astonishingly, that figure climbs to 20% for financial services professionals with 10 years or less in the industry.
- Given the pressure to perform and a concerning lack of faith in leaders to address criminal activity, we wondered if employees felt comfortable reporting misconduct. 24% of respondents felt their employers would likely retaliate if they were to report wrongdoing in the workplace. This astonishing figure is a full 9 percentage points higher than our 2012 survey.

One in five professionals with 10 years or less in the industry believed that if leaders of their organization learned that a top performer had engaged in insider trading, they were unlikely to report that crime to law enforcement or regulatory authorities.

- Of great concern, there was a 19-point gender differential among financial services professionals, with 36% of female respondents believing that they would be retaliated against if they were to report wrongdoing in the workplace, compared to 17% of male respondents.
- Even more alarming, nearly one-third (32%) of professionals with 10 years or less experience would fear retaliation, which represents a 21 percentage point increase over those with more than 20 years' experience.

Fear Factor.

36% of women in the financial services industry believed they would be retaliated against if they were to report misconduct, 19% more than their male counterparts.

32% of professionals with 10 years or less experience would fear retaliation, which represents a 21 percentage point increase over those with more than 20 years' experience.

Climate Change

Last year, when we asked financial services professionals about their confidence in the primary regulators of the financial services industry—the Securities and Exchange Commission (SEC) and Financial Industry Regulatory Authority (FINRA)—we were surprised by the significant lack of confidence industry professionals had in their watchdogs. In 2012, despite leadership changes, organizational reform and increased enforcement activity, only 26% of respondents felt that the SEC was effective at detecting, investigating and prosecuting securities violations. The number rose to only 27% with respect to FINRA.

The landscape is dramatically different in 2013. Given an uptick in enforcement activity – and perhaps aided by the announcements of whistleblower awards – there was a significant shift in opinion.

- 62% of respondents felt the SEC is effective in detecting, investigating and prosecuting misconduct. This figure was relatively consistent with regard to years of industry experience.
 - Gender was a factor here. Female respondents reported greater confidence in the SEC, with 66% thinking it effectively detects, investigates and prosecutes misconduct, compared to 59% of their male counterparts.
- 57% of respondents felt that FINRA is effective in detecting, investigating and prosecuting misconduct.
 - Women reported greater confidence in FINRA than men, at 64% versus 53%, respectively.
 - Professionals with more than 20 years of experience indicated a 10 percentage point increase in confidence in FINRA over their counterparts with 10 years or less experience, at 62% and 52%, respectively.

The SEC Whistleblower Program

Recognizing that financial regulators and law enforcement authorities cannot effectively and efficiently police the marketplace without the assistance of private individuals, the Dodd-Frank Wall Street Reform and Consumer Protection Act, signed into law in July 2010, directed the SEC to establish a whistleblower program that would help to detect and deter securities violations. The SEC Whistleblower Program, finalized and implemented in August 2011, has broad extraterritorial reach. And, other jurisdictions around the globe are considering and implementing similar programs to encourage individuals to break their silence and report possible violations of the law.

At the close of Fiscal Year 2012, the balance of the SEC's Investor Protection Fund, from which whistleblower awards will be paid, exceeded \$453 million.

All signs point to the fact that the program is working. In fiscal year 2012, the SEC received 3,001 whistleblower submissions from every state in the nation and numerous international jurisdictions. Indeed, while a typical SEC investigation takes 2-4 years, the Commission has already announced awards and promises it's just the tip of the iceberg. Earlier this year, in fact, Stephen Cohen, Associate Director of the SEC's Division of Enforcement, remarked that in the near future, whistleblower submissions will lead to "incredibly impactful cases" with "some extremely significant whistleblower awards."

Are these programs reaching the grassroots? Our survey says yes. Awareness of the SEC Whistleblower Program is on the rise, with 60% of industry professionals aware of the program, an 11% increase over last year's survey results.

"...it is critical to be able to leverage the resources of people who may have first-hand information about potential violations. And, it is especially important to investors whose savings or retirement funds may hinge on our ability to stop an ongoing fraud or obtain hidden evidence. **Already, the whistleblower provision of the Dodd-Frank Act is having an impact."**

SEC Chairman, Mary Schapiro
May 2011

The Power of One

In addition to renewed faith in regulators, perhaps the most promising discovery to emerge from our research rests with the willingness of individuals to level the playing field. When asked if they would report misconduct in the workplace if it could be done with the factors present in the SEC Whistleblower Program—anonymity, employment protections and a potential monetary award—89% of financial services professionals, figures relatively consistent across gender and seniority, would do so. While this figure dropped 6 percentage points since our 2012 survey, it remains a promising reminder that most individuals in the financial services industry believe in doing the right thing.

Outlook for the Future

Misconduct is like bad weather: it happens and it happens everywhere. Even the most ethical organizations face corporate scandal. In those organizations, however, bad actors are outliers. Their conduct is inconsistent with the values of the organization. Employees, clients and law enforcement recognize those inconsistencies and respond accordingly. As a result, the ethically strong not only survive crises, they emerge stronger.

From 35,000 feet, this year's survey signals more than an isolated disturbance. We see a powerful and frightening pattern that threatens an already fragile marketplace. Each critical faction of the marketplace—individuals, leaders and workplace culture—evidenced an astonishing ethical decline. Worse, we discovered that Wall Street's future leaders, the young financial services professionals entrusted with, literally, trillions of dollars, feel the most pressure, are the most willing to engage in illegal activity and are the most fearful of retaliation. These stark realities signal a perfect storm looming, one that may have catastrophic consequences.

Despite these troubling findings, we are pleased by the industry's renewed faith in its regulators; the significant percentage of individuals now willing to report wrongdoing in the workplace; and the growing awareness of the SEC Whistleblower Program, which is the ideal vehicle to do so. We believe that Wall Street's openness to taking a stand for integrity and more positive view of its financial regulators are extremely encouraging. After all, real change and corporate reform requires grassroots action. Financial services firms that don't take ethics seriously will be making a costly mistake.

About Labaton Sucharow

For 50 years, Labaton Sucharow has been one of the country's premier law firms comprehensively representing businesses, institutional investors and consumers in complex securities and business litigation. It was the first law firm in the country to establish a practice exclusively focused on protecting and advocating for whistleblowers who report possible securities violations to the SEC. Building on the firm's market-leading securities litigation platform, the Whistleblower Representation Practice leverages a world-class in-house team of investigators, financial analysts and forensic accountants with federal and state law enforcement experience to provide unparalleled representation for whistleblowers. The practice is led by [Jordan A. Thomas](#), a former Assistant Director and Assistant Chief Litigation Counsel in the Enforcement Division of the Securities and Exchange Commission who played a leadership role in the development of the SEC Whistleblower Program. The firm has been recognized for its excellence by the courts and is consistently among the top plaintiffs litigation firms based on its rankings in Chambers & Partners, The Legal 500, The National Law Journal's Plaintiffs' Hot List and Benchmark Plaintiff. More information about Labaton Sucharow and the Whistleblower Representation Practice is available at www.labaton.com.

Additional Resources

Consistent with Labaton Sucharow's longstanding commitment to corporate reform, the firm has created a Corporate Ethics Clearinghouse, a comprehensive web-based resource that provides thought leadership, organizational resources and informative studies on corporate ethics issues. This is the latest addition to www.SECwhistlebloweradvocate.com, an innovative website that uses interactive tools, videos/webinars/podcasts, legal primers and timely blog entries to help responsible organizations to establish a culture of integrity and courageous whistleblowers to report possible securities violations. Some of the other unique features include:

- SEC Sanctions Database: A web-based tool that provides the public with information on significant SEC enforcement actions since the passage of the Sarbanes-Oxley Act in 2002 through September 30, 2012. The firm's research focused on six of the most common federal securities violations—Financial Fraud, Offering Fraud, Foreign Corrupt Practices Act (FCPA), Trading & Pricing, Municipal Securities and Market Manipulation—and offers information on the parties and monetary sanctions related to enforcement actions where the Commission's sanctions exceeded \$1 million. The easy-to-use and searchable database also provides an interactive map function that offers users a visual snapshot of the location and concentration of significant SEC enforcement activity.
- Whistleblower Eligibility Calculator: A confidential and innovative web-based tool that provides potential whistleblowers with a detailed eligibility report—empowering them to make an informed reporting decision.
- Surveys: As a thought leader in corporate ethics, Labaton Sucharow has commissioned and posted several important surveys on its website including:
 - [Ethics & The Hedge Fund Industry](#), 2013
 - [Ethics & Action Survey: Voices Carry](#), 2012
 - [Wall Street, Fleet Street, Main Street: Corporate Integrity at a Crossroads](#), A Survey of the US & UK Financial Services Industry, 2012
 - [Ethics & Action Survey](#), 2011

Methodology

This report presents the findings of a survey conducted online in the US among a sample of 250 respondents age 18 or older who work in the financial services industry. Specifically, these respondents were employed as traders, portfolio managers, investment bankers, hedge fund professionals, financial analysts, investment advisors, asset managers and stock brokers. This survey was conducted June 18-27, 2013.

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