

FOREWORD BY

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AFTERWORD BY

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# *Stewardship*

LESSONS LEARNED

*from the Lost Culture of*

WALL STREET



JOHN G. TAFT

CEO of RBC Wealth Management—U.S.



# Stewardship



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*Lessons Learned from the  
Lost Culture of Wall Street*

John G. Taft



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*To individual investors . . . and their faith in a better future*

*The author is donating all proceeds from this book to charity.*

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# Foreword

*John C. Bogle*

**N**o one concerned about the role of our nation's financial system can afford to ignore John Taft's marvelous call for *Stewardship* in the culture of Wall Street, and indeed in our nation and in our society at large.

Right at the outset, the author defines precisely what he means:

Leaving a Stewardship legacy requires that we see ourselves not just as individual actors in economic or social systems, but as members of communities. It also requires that we define our purpose not in terms of self-interest alone, of "what's in it for me?" but in terms of how we can serve others. Finally, our Stewardship legacy is defined not just by how we serve others during our lifetimes, but by the impact of our actions on generations into the future. (Taft, xiv)

As I read through John's compelling book, I couldn't help feeling the passion of a kindred spirit, over and over again. For example, the author rails against "Finance Run Amok: Selfishness Trumps

Stewardship” (Chapter 2). In my case, I rail against the Wall Street Casino, where salesmanship trumps stewardship; where marketing trumps management; and where the mutual fund industry—the field to which I’ve dedicated my entire 60-plus-year career—has changed from a business in which “we sell what we make” to one in which “we make what will sell.”

What has developed in the world of finance can be aptly described as an *agency* problem, the classic conflict between agents and the principals who they are honor-bound to represent. This conflict is not new. In the Old Testament, Ezekiel 34 says, “Woe unto the shepherds of Israel, for they have fed themselves and not their flocks.” In the New Testament, Matthew 4:3 and again in Mark 15:30 asserts, “No man can serve two masters.”

It’s all about what happens when agents ignore that principle, too often placing their own interests ahead of the interests of their principals. As Taft puts it,

What drove this growth in the relative importance of financial firms and their simultaneous ability to generate historically outsized returns? Those returns were possible because financial institutions, particularly the larger ones, stopped acting merely as agents on behalf of their clients and started increasingly acting as principals on behalf of themselves . . . creating a culture and set of values different from those of a firm dedicated to helping solve customer problems, facilitate customer orders, or meet customer needs. (Taft, 14)

Quoting Steven Young, author of *Moral Capitalism*, Taft reminds us:

This concept of *agency*—which has embedded in it the concept of serving others—is the link between Stewardship principles and moral behavior. It is the corporate equivalent, if you will, of empathy . . . . A moral sense requires sensitivity to “the use of power when others come into view . . . . Moral responsibility is a form of stewardship, of agency, of fiduciary undertaking . . . . It is a vision of mutuality, of service, of both self and others.” (Taft, 14)

In describing how our financial system has failed us, the author is not afraid to name names. And, while he can only scratch the surface without turning his book into a tome, name them he does, for example, Goldman Sachs, UBS, Merrill Lynch, and Reserve Fund. More broadly, a quotation from Paul Purcell, CEO of Milwaukee investment banking firm Robert W. Baird & Co. encapsulates how an entire industry went wrong:

There's no question our industry has lost its way. Not just the big firms. But the bigger firms get, the more focused they seem to become on pushing proprietary products, on finding ways to make money on all sides of a transaction—structuring, selling, hedging, trading—to the detriment of their clients . . . It's greed, glorious greed. (Taft, 34)

As I reflected on those words from John Taft's book, I quickly recalled a similar but even more stinging description of the failure of stewardship:

I venture to assert that when the history of the financial era which has just drawn to a close comes to be written, most of its mistakes and its major faults will be ascribed to the failure to observe the fiduciary principle, the precept as old as holy writ, that "a man cannot serve two masters." No thinking man can believe that an economy built upon a business foundation can permanently endure without some loyalty to that principle. The separation of ownership from management, the development of the corporate structure so as to vest in small groups control over the resources of great numbers of small and uninformed investors, make imperative a fresh and active devotion to that principle if the modern world of business is to perform its proper function.

Yet those who serve nominally as trustees, but relieved, by clever legal devices, from the obligation to protect those whose interests they purport to represent, corporate officers and directors who award to themselves huge bonuses from corporate funds without the assent or even the knowledge of their

stockholders . . . financial institutions which, in the infinite variety of their operations, consider only last, if at all, the interests of those who funds they command, suggest how far we have ignored the necessary implications of that principle. The loss and suffering inflicted on individuals, the harm done to a social order founded upon business and dependent upon its integrity, are incalculable.

You might think those words came from a contemporary book on the recent near-collapse of our financial system, the crash in our stock market, and the interlocking of interests among institutional money managers and managers of our giant publicly held corporations. They did not. In fact, the words were spoken in 1934 by Harlan Fiske Stone, justice of the U.S. Supreme Court (later the chief justice of the United States) and later that year published in *The Harvard Law Review*.

While 78 years have passed since Justice Stone aptly described what had gone wrong in the financial system, we haven't done much—if anything—to resolve the problems of finance. Ironically, the Glass-Steagall Act of 1934 did a noble job in separating investment banking from commercial banking, but was effectively repealed by gradual erosion during the 1990s. Even more poignantly to me, The Investment Company Act of 1940 demanded that the mutual fund managers place the interests of their fund shareholders ahead of their own (Section 1, Part B), a policy requirement that has nonetheless been almost universally ignored in the industry.

Taft proposes numerous remedies to fix the system and one can only hope—even pray—that these remedies are more successful than their failed predecessors. He has high hopes (higher than my own) for the implementation of the reforms proposed in the Dodd-Frank Financial Reform Act of 2010. And he suggests that U.S. policymakers learn from the experience of Canada, which was well-insulated from the crises endured by its neighbor to the south. (Chapter 4 is entitled “World’s Safest Banking System: Canada, the New Switzerland.”) But it will take a renewal of the *spirit* of stewardship to cleanse and refresh our financial system, one that must be built on (in my own opinion) a federal standard of fiduciary duty for investment advisers and money managers, with protecting the interests of their clients as their highest priority.

More than parenthetically, I should note that the author shares not only my human and ethical values, but my investment values as well. He holds “core beliefs and convictions about how the financial markets operate—like mean reversion, like the predictability of asset classes over long periods of time, like the value of diversification.” (Taft, 106) If investors would begin their approach to their long-term strategy with those elemental concepts, they would serve themselves well.

A closing word. The author of *Stewardship* has the experience, the standing, the high character, and (I might add) the temerity to write this powerful book. He is an industry insider, having served as chairman of the Securities Industry and Financial Markets Association (SIFMA), which is composed of the investment industry’s senior investment executives. He’s also a successful banker and manager of other people’s money, with a broad career encompassing key top positions in both the United States and Canada.

And he’s, well, a Taft. A member of a family that includes some of the staunchest members of America’s political establishment, including a president, a chief justice, a U.S. senator, and more importantly, a family that honors the highest traditions of public service. His grandfather, legendary U.S. senator Robert A. Taft, was known as Mr. Integrity, in John Kennedy’s words (in *Profiles in Courage*), “who stuck fast to the basic principles in which he believed,” no matter what the cost. (Taft, xiii) John Taft knows those traditions.

If you hold those same beliefs—that integrity and fiduciary duty and stewardship are the keys to a better financial system, a better society, and a better America—you’ll love this book. If you don’t yet hold those beliefs, I believe that you’ll be persuaded by this book’s powerful message. Now, let’s all get out there and start to do something about it.

John C. Bogle  
Founder, The Vanguard Group  
Valley Forge, PA  
January 4, 2012



# Introduction

**O**n October 5, 2009, the day before testifying for the first time to Congress, I visited the Robert A. Taft Memorial and Carillon in Washington, D.C. A ten-story bell tower located between the U.S. Capitol and Union Station, it is the only memorial to a member of Congress situated on the grounds of the U.S. Capitol. I was to testify on behalf of financial service firms in front of the House Financial Services Committee. The U.S. Congress was writing financial regulatory reform legislation and it wanted the viewpoint of the banks, broker-dealers, and asset management firms most affected.

I visit that memorial because Robert Taft is my grandfather. My grandfather had public service in his blood. He grew up in the White House, one of three children of U.S. President William Howard Taft (1909–1913), who was the only president to also serve as Chief Justice of the Supreme Court (1921–1930). He was the leader of the Republican Party in the United States Senate in the 1940s and early 1950s, earning him the unofficial title “Mr. Republican.” His four sons included a congressman and senator from Ohio, a U.S. ambassador to Ireland, and a physicist (my father) who served as dean of Yale College. His grandchildren include senior administration officials in the Department of



Robert A. Taft Memorial and Carillon in Washington, D.C.

SOURCE: Architect of the Capitol.

Defense, NATO, the State Department and Department of Health and Human Services, and a two-term governor of Ohio. Standing in front of Robert Taft's statue, I am at once inspired and overwhelmed by the power of my family's legacy; by the Taft family sense of responsibility and obligation to serve; and by our family's commitment, generation after generation, to giving back to society.

Throughout his life, my grandfather set an example of being loyal to core principles, and exemplified the importance of locking one's moral compass onto a personal true north. In his case, true north was the

principle of “Equal Justice Under Law.” To him, those words were the foundation of a free society. They were important enough to compel him to speak out against what he believed to be a controversial example of everything that was contrary to this principle, which earned him a chapter in John F. Kennedy’s book *Profiles in Courage* . . . and also cost him the Republican nomination for president in 1948 and 1952.

“Robert A. Taft,” Kennedy wrote, was “a man who stuck fast to the basic principles in which he believed—and when those fundamental principles were at issue, not even the lure of the White House, or the possibilities of injuring his candidacy, could deter him from speaking out.”<sup>1</sup>

“[H]e was more than a political leader, more than ‘Mr. Republican.’ He was also a Taft—and thus ‘Mr. Integrity.’”<sup>2</sup>

Perhaps because of those visits to the Taft Memorial, perhaps because of my family’s legacy, I have always believed in the importance of core principles. I believe that if you don’t get them right, nothing else matters.

Conversely, if you do get them right, everything else falls into place.

The origins of this book lie in a speech and a white paper titled *Creating a Clear Path Forward*<sup>\*</sup> which I wrote for our individual investor clients—and, quite frankly, our employees—during the height of the 2008–2009 financial crisis. At the time, I was searching for something I could say to comfort them while they were experiencing things many of them had never been through before, such as a 50 percent collapse in the value of their retirement savings. My words needed to reassure them while they were feeling emotions more extreme and primitive than they had ever felt in their adult lives, like fear, confusion, desperation, even despair.

It’s particularly in times like a financial crisis that core principles matter. Core principles are the only solid ground under our feet when everything is, or seems to be, unstable.

The solid ground I discovered in writing *Creating a Clear Path Forward* was the realization that we have all been put on the earth for a reason: to leave the world a better place than we found it.

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<sup>\*</sup>See Appendix C.

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*Perhaps because of those visits to the Taft memorial, perhaps because of my family's legacy, I have always believed in the importance of core principles. I believe that if you don't get them right, nothing else matters.*

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That, in a nutshell, is our Stewardship responsibility, our Stewardship calling.

Leaving a Stewardship legacy requires that we see ourselves not just as individual actors in economic or social systems, but that we see ourselves as members of communities. It also requires that we define our purpose not in terms of self-interest alone, of “what’s in it for me?,” but in terms of how we can serve others. Finally, our Stewardship legacy is defined not just by how we serve others during our lifetimes, but by the impact of our actions on generations in the future.

Our collective willingness to live up to our Stewardship responsibilities will determine whether or not we repeat or abet future recurrences of the financial crisis of 2008–2009. It will also determine whether we prevent similar sustainability threats to society in areas like resource scarcity, climate change, population growth, fiscal policy, and income inequality.

It’s not an exaggeration to say that our future literally depends on our willingness to think and act like responsible stewards.

# Chapter 1

## Core Principles

### *The Ground Beneath Our Feet*

*Serving our clients is our basic purpose. Service is the chief contributor to our growth and profitability.*

—The late Harry C. “Bobby” Piper Jr.,  
chairman of the regional brokerage firm  
Piper Jaffray & Hopwood

**N**ever has the ground under my feet felt as shaky as it did on September 16, 2008, when I received a call on my office phone telling me the Reserve Primary Fund—a money market fund—had broken the buck and, more significantly, had indefinitely suspended redemptions of its shares. This meant that investors in this money market fund could not withdraw their money. Since RBC Wealth Management’s clients had invested in the Reserve Primary Fund, this situation had an enormous impact on the investors we represented, our advisors, and our firm.

Reserve’s announcement was triggered by the fact that the Reserve’s portfolio managers had purchased and still held in the portfolios of

Reserve's largest money market fund—the Reserve Primary Fund—commercial paper issued by Lehman Brothers Holdings on the weekend Lehman Brothers declared bankruptcy. Commercial paper is short-term debt used by companies to finance themselves day to day instead of borrowing money from a bank. It is normally a highly liquid market. But not in the case of a sudden bankruptcy. Overnight, the value of the Lehman Brothers commercial paper fell to \$0, or close to \$0.

The amount the Reserve Primary Fund held of these securities, namely the Lehman commercial paper, was so large—\$785 million—that it could no longer afford to offer its investors \$1 for each \$1 they had invested in the Fund. This is why it is called *breaking the buck*. As rumors of the decline in the Reserve Primary Fund's value hit the markets, the Fund received requests from investors with billions of dollars in the Fund to get their money back—the mutual fund equivalent of a run on the bank. Rather than sell off portfolio securities in the worst market in recent history, the Fund's trustees elected to indefinitely suspend redemptions—the mutual fund equivalent of closing the teller windows and locking the doors to the bank.

RBC Wealth Management-U.S., the firm I run, had recently acquired a well-regarded regional brokerage firm, Ferris, Baker Watts, based in Baltimore and Washington, D.C. Ferris, Baker Watts used the Reserve Primary Fund as the investment vehicle for its clients, as the place it swept clients' cash into, and as a vehicle for their investing activities. Our clients assumed their money market fund investment could be converted into cash by the next day. Now that the Reserve Primary Fund had suspended redemptions of Fund shares for cash, our clients had no access to their cash. This meant, in many cases, that they had no way to settle pending securities purchases and therefore no way to trade their portfolios at a time of historic market volatility. No way to make minimum required distributions from retirement plans. No way to pay property taxes. No way to pay college tuition. It meant bounced checks and, for retirees, interruption of the cash flow distributions they were counting on to pay their day-to-day living expenses.

## **Global Crisis of Confidence**

That day, and the days that followed, were marked by chaos and confusion. Hundreds of thousands of panicked clients called their advisors, who