

Greg Smith, Goldman Sachs, and Muppets?

On March 14 the readers of *The New York Times* op-ed section opened their papers to a blistering essay by a man named Greg Smith. Greg Smith was resigning from Goldman Sachs. As one of nearly 12,000 Goldman Sachs employees at the vice president level, his departure was not in itself all that noteworthy. However, the content of Mr. Smith's parting shot was so undeniably damaging that it was credited with singularly reducing the value of the Goldman Sachs empire by more than \$2 billion in one trading day. The long-term implications of his thesis on the morally bankrupt behavior of some of his peers remain to be seen. With certainty, he has provided deep and long-lasting impressions of the antics of Wall Street's most hallowed companies.

The quintessence of Smith's piece is terribly damning for Goldman Sachs. He illuminates one uncomplicated, easily identifiable problem in the company: the fact that Goldman routinely screws its own clients for its own gain. The expressiveness and bravery of the former Rhodes Scholar finalist makes his writing so moving that its authenticity is self-evident. We've captured some quotes from his writing in the blue text extractions that are interspersed throughout this piece.

However, before we get too much further, we need to stop and clearly state that we're not writing this piece about Goldman Sachs. This piece could easily be about any investment bank or brokerage house of that ilk – the fact that we are mentioning Goldman Sachs is essentially irrelevant. Our writing is about discerning who puts the client first and who does not.

Clearly, not every employee at Goldman is a "vampire squid," relentlessly feasting on anything that carries the scent of money. We have dear friends and family members who are current and former employees of Goldman and they are honorable people of integrity. In fact, any organization of that size has a certain percentage of people who will regularly do the wrong thing for personal gain, especially when it results in a quick buck or a promotion. We know there are going to be "bad apples" out there and hopefully Mr. Smith just happened to interact with a disproportionately large share of them.

That being said, even within a small subset of its employees, it is simply inexcusable for the leadership

of an organization as significant as Goldman Sachs to permit a culture to exist where a client is viewed like a carcass to be carved up by vice presidents trying to eat their way up to becoming managing director.



Sadly, the gentlemanly culture in which uprightiness and looking out for your client generally prevailed is long gone – not just at Goldman, but across all of Wall Street. Accordingly, among the reasons for his departure, Smith wrote: "It makes me ill how callously people talk about ripping their clients off. Over the last 12 months I have seen five different managing directors refer to their own clients as 'muppets,' sometimes over internal e-mail." He's not referring to the lovable Kermit the Frog or Miss Piggy – in Britain a "muppet" is an unintelligent person. Smith has deconstructed the firm's ethical decline by describing a culture of moral bankruptcy running so deep that the firm has evolved into a machine for profit making that depends on working against client interest.

In his words:

To put the problem in the simplest terms, the interests of the client continue to be sidelined in the way the firm operates and thinks about making money. Goldman Sachs is one of the world's largest and most important investment banks and it is too integral to global finance to continue to act this way. The firm has veered so far from the place I joined right out of college that I can no longer in good conscience say that I identify with what it stands for.

Let us describe a hypothetical example that shows why Greg Smith was so upset:

Let's assume our company bought lots and lots of a lousy investment – much more than we should have, even though it looked like a good investment. Now it is sitting in our company's investment account. We know it's a ticking time bomb and we need to get rid of it somewhat quietly before everyone else realizes it's a lousy investment and about to become essentially worthless. So what do we do?

If we are a Wall Street investment bank, we offer big cash incentives to our brokers to call their best clients (evidently referred to as muppets, elephants, unicorns, etc.) and convince them that this investment is wonderful and that they should buy as much as they possibly can before word gets out about how great it is. Once we sell all of the lousy investment and it soon becomes worthless, we are sure to remind any of our clients who happen to be upset that technically we are brokers and not "advisors." Didn't they read the fine print?

These days, the most common question I get from junior analysts about derivatives is, "How much money did we make off the client?" It bothers me every time I hear it, because it is a clear reflection of what they are observing from their leaders about the way they should behave. Now project 10 years into the future: You don't have to be a rocket scientist to figure out that the junior analyst sitting quietly in the corner of the room hearing about "muppets," "ripping eyeballs out," and "getting paid" doesn't exactly turn into a model citizen.

It sounds almost comical to describe a client-advisor relationship this way. But that is the way the world works if you are not working with a fiduciary. A significant takeaway from this piece is that we as the public should not be naïve. Should we choose the folly of working with brokerage houses and the big banks, we *must* assume that they are looking out for their

own bottom lines, not ours. We can't imagine getting investment advice from a company that recommends a trade to us only to find out that the company is on the other side of the trade, trading against us for its own portfolio. Sounds crazy, we know, but it happens all the time to clients of the big Wall Street firms.

We hope you derive comfort that as clients of Rockwood Wealth Management, you know that we are fiduciaries who protect your best interests in every facet of our relationship with you. You can sleep well at night knowing that you won't wake up one day to find that you have been "muppetized."

The Integrity Muscle

– observations by John Augenblick

Over the years I have come to think of integrity as being like a muscle. The more you use it, the stronger it gets. I don't think it makes sense that each of us is born with or without integrity – it's not like having blue eyes or a predisposition for a receding hairline. Sure, integrity can be learned or even corrupted in our youth. But if we think about our interactions with most adults, it is too easy to assume that there is permanence to the level of trustworthiness that we assign to each other.

It has always intrigued me that an unfortunate proportion of the nation's best and brightest business students who flock to Wall Street end up facing moral conundrums before they get through their first workweek. They certainly do not head to Wall Street expecting to check their integrity at the door. So what happens? With respect to character development and honesty, I think a factor that is not given its due is the purposeful creation of an environment that demands absolute integrity versus one that discounts integrity altogether. Here's what I mean:

Take a smart and basically honest college kid and put him in an entry-level investment product sales job where he has to tell small lies and half-truths to make his monthly sales quotas so that he doesn't get fired for not "producing." He knows if he tells the truth, the clients wouldn't buy that annuity, that private REIT, or that limited partnership that happens to pay the largest commissions.

He'll soon look around at the other, more senior brokers who drive the fanciest cars and quickly learn that if he tells a few more lies (and bigger ones too), he'll earn a bigger paycheck and a more professional status and be on the fast track to annuity salesman of the month. He'll quite quickly get used to a system that financially rewards the suspension of integrity. He'll just assume that this is "how it works." Soon he won't even realize that he is putting his own interests (and his parent company's interests) before those of his clients. It will just feel natural to him. To the embryonic employee, soon this will all just feel like a normal workday.

Juxtapose that environment with the one that exists at Rockwood Wealth Management. If there were even the slightest whiff of an integrity lapse by a staff member (or a partner, for that matter), he or she would be out on the street in a nanosecond. We uphold a culture and an environment where there is absolutely zero tolerance for integrity issues of any kind. We foster that sentiment in the workplace and demand it of our clients, other professionals we engage to work with our clients, and each other. Take that same basically honest college kid and park him at my firm for a year and you will have the shining pillar of integrity by which all other college kids are benchmarked. I firmly believe that the right culture flexes that muscle of integrity, making it stronger until it is unassailable.

Beyond a toxic environment where moral transgressions are financially rewarded, I have found that the archenemy of integrity is situational ethics. Situational ethics is a concept that allows the current situation to dictate what one's ethical constraints should be. Someone might be trustworthy today, but tomorrow if that person is told that he or she can earn a huge commission for selling a particular mortgage-backed security off his or her company's shelf that the firm thinks is going to be a loser – well, now, that's a different situation.

Creating and upholding a culture of integrity takes real leadership and the ability to consistently make difficult choices. I remember from my third deployment on my submarine that I assigned a critical nuclear reactor maintenance procedure to a sailor who worked for me. He lied and claimed that he had performed this procedure when he hadn't.

But I knew, his peers knew, and his subordinates knew that he wasn't even onboard the boat at the time

when he falsely recorded in the logbook that he completed the maintenance. The culture we worked within on the submarine had zero tolerance for integrity failures – there was never a doubt as to the consequences of telling a lie.

We at Rockwood Wealth Management feel strongly that the approach to managing a client's life savings requires a moral standard of care every bit as high as that which is applied to operating a nuclear reactor or targeting nuclear weapons. In either case, the creation of a culture of integrity and leaders possessing the moral fortitude to enforce it are the ingredients that lead to favorable outcomes.

By the way, as a result of his lie, that sailor was immediately transferred off the submarine and stripped of his rank; the last I heard he was scraping barnacles off some dry-docked oiler in New Jersey.



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