

## **From Corporate Values to Lived Principles: Building an Ethical Culture**

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### **SECTION 1**

#### **Troubled Times**

Thank you for your generous words of welcome. I'm delighted to be here to speak about this important topic to such a thoughtful group. In fact, in these complex, ever-changing and somewhat unsettling times there is nothing I see as more important than how we as individuals act, and how the institutions we create, conduct themselves.

Never has the debate about business ethics been so spirited; never has the need for everyone's attention been greater. In recent times we have seen many business leaders accused of abusing their power and substituting personal interests for the greater good of shareholders, employees and the public at large. That absence of corporate values and ethical conduct has shaken investor confidence in the global economy. Stock markets plummeted; individuals watched their hard-earned savings evaporate. Companies collapsed into bankruptcy; long-term employees lost their jobs. **Business ethics seemed like a thing of the past.**

When so many negative and shocking events occur, you know that people are feeling insecure, and we can't help but wonder if the veneer of civilization - has begun to crack under the strain and people are being seen at their worst.

## **Framing**

I want to reassure you that I do not intend to tackle all of those issues today; I do not pretend to have solutions for every problem.

However, I do take the position that ethical conduct and corporate values must become front and centre in our priorities on the personal level and on the institutional level.

My speech today is divided into three parts:

1. First, I want to talk a bit about what has recently happened – a disturbing example of how ethical principles can erode.
2. Second, I want to give some examples how BMO Financial Group has responded by raising to even greater heights our already high ethical standards.
3. Third, I'll make some suggestions about the imperatives of corporate governance and ethical leadership.

## **Final Accounting**

While it's easy to have tough-minded opinions about the need for ethics, doing the right thing on a daily basis is much more difficult.

For proof positive of how ethical principles can erode, we need to look no further than the riveting experience of Barbara Ley Toffler, as detailed in her recent book, *Final Accounting*. Ms. Toffler taught at Harvard Business School and was a consultant in business ethics before joining Arthur Andersen in 1995.

She saw immediately that the accounting firm suffered from, in her words, a “culture of greed ... [and was] a place where the mad scramble for fees had trumped good judgment.”

Above all, it is said that the company valued loyalty to the leaders and the behaviors they role modeled.

As a result, employees would do anything when asked by partners, even to the point of overcharging fees or overlooking balance sheet items that should have been brought to light.

Of course, with all the recent media coverage about Arthur Andersen, we’ve heard all about this.

### Revelation

But I believe, among the book’s **most** important revelations for our topic today is this: the author tried and failed to put in place an internal ethics program at Arthur Andersen.

Rather than keep pushing for procedures that she knew were right, and despite her training in ethics, Ms. Toffler frankly admits that she was seduced and ensnared. [Quote] “I, too, heard the call of the almighty buck. I was making more money than I ever had in my life. How could I give it up?” [End of quote.] She stayed four years before finally departing prior to the company’s implosion. Arthur Andersen, the firm, had strayed a long way from the founder’s motto, which was, “Think straight. Talk straight.”

But before we insist that nothing like what happened to her could ever happen to any of us ... we need to ask ourselves this: when have we seen signs of that same slippery slope in our organizations?

### **Re-examination Not New**

Such landmark corporate scandals as those we have seen recently tend to force businesses to reexamine their behaviour. This is not altogether new.

In the 1980s many companies vowed to change their practices concerning insider trading after a series of scandals erupted on Wall Street. In 1989, many corporate leaders professed their interest in being better environmental stewards after the Exxon Valdez spilled 200,000 barrels of oil over 1300 miles of Alaskan coastline.

### **Current Issues: Financial Integrity**

Lately however, the questions have tended to focus more on financial integrity – and the admonitions for change have come from the highest levels. Without naming specific companies, U.S. President Bush last year challenged business to set a better example. He said in his *State of the Union Address*, and I quote: “through stricter accounting standards and tougher disclosure requirements, corporate America must be made more accountable to employees and shareholders, and held to the highest standards of conduct”.<sup>1</sup> While there has been an absence of such high profile scandals here in Canada, similar sentiments have also been expressed by Canadian lawmakers and regulators.

### **Lack of Virtue or Systemic**

But can the recent corporate scandals be traced to lapses in CEO virtue, or are the problems systemic? While it is quite clear in some of the more recent scandals that the ethical failure of corporate leadership was to blame, more importantly I would suggest that whether or not the majority of companies have these kind of problems, they are all

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<sup>1</sup> G.W. Bush, *State of the Union Address*, 2001

APRIL 24th SPEECH (Canadian Centre for Ethics and Corporate Policy) Remarks by Rose M. Patten highly vulnerable under the wrong circumstances. One of the most lethal threats to any organization is misconduct within its own walls. As Larry Colero, from University of British Columbia stated [and I quote] “the lack of attention to ethics can be a corporation’s Achilles heel, with the potential for a single employee to topple even large well-established companies”.<sup>2</sup> For example London’s Barings Bank<sup>3</sup>, and more recently, Enron, and WorldCom were toppled by their own officers.

### **Corporate Values/Ethical Leadership**

Some of what was done by business leaders was downright illegal; much of it was all too avoidable. While there are differences in exactly what went wrong at each of the corporations in question, I believe all of them had one element in common.

In each case, ethical leadership and corporate values went askew ... and corporate values can only be fostered at the top. If the CEO doesn’t hold ethical conduct front and centre, if senior executives are able to push self-serving agendas, if directors act in a lackadaisical manner, then the entire firm and everyone who works within it will quickly become complacent...from the top down ... and core values become meaningless.

### **What to do**

So, what can we do to begin the long painful process of restoring confidence and foster cultures and work environments where employees behave in the right ways, in an ethical manner – even when they know they are not be watched. How do we foster trust and sustain impeccable credibility in our conduct?

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<sup>2</sup> Colero, Larry “Five Questions that Corporate Directors Should Ask”, UBC, 2002

<sup>3</sup> reference to the 28 year old employee who with a few key strokes of the computer, and with the inadequacy of oversight systems – caused the failure of the bank. See Finlay, J.R. (1995, March 11) “Business ethics is not a soft issue, it is a matter of Survival” *Financial Post*, p. 21

## SECTION 2

### **BMO & Accountability**

Well, let me share a few ideas with you in the second part of my speech, ideas about corporate values that we have put in place at BMO Financial Group, values that we believe help build an ethical culture and engender trust – which we all know can be fragile in troubled times. If there is to be a sea change in corporate values that tide must flow from the very top. Senior executives must lead by example, take personal accountability for high ethical standards, and have zero-tolerance for those who stray.

As a first measure in setting that tone for accountability at the top, we have made important improvements in the way we compensate our executive members based on performance, particularly when it comes to the use of stock options. As you know stock option abuse, has been at the very centre of many of these recent scandals.

### **Disney Example**

The extreme example may well be the gain of \$570 million (U.S.) realized in 1997 by Disney Chairman and CEO Michael Eisner. From 1996 through last August Mr. Eisner's cumulative pay was more than \$700 million (U.S.). During that same six-year period, Disney share price fell 23 per cent. Somewhere along the way the connection between pay and performance, options and rewards, got lost.

### **Aristotle**

Its understandable, investors and the public have become skeptical. It was Aristotle who said, "It is impossible, or not easy, to do noble acts **without** the proper equipment." With that in mind, we have put in place "the proper equipment" by making important adjustments to the components that comprise executive compensation.

The change for the current fiscal year modifies the mix of compensation to appropriately balance short, mid and long-term incentives based on the individual executive's ability to impact results. This change reduced the use of stock options by more than two thirds.

### **Performance Conditions – Stock Options**

While BMO's stock options vest at the rate of 25 per cent a year, over a period of four years – a practice which is common, we have added a performance feature that only allows Executives to exercise these options once a share price hurdle has been met.

### **Share Price Hurdles**

For example, our most senior executives can only exercise a portion (33%) of their options once the share price has risen 50%, and another portion (34%) can only be exercised once the share price has increased by 100%.

In setting these high hurdles, we are encouraging executives to hold options for the long haul and to realize gains only when other shareholders have also realized equally substantial gains. To the best of our knowledge, we are the only bank in Canada following a plan that so closely aligns executive long-term rewards with sustained shareholder returns.

### **Sarbanes-Oxley**

But compensation hasn't been the only problem despoiling the corporate landscape. I talked earlier about Arthur Andersen, but all of the auditing firms have come under fire for tighter controls and potential conflict relating to revenue from consulting work. Other practices such as insider trading and analysts on the take also ran rampant. No one in financial services has adopted a more thoughtful response to these very serious issues than BMO Financial Group. We eagerly embraced the new provisions of the Sarbanes-Oxley Act. Because, 39 per cent of our annual net income flows from the United States we also follow the law of that land. Our Chief Executive Officer and Chief

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Financial Officer were among the first Canadian executives to certify financial information and sign off as required by U.S. law.

In fact, providing high quality financial disclosure is not a new practice for our organization. Indeed BMO, Financial Group possesses a strong and well-established reputation for consistent leadership in disclosure practices – and in corporate governance generally.

Our achievements were recognized again last year when *The Globe and Mail's* survey of corporate governance practices ranked BMO first among Canadian Banks.

### **Quarterly Attestation**

In taking this accountability one step further, each quarter ... before our financial results are released ... I, along with the other members of our Executive Committee ... meet individually with our CEO, Tony Comper and attest to the accuracy of everything we oversee professionally.

When corporate integrity is at stake, nothing can replace executive vigilance, nothing can match personal accountability. In so doing, we are applying the memorable phrase that Ronald Reagan coined in the 1980s when he was dealing with the former Soviet Union. "Trust but verify."

### **First Principles**

Our attention to ethics extends down throughout the organization. Every employee follows a thirty-page guide entitled "*First Principles: Working with Integrity.*"

Employees are asked to confirm they have read the publication once a year to remind themselves what's expected, to use the case studies to see how ethical practices play out in the workplace, and to personally sign a declaration. *First Principles* also outlines three key questions employees must ask themselves before embarking on any course of action. The questions are: Is it fair? Is it right? Is it legal? By keeping these questions

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front and center as a guide in decision-making we can go along way to ensuring that  
honesty, integrity and the highest ethical standards underlie everything we do and  
every decision we make. When you boil it down to its essence this is what our  
Corporate Values are all about at BMO.

### **Corporate Values at BMO**

Three years ago, my colleagues and I on BMO's Management Board Executive  
Committee had an offsite meeting devoted to articulating our Corporate Values.  
In other words, BMO's leadership sat down, reflected on our history and came to  
agreement on the statements that best reflect the values we have stood for and upon  
which our organization is built. Shared values affect performance: they provide a stable  
base for guiding employee decisions and actions...they form an integral part of an  
organization's value proposition to customers and employees and create a source of  
competitive advantage in the recruitment and retention of top talent.

These Corporate values represent BMO's core beliefs. They stand as our collective  
commitment and accountability to each other, to our customers, to our shareholders  
and the communities of which we are a part. They recognize the value of diversity,  
respect, and encourage all to have a voice. We try to ensure that these are living values.  
Not abstract ideas.

### **Corporate Compliance**

In this endeavour, our Corporate Compliance team plays a very central role. They  
assist our 34, 000 employees ensure that they work both within the letter and the spirit  
of the law. They provide guidance on issues such as confidentiality of information and  
avoidance of conflict of interest While, worldwide our Bank is subject to over 200  
statutes and over 150 regulations, at BMO our *First Principles* and our corporate policies

APRIL 24th SPEECH (Canadian Centre for Ethics and Corporate Policy) Remarks by Rose M. Patten encourage employees to view compliance not just from a technical point of view, but in a principled manner – In other words, to do what’s right.

## SECTION 3

### **Ethical Leadership Starts at the Top**

This brings me to the third and final part of my comments today – a few suggestions on how to create and sustain ethical leadership – Leadership that truly realizes that responsibilities extend beyond that of maximizing shareholder value: this includes being a positive force in society, and leading an organization where ethical conduct is the norm and not the exception to it.

### **Rules and Regulations**

We are now seeing new undertakings by Canadian lawmakers and regulators, and the increasing scrutiny that accompanies these efforts.

This is both responsible and welcome, and hopefully this will result in comprehensive and not duplicative frameworks. But, as I mentioned earlier, both the “letter of the law” and the “spirit of the law” needs to prevail. The “spirit of the law” is about doing the right thing. To me, the key imperatives revolve around corporate governance and leadership practices. This begins with the fundamental requirement that ethical leadership starts at the very top of the organization. It starts with the Board of Directors, the CEO, and the senior officers who actually assess all decisions, not just against business and legal criteria, but also within ethical standards and principles.

### **Board of Directors**

In practice, boards of directors must operate in an effective and independent manner and ensure that the tenants of sound corporate governance – transparency, disclosure and honesty – are a reality throughout an organization. But, at BMO we have adopted a Charter of Expectations for our Directors – which set out the specific responsibilities to be discharged by the bank’s directors and the individual roles expected of them. Those roles specify: ensuring ethical

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behaviour and compliance with laws and regulations...and Bank's own governing  
documents...including our corporate code of ethics/our Corporate values<sup>4</sup>.

### **Codes no guarantee**

Now while, corporate values, or closely held beliefs are a starting point – for achieving a desired ethical culture, the fact they are written down or codified is **no guarantee** of success.

In fact, in business it has become common practice over the years to outline the organization's values and principles in a written formal document.

According to KPMG, 68% of Canadian companies have such a code. Yet, history has proved all too often that "Codes" are no indication of the ethics of a company or its leadership.

For example, the other day I read that "one of the hotter items on e-Bay (the online auction service) is a 64 page paperback that would not be mistaken for a Stephen King novel... it's the Enron corporate code of ethics- 'never been opened' proclaims one seller, a former employee"<sup>5</sup>

### **Ethical Leadership must be visible**

And similarly, as I referenced before in the Anderson case, having read the corporate values is not enough...the corporate code must be a living document, the values and principles outlined within it must be evident in the actions taken by the leadership – in other words, employees must see:

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<sup>4</sup> BMO Financial Group, 2002 Proxy Circular, p. 30

- 1) that the boss is willing to accept ethical behaviour as a constraint or cost at times.
- 2) that employees who are recognized and/or promoted are so because they have modeled ethical behaviour, and
- 3) that there must be consequences for acting unethically. In other words, employees have to know, see or learn that, those who have behaved unethically will be held accountable for their actions.

### **Education**

In embedding values throughout the organization, education also plays a fundamental role and ongoing role. At BMO over the past number of years our leadership has worked very hard to embed within our training systems, the values that we as an organization hold fundamental.

Among our many leadership and managerial programs, the skills and traits associated with excellence in leadership, are those that include ethical behaviour, our Corporate values, and our long-standing First Principles. Topics such as diversity and equity, are also part of our core curriculum.

### **Measurement**

And the last part I would like to speak to is around the issue of measurement. One of my favorite sayings is this: “anything that gets measured gets paid attention to”, in fact we have introduced measurement in a very explicit way into our Annual Employee Survey. Our Annual Employee Survey, is a central and highly used indicator of what employees are really experiencing within their area of the organization. Beginning this year, we will ask questions on this survey, in order to gauge if the values are playing

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<sup>5</sup> Axtman, K. and R. Scherer, ‘Enron lapses and corporate ethics’ *Christian Science Monitor*, February 4, 2002

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out in each area. A measurement index on demonstrated values will be created and  
sent to leaders as part of the survey results.

## Closing

In closing, I am often asked whether I think an organization needs to have ethical leadership explicit in its top priorities in order to be successful? In short, I believe an organization's **success**, in fact its very **survival**, depends on ethical leadership practices being front and center.

Thank you