Approaches to Embedding Ethics in Finance and in Finance Degree Programs

Edward Bace
Middlesex University Business School

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Abstract:
The importance of proper behaviour, and the need to improve it, is demonstrated on an almost daily basis by our financiers and those in other walks of life, including politics and journalism. All these activities, in order to be effective and make a meaningful positive contribution, must be based on relationships of honesty and trust. In this paper are explored some of the ways in which this is being done in institutions primarily in the US and UK, not just in universities, but also in firms and professional associations, in the realm of finance and investment. These initiatives are essential to change behaviour. The finance industry can learn from other professions, and eventually financial services can provide lessons for others.

Keywords: Ethics, Finance, Banking Industry, Education

JEL Classification: G30, I22

1 Introduction

Need for ethics awareness

A number of business schools in the US, Europe and elsewhere (for example, UVA In the US, Cranfield in the UK, IE Business School in Spain) have over the past few years established MBA, MSc and even bachelors programs that offer more of a focus on ethics, sustainability and social responsibility than traditional programs have featured (Ryan, 2011). Part of this no doubt results from lessons of the credit crisis, which was exacerbated by a flawed appreciation of the implications of selling certain investment products, accompanied by a questioning of any scientific basis of finance (Kaplan, 2011). The soul searching prompted by the crisis has given many the opportunity to look at wider issues around poverty, climate change and the environment, among other things, and greater incorporation of these important issues into financial education is to be welcomed. These developments are changing the investment industry ultimately for the better, it is to be hoped, in terms of what drives the practitioners, and what motivates those aspiring to careers in finance and investment.

Perhaps not surprisingly, public surveys in the UK (Which?, 2011) and US (Edelman, 2014) continue to show that banking is one of the least trusted professions, ranking only just above journalists and politicians, but well below law, medicine, or the police. The 2013 Edelman Trust Barometer survey portrayed only 46% of the general public as trusting the financial services industry, versus 73% for technology and 66% for the auto industry (cited in EIU, 2013). This finance percentage has remained almost static over the past few years. A meaningfully higher percentage of finance practitioners, paradoxically, view the industry's ethical reputation positively, and think that their firm's reputation outperforms the industry. Clearly there is a disconnect between internal and external perceptions. Regulators and other industry participants are understandably keen to improve upon this situation, through a combination of training and building of awareness. The latter includes encouraging participation in professional associations with their own codes of conduct, continuing professional development, or CPD, and knowledge of and adherence to high professional standards imposed by employers and institutions. The recent Lambert review proposals in the UK (2014), while arguably late in coming, provide some encouragement for future prospects. The mission of the Lambert review is to create an overarching professional body in Britain to promote high standards of behavior for the banking industry. There exist already several professional associations in the UK and US, which strive to do the same for their particular sub-industries within financial services, whether it be asset management, like CFA institute, risk management, like PRMIA, or financial advisors, like the Chartered Institute for Securities & Investment, known as CISI. The reality is that only a small proportion of practitioners employed in finance participate actively in such professional associations, and the miniscule number of disciplinary cases arising from these associations suggests that these individuals are not the ones raising concerns.

Many working within the finance industry seemingly do not regard themselves as part of a profession, in the way that doctors or lawyers might. The range of financial services activities is so wide that it may be difficult to categorize a bank teller, for instance, as pursuing the same profession as an economic analyst at a hedge fund. Yet at the end of the day are they not part of the same undertaking, serving similar customers and stakeholders?

What defines a profession, or a professional body? it intends to represent an organized trade, such as accounting, medicine, or law, it awards recognized qualifications and offers CPD for ongoing professional development, and it prescribes a mandatory code of conduct for its members, taking disciplinary action where necessary (Chartered Institute, 2014). The end goal of these activities is to maintain a high standard of service, or to paraphrase the CISI's mission statement, "to set standards of professional excellence and integrity for the securities and investment industry, providing qualifications and promoting the highest level of competence to our members, individuals and firms." Such public statements are intended to build trust on the part of clients and other stakeholders, ultimately raising trust in the profession and in the industry as a whole.

Aside from professional associations, virtually all leading financial institutions by now have, or should have, their own codes of conduct, by which employees are expected to abide. Yet experience, much of it recent, demonstrates that ethical codes alone are insufficient. It is difficult to determine if the words in a code have any effect on how business is conducted. Enron's code of ethics, for example, ran to 64 pages (Enron, 2000). Nonetheless codes, when properly reinforced, can set an appropriate context for what a professional's self-interest really is, or ought to be: honest, empathetic behaviour that nurtures long-term relationships.

The raft of banking legislation and reforms following the financial crisis seems so far to have done little to stem the tide of abuses, or are we just becoming more aware of them? Dodd Frank in the US, and ring-fencing proposals in the UK and EU, are designed to curtail misconduct, but these efforts have many critics (for example, Coppola, 2014). The number of SEC enforcement actions, to take the US as an example, has only risen about 20% from 574 in 2006 to 686 in 2013, a number around which it has hovered since 2008 (SEC , 2013). Regulation is notorious for being reactive, and resource constraints on regulators suggest that reliance on a regulatory framework will not be the most successful route to establishing ethical behaviour in the industry. Moreover, regulation tends to be inconsistent from one jurisdiction to another, and is thus unlikely to be an effective substitute for a perspective of global professionalism.

How does one reconcile a competitive, zero-sum endeavor like finance, where self interest dominates, with principles of honesty and integrity? As investors and shareholders, do we not want managers who can be single-minded, driven, and even ruthless, on our behalf? Yet inevitably conflicts arise between asset owners and asset managers. No volume of ethics education will actually prevent someone who is bent on fraud for personal enrichment. However, few people, one must believe, enter banking or investment professions with the deliberate intent to engage in unethical conduct. Thankfully, fraudsters tend to be in the minority. Yet many investment and banking professionals who have a healthy sense of decency will be severely tested at times by challenging situations and conflicts of interest inherent in agency relationships. Even well-intentioned practitioners may find themselves in situations where they will try to cut corners. While success is an important consideration in any business, achieving this at the expense of integrity, honesty and trust is counterproductive from a purely business perspective (Dannhauser, 2008).

What is needed, therefore, is a framework to raise awareness of ethical dilemmas and to provide some guidance as to how to deal with them appropriately. The goal of any good ethics education program should be to identify ethical dilemmas and help individuals who seek to act in good faith to neutralize cognitive or other biases which can be harmful (Felton and Sims, 2005).

2 Related Literature

Research is currently being undertaken at University of Nottingham (Love, 2012), among other places, to evaluate people's predisposition to take risk or act unethically. Early successful identification of such biases can help focus training initiatives.

Some academics (like Dobson, 2005) regard ethical behaviour as natural behaviour. Why then are there so many abuses? Natural inclination or disinclination, if it exists, needs to be reinforced by teaching and practicing ethical decision-making skills.

Furthermore, behaviour needs to be tied to a code adopted by the firm. A focus on actual rather than theoretical issues will help hone sensitivity to ethical traps (Oberlechner, 2007). By applying analytical techniques to new situations, in case-based studies, a framework for ethical decision making can be developed, thereby bringing the principles of the code to life.

People confronted with decisions that have ethical implications are subject to biases that influence how they behave. These may include: obeying authority figures who condone unethical behavior for economic gain; conformity bias that pushes people to conform judgments to an unethical corporate culture; self-serving bias which leads decision makers to process information to advance their own self-interest and support their pre-existing views; incrementalism, which gradually lowers the bar of acceptable conduct; as well as groupthink, overconfidence and over-optimism (Statman, 2014). These individual foibles emphasize the importance of organizations building a culture of integrity in the workplace.

Can ethics be taught?

Can cognitive or other biases be overcome? Many would argue that the place to start in embedding ethics is at the postgraduate or even the undergraduate level, not only in business-oriented curricula, but across a host of industry specializations. Research (cited by Velasquez et al., 2013) suggests that this is a formative period for young adults, who can be influenced by formal education in their decision-making processes.

The ethical and sustainable dimension in many university finance degree programs has often not received the emphasis it should. In some cases it is still completely lacking, which in today's environment of needed renewed focus on high standards is a serious drawback. If the LIBOR-rigging traders at RBS and other banks had received some firm grounding in ethical behaviour and responsibility from their schools or employers , their flagrant abuses might have been prevented. Organizations such as CISI, and CFA Institute, in partnering with academic institutions, demand that the ethical and responsible component be addressed in the university's finance curriculum, just as it forms the core of the CISI and CFA Candidate Bodies of Knowledge. Ethical and professional standards appeared on the first CFA Exam given in 1963, for example, and they continue to feature prominently. Many finance degree programs find the incorporation into their curricula of an integrity component a useful foundation, not only for reinforcing ethical and professional conduct, but also to cover a comprehensive, updated and relevant breadth and depth of topics in finance, encompassing sustainability (Ritter, 2006). Financial employers too are increasingly making their employees aware of the importance of ethics and social responsibility, not just in order to avoid fines or other penalties, but as the right way of serving their customers (Bell et al., 2014).

Should ethics be taught?

Candidates studying for the CISI and CFA exams are certainly exposed to questions of integrity and best practice, whether or not they are (or have been) university students. Moreover, all CFA charterholders are required to make an annual declaration of adherence to the CFA Code of Conduct as a condition of their continued membership, and all CISI members are required to pass their IntegrityMatters online test. As a result designations such as MCSI or CFA can provide effective preparation for a more challenging, but just, conduct environment incorporating social responsibility. Clients or employers evaluating the merits of a candidate for investment or financial services should find additional comfort in the belief that those equipped with a professional designation have been exposed to and, it is hoped, embrace the highest standards of ethical behaviour and professional conduct, with a deep appreciation for socially beneficial activity. It is also incumbent on firms to make employees aware of their responsibility not only to the company, but above all to the end customers and to society overall. All employers of any meaningful size should have a written code of conduct promoting ethical standards which employees must abide by or face consequences, and the example must start from the top. In years spent in banking, the author was exposed to examples of unethical behaviour being tolerated, at times even encouraged. Bankers were not primarily working in their clients' interests, but all too often in their own. Efforts to blow the whistle were, it is to be admitted, not uniformly well received.

Not long ago the author participated in IE Business School's annual Forum on Corporate and Social Responsibility (CSR), which was well-attended and attracted prominent professionals from the finance industry in Europe. While some financiers express a somewhat jaded view of socially responsible investing, many seem to embrace the importance and validity of CSR, with its emphasis on sustainability as good business. Certainly the students regarded this as very important. The Aspen Institute's last survey of MBA programs (2011) indicated that, since 2008, more courses had been observed with content on social, ethical and environmental issues, and more courses viewing business as a positive agent for change (up 38% in finance departments). This was accompanied by more exposure of students to this content, and more research published by faculty on the relevant topics. The percentage of schools requiring students to take a course dedicated to business and society issues rose from 34% in 2001 to 79% in 2011. Many more abstracts published by faculty addressed the impact of Sarbanes-Oxley, disclosure practices and effects of the financial recession than they did in 2009.

Awareness raising has also intensified on the practitioner front. According to last year's Economist Intelligence Unit survey (EIU, 2013), over two thirds of firms represented have raised awareness of ethics over the last three years, and nearly as many have strengthened their formal code of conduct and systems for evaluating employee behaviour. Nearly half the firms have introduced career or financial incentives to encourage adherence to ethical standards. By the same token, more than half of those surveyed believe that career progression at their firms would be difficult without being flexible on ethical standards, and the same proportion also thinks their firm would be less competitive as a result of being too rigid in this area. Less than 40% think their firm's financials would improve due to improvement in their employees' ethical conduct. Initial research on this subject suggests, however, that good conduct produces superior equity returns (Bace, 2014). Where over half did see benefit, however, was in the firm's ability to withstand unexpected and dramatic risks. The increasingly complex risk environment was given as the chief reason to improve one's knowledge of the financial services industry.

The above ties directly into good corporate governance, and the responsibility for senior management and the board of an organization to lead on ethics. A board is charged with determining, articulating and communicating the values and standards of the business, and with ensuring that the policies, procedures and controls in place act to embed, rather than hinder, ethical values throughout the business. Boards take decisions which have far-reaching consequences and directly affect the lives of their employees and other stakeholders, a recent example in the UK and US being tax avoidance. The culture of an organization will be strongly influenced by the nature as well as the quality of the leadership shown by the board. Recent research from the Institute for Business Ethics in London (Casson, 2013) has found that explicit reference to ethical principles and terminology has generally been absent from corporate governance guidance and regulation both at the EU level and within most member states. The link has yet to be made unequivocally in corporate governance discourse that what is ethical is good for business, or at least that what is unethical has a negative effect on business.

Business schools as well as employers are adapting to the post-financial crisis environment. They have to play a seminal role in restoring trust in the system. They are arguably also addressing different markets than they did even a decade ago. An MBA or Masters in Finance degree from a top school is no longer an automatic passport to a lucrative career in investment banking, given how bankers are constantly pilloried in the press these days (many with justification) and public opinion damns many of them (often rightly) for short-sightedness and self-interest. Nor, it may be argued, are MBA candidates still in blind pursuit of such careers, given the transformation of technology and thinking that has occurred just within the past few years. Based on their recent experience, most financial employers in their right mind, one may believe, are looking for more than simply a degree, but just as importantly attitudes and awareness that will allow the individual to prosper in an environment of ever-growing social exchange and alternatives. At the same time, employers have not become less demanding of fundamental skills. Again, a designation founded on a generalist, up-to-date, practice-oriented approach to investments and finance, with an emphasis on ethics and good practice, can be a valuable adjunct to a finance degree, especially in a job market where any positive competitive advantage has to be exploited. Nonetheless, any reputable graduate finance program today is remiss if it does not address ethics and corporate responsibility (AACSB, 2004).

The demand for sound finance and investment management skills has overall not declined following the financial crisis and economic slowdown, but has increased. High growth outside the previously-dominant markets of North America and Europe is indicative of a growing global demand for qualified and trustworthy finance and investment managers. Emerging markets such as India and China are experiencing growing wealth that needs to be managed, and their markets are responding. Graduate finance cohorts observed in the UK are overwhelmingly populated by students from Asia and other developing markets. At the same time, finance and other educational programs are proliferating in the home countries of these students. One hopes that in these domestic programs due attention is paid to ethical behavior and social responsibility, ideally in an integrated approach, otherwise a problem is being perpetuated (McDonald, 2004).

3 How should ethics be taught?

This need raises the question of whether ethics can be taught effectively. There is a growing body of research on this subject, which suggests that it can, despite editorials to the contrary that often appear in financial journals (Korn, 2013; Gundersen *et al*., 2008). Specifically in response to this, academics (Velasquez et al., 2013) at Santa Clara University's Markulla Center for Applied Ethics have cited compelling research from Kohlberg to James Rest. Critical to success of embedding ethics, however, is the way in which it is done.

Least effective seem to be the online "click and tick" tests mandated by many employers, designed to acquaint employees with issues such as bribery and information security. In-person training equally has its critics. There is the risk of decoupling, whereby important activities such as sales do not require compliance training (Maclean and Benham, 2010), and lack of timeliness, which can render training efforts futile (Mazar *et al*., 2008).

One of the most effective mechanisms for raising awareness of ethical dilemmas in institutions is through presentation of real-life issues. Dedicated organizations like the CISI do a particularly good job of presenting live to groups of students and practitioners, wherein complex situations that have been encountered in real life are recounted, with the audience given a series of choices (generally out of four - much like the way the CISI's IntegrityMatters online test functions). Groups within the audience are given the opportunity to discuss the issues among themselves, and then each participant votes for his or her own choice individually, using an electronic voting machine. The results are then displayed and a debrief follows, wherein a recommended course of action readily emerges. The CISI likes to uses a four letter acronym which it has found to be effective, that is HOTF, standing for honesty, openness, transparency and fairness. If your chosen action meets all these criteria, it is likely the best course. Feedback surveys on these presentations have been overwhelmingly positive, such that CISI endeavors to present them as often as possible, anywhere in the world. Experience shows that distance delivered offerings in this respect tend to dilute the message, since interactivity and discussion are key to embedding successfully. The concept outlined above has received further support from students, based on their own experience (Magee, 2014).

4 Conclusions

Research suggests that a live, interactive approach yields effective results, but the effort in financial services, as in any institution, has to be supported unequivocally from the highest levels downward, and also needs periodically to be reinforced. For both students and practitioners, membership and participation in a professional body, with its concomitant mandatory CPD and conduct standards, is a valuable and important adjunct. Widespread adoption by institutions of these practices may begin to help the finance industry achieve its inherent worthiness, with consequent benefits for society as a whole.

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Contact: **Dr. Edward Bace** (e.bace@mdx.ac.uk)

Middlesex University Business School

The Burroughs, Hendon

London NW4 4BT

United Kingdom

Tel +44 208 411 3238

Fax +44 208 411 6011