

FINANCE : to be ETHICAL or not to be

Jean BERTHON
Presidents' Forum
Zagreb

- The current crisis is directly a consequence of the characteristics of the world of finance today :
 - Globalization of the finance industry
 - Disintermediation
 - Deregulation
 - Greed
 - Role of the regulators
 - Role of the politicians

Investors and ordinary people have been deeply affected by these shifts in the finance industry

Because of the 2008-20 ? crisis they have lost their confidence in the prevailing economic model

- Result is frightening :
 - Erosion in trust and confidence in the institutions, in the products and services, and in the individuals involved.
 - Refusal of the economic measures that have to be taken to solve the debt problem
 - Mistrust in the free market and capitalist system

- Can we accept that it should be again :
“business as usual” in finance today ?
- Does the world of finance should not change?
- What can the actuaries bring in this debate?

- We have to put more ethics into all of this by proposing a solution that would promote ethics in the finance industry :
 - What can be done to better organize the financial sector ?
 - What do we to do as actors of the world of finance ?

- Actions have been taken by the governments
 - G8 / G20 meetings
 - On Remunerations
 - On Transparency
 - For more regulation

- Is it sufficient ?
- Partly yes but only partly
 - Rules are necessary but we have to change the behavior of the actors
 - By defining better the role or the economic function of the players
 - By putting more ethics into all of this

- Ethics in finance is an imperious necessity for a well-ordered finance, which will play its fundamental role of feeding the correct resources into the most fruitful projects.
- If finance in its role as mediator substitutes the ends for the means, and becomes its own idol, the ethical dimension obviously becomes compromised if not disappear

- How does this fit with the current financial paradigm ?
- The behavioral assumption of the modern financial-economic theory is based on the rational-maximiser paradigm : Individuals are egoistic and tend to maximize their own interests.

- Also at the heart of the modern economic and financial system is the principal-agent model of relationships which refers to an arrangement whereby one party, acting as an agent for another carries out certain functions on behalf of that other

- Contract also is an essential element of the financial system :
 - Transactions are based on trust
 - Building trust is a central ethical requirement, closely related with reputation
- For trust to work, agents must be intrinsically trustworthy.

- But in the finance paradigm the act of honoring trust in and for itself has absolutely no value.
- This infringe personal ethics rules :
 - trustworthiness,
 - loyalty,
 - fidelity,
 - stewardship,
 - concern for others (underlie the traditional principal-agent relationship).

- Challenging the current financial paradigm :
 - Dobson and the virtue approach
 - Challenge the behavioral assumption
 - Walter and the questioning of the Brownian motion
 - Challenge the current mathematical measure of risks.

- As Dobson said, a proper theoretical understanding of finance requires a necessary foundation in some set of ethical assumptions.
- He then argues that the best way to conceive this ethical basis and the most useful basis from a practical point of view is that of “virtue ethics”.

- Dobson want to enlarge the financial paradigm to encompass a moral dimension supplied by the virtues ethics theory.
- This theory exhibit 4 basic attributes
 - Importance of virtues of character, such as honesty, perseverance, consistency and fairness,
 - role of the community
 - the central role of sound judgment
 - the importance of moral exemplars

- Virtues in the context of business (Goodpaster)
 - Prudence : neither too short-term not too long-term in time horizon
 - Temperance : neither too narrowly materialistic(want-driven) nor too broadly dispassionate (idea-driven)
 - Courage : neither reckless nor too risk-averse
 - Justice : neither too anarchic regarding law nor too compliant
 - Loyalty : neither too shareholder-driven (private sector) nor too driven by others stakeholders(public sector)

- Walter approach is totally different :
- For him it is necessary to analyze the mathematical evaluation of risk. The Brownian motion, the virus, is an intellectual ill that attacks our concepts of uncertainty and leads us to believe that it is possible to control and calculate risks that can then be factored out.
- Walter is today director of the chair of Ethics and Finance in the Catholic Institute of Paris

- But now what can we do ?
- Implement real ethical codes of conduct in the financial firms for good corporate practices
- Organize the financial profession in order to insure an ethical behavior of its members.

- Corporate practices : 5 recommendations by Prof Domenec Mele Carné (IESE Navarra)
- Have the selection criteria include moral honesty and ethical values
- Properly consider the risks of growth and debt and avoid situations that force deceitful or fraudulent maneuvers to be made
- Promote fairness in decision making, along with effectiveness and efficiency

- Establish the appropriate rules and control processes that provide transparency and relevant information, while impeding excessive or unfair actions
- Develop a culture of accountability and honesty, through several means, especially through prudent, exemplary leadership

Organization of the financial profession

- The current organization of the actuarial profession give us an example of what could be done
- Integrate all professionals of finance (including the Chief Executives) into a unique professional body consisting of various chambers that will represent the different professions of the sector.

- To be sure that candidates have a sufficient basic grounding in ethics, to be admitted to the profession one would be obliged to pass a non-financial examination on ethics in finance and business which will have as much as importance than the professional exams.

- Principles to incorporate in the ethics code
 - Integrity
 - Objectivity
 - Competence
 - Fairness
 - Confidentiality
 - Professionalism
 - Diligence
 - Transparency
 - Accountability

Some recommendations for immediate action :

- Get in touch with the other stakeholders to start discussing the “common umbrella” project
- Issue public statements on the main subjects that have been identified and make recommendations for action :
 - Organization and role of the markets
 - Organization and role of the banking industry
 - Promote Ethical behavior in the financial sector
 -

- To conclude on a more positive mood : there is an encouraging trend :
 - Ethical finance : some initiatives in finance, show that we are on the way to re-discover the instrumental function of finance in support of the economy with an increasing consideration of environmental, social and governance issues in investment decisions and services being offered.
 - NGOs/ Foundations, Finance Watch initiative
 - Increasing number of chairs in ethics and finance

Short bibliography

- Boatright, J. 2010. *Finance Ethics - Critical Issues in Theory and Practice*, New Jersey : John Wiley & sons
- Dobson, J. 1997. *Finance Ethics : the rationality of virtues*. Lanham, Maryland: Rowman and Littlefield Publishers, Inc
- Pellerin E. & Casimiro M. 2009. " du bon usage de l'Ordre dans le désordre de la finance, Robin Cosgrove Prize" *Finance et bien commun* n°33
- Walter, C. 2010. "L'éthique de la finance après le virus brownien" *Finance et bien commun* n°36