

ETHICS AFTER THE CRASH



Society of Financial Analysts
Toronto, Canada
December 10, 1987

We are here to honor the 51 financial analysts of Toronto who this year became members of the Institute for Certified Financial Analysts (ICFA) and are now entitled to the designation "CFA". Of those 51, 36 are present here today as members of your Society.

They have certainly earned our honor. They studied three years more or less on their own while working full time as financial analysts. Each year ended with a rigorous day-long examination. They had to pass all three. In addition, these new CFA's have--like the rest of you--committed themselves to the demanding requirements of the FAF/ICFA Code of Ethics and Standards of Practice.

They didn't have to do any of that. They might instead have chosen to treat other financial analysts as mere competitors and financial analysis itself as no more than a money-making occupation. They might honorably have adhered to no standard but law, market, and ordinary morality. They have, however, freely chosen to join with other like-minded financial analysts in a cooperative enterprise; to undertake responsibilities beyond those law, market, and ordinary morality impose; to conduct financial analysis according to special rules the primary purpose of which is to benefit those whom financial analysts serve. They have, in short, freely become members of a profession.

What makes an occupation a profession? Some have answered high salary, prestige, state licensure, special knowledge, organization, or some combination of these. But, it seems to me, these are neither necessary nor sufficient. There is no profession without something to profess. Those who would be members of a profession must be more than well-paid, well-thought-of, licensed, learned, and organized. They must claim, declare, openly assume--that is

to say, profess--a higher standard of conduct than that of ordinary people. They must take on special responsibilities. There are low-paid professions--my own, teaching, comes to mind. There are professions the state does not license. Your profession, financial analysis, is a good example. But there is not, I believe, any profession without its own ethics. So, it is altogether fitting that our subject today is ethics.

My title, "Ethics After the Crash", may suggest a concern with wrongdoing. Though I shall indeed begin with wrongdoing, my primary concern is not wrongdoing but good conduct, how to get people to do the right thing. I shall argue that you have a special role to play in the firms for which you work, a role that goes beyond financial analysis. Your training in ethics and your commitment to a standard higher than law, market, and morality, give you insight into certain hard choices that your employer or co-workers may lack. I shall also argue that you should go out of your way to make that insight available.

I. The Origins of Misconduct

I must apologize for beginning a discussion of ethics with a discussion of wrongdoing. Beginning in that way gives pride of place to wrongdoing and so suggests that wrongdoing is common while ethical conduct is rare. Yet, in fact, the reason I begin with wrongdoing is itself an indication of how rare wrongdoing is (though it is still common enough to be worrisome).

Most of what I know about ethics I have learned from the study of actual cases such as the Iran-contra scandal or the Challenger disaster. I am to ethics what a pathologist is to health. Most of what ends up in my "lab" is "diseased tissue". Why? The answer is simple: Newspapers seldom want to know why a project or policy succeeded; legislatures

do not hold hearings to find out why people did the right thing; and trials decide whom to punish or hold liable, not whom to reward or honor. Why do newspapers, legislatures, and courts focus on wrongdoing? The answer for newspapers is proverbial: Dog bites man is not news, since it happens every day; man bites dog is news--it hardly ever happens. Much the same is, I think, true of legislatures and courts. If wrongdoing were common, the legislatures would investigate the few cases in which things went right, hoping to find out why; and courts, overwhelmed by crime, would have to reward the few who did what they should.

There are exceptions to this rule, of course. Johnson & Johnson has been written up, studied, and praised for taking Tylenol capsules off the market as soon as it had reason to believe someone was putting poison in them. But such exceptions simply prove the rule. They show, however unfair this may in fact be, that most people do not yet expect business to conduct itself decently in difficult circumstances.

So, that's why I shall begin with wrongdoing. What have I learned from my studies? One thing I have learned--what has given me the theme of my talk today--is that most of the people involved in the wrongdoing I have studied are disturbingly like the rest of us. They did not consciously choose to do wrong. They got into trouble by degrees, without ever quite realizing what they were doing and therefore without ever thinking it through. They did not yield to temptation. Instead, they simply lost perspective on what they were doing.

Let me give one example. The Wall Street Journal of November 18 carried a follow-up on the fifty people convicted of inside trading over the last ten years. Here is part of what we learn about one of the fifty:

"When it all started, I didn't even know what inside information was," Mr. Taneja insists. Around 1979, he

says, he began reading about people being arrested for insider trading--yet he continued trading even though he knew it was illegal. It's a decision he wouldn't repeat, Mr. Taneja says, explaining: "In the long run, you are going to get caught."

Taneja, a civil engineer, was a small investor, not a broker, analyst, arbitrageur, or the like. But, for our purposes, that does not matter.

If we are to believe what he says--and I think we should--he knew early on that he was doing something illegal and stood a good chance of being caught. Yet, he continued his inside trading. Why? He doesn't say and, in fact, he seems not to know. What he does know is that he would not have done it if he had known then what he knows now. What does he know now? It cannot be what he says, that is, "In the long run, you are going to get caught". He has no way of knowing that every inside trader will be caught in the long run. We have no statistics on the rate of illegal inside trading (and are unlikely to have them any time soon). But, given what we do know about illegal conduct in general, it is almost certainly false that everyone will be caught in the long run. For almost any crime, a substantial percentage of those breaking the law will never be caught.

Taneja's overstatement of the risks of being caught seems, then, better understood as a way of calling attention to what he risked and would not risk again. Taneja now regrets doing what he did because he now appreciates what was at stake in a way he did not at the time. He does not so much have new information as a new perspective on the information he had all along. He has at last had a chance to think through what he did. He has regained some perspective.

If this seems the correct way to understand what Taneja said, we need not suppose him to be stupid, evil, blind, or

weak-willed to understand how he could have done what he did in fact do. We need only suppose that he lost sight of how much he valued freedom, reputation, doing right, and other good things to which we seldom give much thought. Losing sight of how much we value such things is something that could happen to any of us.

If such loss of perspective explains much wrongdoing, who is immune to doing wrong? If Taneja is not so different from the rest of us, then we cannot be sure that, in his position, we will not do what he did. To be sure we will not do what he did, we need a strategy for avoiding his position. It is to such a strategy that I now turn.

II. Preparing to Act Ethically

I have spoken so far about moral, legal, and ethical conduct, without much distinction. Though all such conduct does have much in common, there are differences. Morality consists of those standards binding on each of us whatever our status, commitments, or training. Morality binds all rational agents. A law, on the other hand, binds only some rational agents, for example, all those born or located within the territory of a certain state. Morality and law are alike in binding people because of what they are, not because of what they do.

Ethics resembles law in binding only special groups. Christian ethics binds only Christians. Business ethics binds only business people. Legal ethics binds only lawyers. But, unlike law, ethics does not bind simply because of what one is. The ethics of a group is binding on members of a group only insofar as they do something, for example, take an oath or voluntarily accept benefits not available to those known not to be members of the group. So, while neither morality nor law rests its claim to bind on a voluntary act, ethics generally does. Christian ethics

binds only those who become Christians; business ethics only those who engage in business.

What is true of ethics in general is true of professional ethics in particular. Claiming to be a member of a certain profession is claiming the respect, trust, and pay accorded persons believed to adhere to the standards of practice to which that profession is publicly committed. Those who claim membership in a profession and yet do not adhere to its standards are taking unfair advantage of those who do adhere. They are taking the benefits generated by the living commitment of other members of their profession to its standards while refusing to do their share to help to maintain those benefits. Unprofessional conduct is, in short, a violation of the moral principle, "Don't cheat".

That, then, is the difference between morality, law, and ethics. Since your profession requires nothing inconsistent with morality or law, we may now address the question of how you can prepare to act ethically. What I have said so far suggests two lines of inquiry. The first concerns what you can do to make it likely that you will have the right perspective when the moment of decision comes. The second concerns what you can do to make it likely that, should you not have the right perspective, someone will alert you.

Having the right perspective seems to presuppose three conditions. First, you must understand what is required of you. Since a professional code is a special standard, not one everyone is subject to, that means learning your profession's standard much as you might learn a code of laws. Those of you who passed the CFA examinations no doubt satisfy this first condition. So, let's go on to the second.

Understanding what your profession requires is not enough to get you to do what it requires. You must also

care about doing what it requires. Those who do not care will simply fail to act as required whenever convenient. So, caring about doing what is required is the second condition for having the right perspective to act ethically.

Do you satisfy this condition too? Almost certainly. You have, after all, joined with other financial analysts in a professional organization you need not have joined. You have committed yourselves even though you need not have. Why do that if you do not care about your profession's ethics? If that is not reason enough to think you care, here is another: If you do not keep your commitment to acting ethically, you will be cheating those who keep theirs. A morally decent person cannot be indifferent to whether he cheats.

That brings me to a third condition for having the right perspective to act ethically, the hardest to satisfy. You must have a clear head at the moment of decision. How can you assure that you will have a clear head? Unfortunately, you cannot. All you can do is increase the probability that you will. How do you do that? You must prepare now for the decisions to come.

One way to prepare is to study ethical problems the way generals study old battles, so that you see immediately the essential facts in the fog of detail. Since you have already done a good deal of such study, I shall say no more about it--except to add two problems of my own in a moment.

Another way to increase the probability that you'll have a clear head at the moment of decision is to reduce the pressures likely to cloud your judgment or crowd out relevant considerations. For example, if someone lives from payday to payday, without enough savings to get through a few months of unemployment, she is more likely to worry about whether an honest answer to a technical question will get her fired and so likely to have more on her mind than giving an honest answer. Part of maintaining the right

perspective to act ethically is maintaining a certain amount of financial independence.

Some philosophers talk as if the price of virtue is a life of bread and water. I would not go that far. But I do think it worth stressing that having a clear head depends in part on one's working environment and one's working environment includes more than the office. We cannot easily separate how we live from how well we work.

III. Helping Others Do the Right Thing

I doubt much of what I have said so far surprised many of you. But I expect what I shall now suggest will: You should go out of your way to give moral advice to those with whom you work, whether they want it or not. I'll first give two examples of what I have in mind and then explain why I think you should do as I suggest. I could have given you some real examples, but the real ones are both complex and undramatic. Ethical problems generally do not come labeled as such; and many of the trickiest come mislabeled, for example, as "only a technical matter" or "only a business decision". So, I have chosen to sacrifice realism to make the examples short and memorable. I hope I will be forgiven.

First example: Suppose a colleague suggests a questionable course of action and defends it in part by asking, half jokingly, "Why would anyone go into this business except to make a bundle?" What should you say? You should reject the proposal, of course. But you should not, I think, just reject it. If you just reject it, your colleague may well shop around until she finds someone who will not reject it. You will then have kept your hands clean but will not have done much to help her or your firm.

So, what I suggest is that you follow up your rejection with something like this little speech:

"Well, I like the good life as much as you do. But I do not think of myself as in this business simply for the money. Part of why I'm in this business is that I like doing a good job; but part too is that I like to use what I know to help others.--Don't look at me as if I must be crazy. I'm far from alone in this. I belong to an organization of many financial analysts who expressly endorse this view of our business. Since you don't need the money, why don't you try another tack, one you wouldn't mind having reported in the newspapers?"

However your colleague eventually answers your final question, you will have given her something to think about. She will not be able to say to herself that the only difference between you and her is that you lack daring. She will instead have seen the world from another perspective, one that upon reflection she might find attractive.

Here's a second example. Suppose that your boss asks you to do something unethical, making it clear that he does so only because he is desperately trying to keep the firm from bankruptcy. He knows that what he is proposing is not right, but he thinks it excusable under the circumstances. What should you do?

Again, it is not enough to say that your professional ethics forbids such conduct (though of course it does and you should say so). You should--and notice how surprisingly strange this sounds--help your boss put the loss of his firm in perspective. If, as people sometimes do, he has devoted his life to the firm, letting his marriage fall apart, neglecting his children, and otherwise turning himself into a machine for producing money, he is now as capable of breaking the law as any father who believes he can only save his starving child's life by stealing bread. So, what

can you say to him? My suggestion is that you say something like this:

"Stop and think. There are worse things than going bankrupt. What? Well, for starters there is going to prison, living every day in fear that you will be raped or beaten. What else? What about staying in business for a year or two longer afraid someone will discover what you have done and then having it discovered and never being able to work in financial services again? The sun will rise tomorrow. Even if you go broke now, you can start over--and with a clear conscience. Bankruptcy is not death."

Those are my two examples. Whatever their faults, they do illustrate an approach you can take in less dramatic circumstances, for example, when all that is being suggested is something which, though legal, is still morally wrong or just not good practice. Indeed, these two examples illustrate an approach you can take even when all that has happened is that someone in your firm has begun to talk like your colleague in the first example ("Why would anyone go into this business except to make a bundle?"). Your profession--and here I mean your commitment as well as your preparation--gives you an insight most without a profession will lack or, at least, a perspective they are likely to have forgotten.

IV. Why You Should Help Others

So, your profession fits you to help those around you choose to do the right thing even when the decision does not require financial analysis. So what? That's a fair question. After all, your profession does not require you to help those with whom you work do the right thing. So why should you, as professionals, be told that this is something

you should do? I think there are three reasons why you should gladly shoulder this additional responsibility.

The first two are not specifically professional reasons. You should help those around do the right thing, first, because helping others do the right thing is a morally good thing to do; and second, because helping them is in your self-interest. You will be less likely to find yourself embarrassed by your association with your firm and industry if you help those around you look at what they are doing the way you do.

That brings me to the third reason, one that is specifically professional. You should help those around you do the right thing because helping them in the way I have suggested will help maintain an environment in which you will find it easier to do what your profession requires. The more you help those around you adopt something like your professional perspective, the more likely that one of them will challenge you when you yourself lose perspective--as we all do, however much we prepare ourselves to prevent it. Ethics was a cooperative enterprise before the Crash. The Crash has not changed that. So, why not try to extend the network of cooperation beyond the bounds of your profession?.

With that exhortation, I conclude. Thank you.

Center for the Study of Ethics in the Professions
Illinois Institute of Technology
Chicago, Illinois 60616