

Ethics in Finance
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Proposed Freshman Seminar Syllabus – Fall 2019
Princeton University

Course description

Despite the slew of high-profile scandals exposed over the past two decades, examples of ethical transgressions in financial markets continue to abound. The global financial crisis arguably highlighted the extent to which we seem to have made little progress in stamping out unethical behavior in markets. This seminar will explore ethics in the finance industry using a case-based method. Our approach will be grounded in an understanding of the role of a financial system in an economy and society. We will frame the discussion by reviewing the economic development and egalitarian arguments in favor of markets and considering their limits. We will discuss the applicability of Utilitarianism, Kantian Ethics, and Virtue Ethics as moral approaches to finance. We will address the seminar's topic from various angles, drawing on moral philosophy, financial theory and concepts of behavioral ethics, corporate governance, economic development, and public policy.

In addressing ethical issues, a few themes will be emphasized through-out the semester:

- A discussion of the underlying assumptions of finance theory, their impact on the practice of finance and on the practical role of morality in the industry, and the applicability of Kantian, Utilitarian, and Virtue Ethics philosophies to finance.
- An attempt to distinguish ethical issues that are systemic in nature from those that relate to individual decision-making and character.
- For the systemic issues, a comparison of corporate governance across national financial markets, with particular emphasis on the United States, China, Japan, and India, and how the typical conflicts of interest encountered in each of these countries might be linked to the nature of their financial systems.
- For the issues related to individual decision-making, case studies to illustrate various patterns observed in markets, from outright deceit, fraud, and manipulation to more nuanced mishandling of conflicts of interest. For the latter, we will pay particular attention to the concept of “bounded ethicality” and the grey areas in which financial actors have to balance a complex web of duties and incentives. Many of these discussions will center on the conflicts that arise from agent-principal relations such as corporate executives acting on behalf of shareholders and investment managers acting on behalf of clients.
- A discussion of role models – finance professionals that pursue their self interest in a responsible manner, in ways that seek to benefit society rather than extract value from it. Some of these role models will participate in the seminar to discuss specific decisions they made that are at odds with the path taken by their peers.

- An exploration of the economic and social value of investments and which types of investments might create most positive impact beyond financial returns.

The seminar is targeted at a broad group of students, including students that have an interest in financial markets from an investment, economic development, or public policy perspective, and those that have an interest in concepts of moral reasoning applied to finance. There are no specific pre-requisites for the class, although having taken introductory economics will help.

The course will feature several guest speakers, including a business leader, a regulator and finance practitioners that are ethical role models who can provide a personal perspective on conflicts of interest encountered in financial markets and specific ways in which they have tried to address them during their careers.

Readings

Weekly readings will generally be anchored on one or two case studies and be supplemented by a combination of academic articles and working papers, research notes by global banks, research by consulting firms, and topical articles. Two books are recommended for purchase:

- Bazerman, Max H., and Ann E. Tenbrunsel. *Blind Spots*. Princeton University Press, 2011.
- Sandel, Michael. *What Money Can't Buy*, Farrar, Straus and Giroux, April 2012.
- Optional: Shiller, Robert. *Finance and the Good Society*, Princeton University Press, March 2012.

Assessment

This is meant to be a very interactive class with 30% of the final semester grade to be based on class participation, 20% from a short midterm paper, and 50% from a final written assignment which will comprise three topics drawn from key issues discussed during the semester.

Week-By-Week Syllabus

1. Introduction to ethics in finance

- Definition of ethics
- Discussion of applicability of Kantian, Utilitarian, and Virtue Ethics philosophies to finance
- Conflicts of interest
- Bounded ethicality and unreflective pursuit of self-interest

Readings:

1. Ethics: A Basic Framework, Harvard Business School Note #9-307-059, May 2007.
<https://hbsp.harvard.edu/import/568976>
2. Corporate Purpose and Responsibility, Harvard Business School Note #9-396-201, November 1996.
<https://hbsp.harvard.edu/import/568976>

3. Bazerman, Max H., and Ann E. Tenbrunsel. *Blind Spots*. Princeton University Press, 2011, chapters 1-4, pp. 1-76.
4. Geisst, Charles. *Beggar Thy Neighbor: A History of Usury and Debt*, Philadelphia: University of Pennsylvania Press, 2013, pp. 1-12 (Introduction).
5. *Virtue Ethics*, Stanford Encyclopedia of Philosophy, December 2016.
<http://plato.stanford.edu/entries/ethics-virtue/>
6. *Deontological Ethics*, Stanford Encyclopedia of Philosophy, October 2016.
<https://plato.stanford.edu/entries/ethics-deontological/>
7. The Milgram experiment, YouTube.com,
<http://www.youtube.com/watch?v=W147ybOdgpE>

2. The Benefits of Financial Markets: The Case for Institutional Development

- Role of finance and capital markets
- The “macro” case for markets
- The libertarian and utilitarian cases for markets
- Trade-offs of financial development

Readings:

1. Rousseau, Peter L. and Richard Sylla. “Financial Systems, Economic Growth, and Globalization”, *Globalization in Historical Perspective*, Chapter 8, University of Chicago Press, January 2003.
www.nber.org/chapters/c9594.pdf
2. Turner, Adair. “What Do Banks Do? Why Do Credit Booms and Busts Occur and What Can Public Policy Do About It?”, *The Future of Finance: The LSE Report*, Central Books, September 2010.
<https://harr123et.files.wordpress.com/2010/07/futureoffinance5.pdf>
3. Zingales, Luigi, “Does Finance Benefit Society?”, The Initiative on Global Markets, The University of Chicago Booth School of Business, Working Paper #117, January 2015.
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2585194
4. Cecchetti, Stephen and Kharoubi, Enisse. “Reassessing the Impact of Finance on Growth”, BIS Working Paper #381, July 2012.
www.bis.org/publ/work381.pdf

3. Have Markets Gone Too Far?

- Market economy versus market society
- Asymmetric risks and moral hazards

Readings:

1. Haldane, Andrew, “Control Rights (and Wrongs)”, Wincott Annual Memorial Lecture, October 24, 2011.
www.bis.org/review/r111026a.pdf
2. Sandel, Michael. *What Money Can't Buy*, Farrar, Straus and Giroux, April 2012, pp. 1-91, 131-163.
3. Zingales, Luigi. “Do Business Schools Incubate Criminals?”, Bloomberg.com, July 16, 2012.
www.bloomberg.com/news/2012-07-16/do-business-schools-incubate-criminals.html

4. Shiller, Robert. *Finance and the Good Society*, Princeton University Press, March 2012, pp. 151-167, 178-190.
5. Rajan, Raghuram. "Do Bankers Need a Social Conscience", *Financial Times*, June 2010.
http://faculty.chicagobooth.edu/raghuram.rajan/research/papers/articles_files/Do%20bankers%20need%20a%20social%20conscience.pdf

4. Conflict of interest case studies: Ratings agencies and auditing firms

- Assessing the role of ratings agencies in the subprime crisis
- Business models based on inherent conflicts of interest

Readings:

1. Bazerman, Max H., and Ann E. Tenbrunsel. *Blind Spots*. Princeton University Press, 2011, chapters 5-7, pp. 77-151.
2. US Senate Report, "Inflated Credit Ratings: Case Study of Moody's and Standard & Poor's" in "Wall Street and the Financial Crisis: Anatomy of a Financial Collapse", pp. 243-317, April 13, 2011. Available on Blackboard.
3. US Senate Report, "Enron's Credit Rating", 83-604 PDF, January 3, 2003. Available on Blackboard.
4. McRoberts, Flynn, "A Final Accounting: The Fall of Andersen", *Chicago Tribune*, September 1, 2002.
www.chicagotribune.com/news/chi-0209010315sep01_0_538751.story
5. "Undue Credit", *The Economist*, May 30th, 2015
www.economist.com, ID#21652364.
www.economist.com/news/finance-and-economics/21652364-regulation-helping-very-firms-it-designed-tame-undue-credit
6. "Reforming the Big Four", *The Economist*, May 14th, 2018, ID#21635978.
www.economist.com/leaders/2018/05/24/reforming-the-big-four

5. Conflict of interest case study: Goldman Sachs and the sub-prime crisis

- Conflicts of interest in investment banks
- Assessing the ethics of creating synthetic CDOs and other derivatives prior to the subprime crisis

Readings:

1. US Senate Report, "Failing to Manage Conflicts of Interest: Case Study of Goldman Sachs" in "Wall Street and the Financial Crisis: Anatomy of a Financial Collapse", pp. 376-639, April 13, 2011. Available on Blackboard.
2. Congressional Testimony, Lloyd Blankfein, April 27, 2011. Available on Blackboard.
3. Congressional Testimony, Fabrice Tourre, April 27, 2011. Available on Blackboard.
4. Lewis, Michael, "The End", *Portfolio*, November 2008.
www-stat.wharton.upenn.edu/~steele/Courses/434/434Context/The%20End%20by%20Michael%20Lewis.pdf

6. The ethics of career choice

- Purpose and social benefit of financial market occupations
- Impact of their popularity
- Ethics of career choice

Readings:

1. Shiller, Robert. *Finance and the Good Society*, Princeton University Press, March 2012, pp. 1-17, 135-138.
2. Shiller, Robert. “The Best, Brightest, and Least Productive?” *Project Syndicate*, September 20, 2013.
www.project-syndicate.org/commentary/the-rent-seeking-problem-in-contemporary-finance-by-robert-j--shiller?barrier=accessreg
3. Crouch, William. “Replaceability, Career Choice, and Making a Difference”, Working Paper.
www.academia.edu/1557895/Replaceability_Career_Choice_and_Making_a_Difference
4. Benabou, Roland and Jean Tirole. “Individual and Corporate Social Responsibility”, *Economica*, #77, 2010.
<http://onlinelibrary.wiley.com/doi/10.1111/j.1468-0335.2009.00843.x/full>
5. Pfeffer, Jeffrey, “Why the Assholes Are Winning: Money Trumps All”, *Journal of Management Studies*, January 25, 2016.
<http://onlinelibrary.wiley.com/doi/10.1111/joms.12177/full>

7. Character and Ethical Leadership Part I

Previous year guest speaker: John C. Bogle, Founder, The Vanguard Group.

- The fiduciary principle and conflicts of interest in the financial services industry
- Limits of financial capitalism
- Role models

Readings:

1. Sommer, Jeff. “A Mutual Fund Master, Too Worried To Rest”, *New York Times*, August 11, 2012.
www.nytimes.com/2012/08/12/business/john-bogle-vanguards-founder-is-too-worried-to-rest.html?_r=1&pagewanted=all
2. Bogle, John C., “The Fiduciary Principle: No Man Can Serve Two Masters”, *The Journal of Portfolio Management*, Fall 2009.
<http://johncbogle.com/wordpress/wp-content/uploads/2010/04/JPM-Fid-Principle-Fall-2009.pdf>
3. Bogle, John C. “Ethical Principles and Ethical Principals”, Speech, The Johnson School at Cornell University, November 11, 2010.
Available on Blackboard.
Available on Blackboard.
4. Bogle, John C. “Fund Managers Must Break Their Silence”, *Financial Times*, September 19, 2012.
www.ft.com/intl/cms/s/0/e19b6a54-fbf8-11e1-ae9f-00144feabdc0.html#axzz27cVx0NXv
5. Bogle, John C. “Balancing Professional Values and Business Values”, *Financial Analysts Journal*, CFA Institute, Volume 73, Issue 2, Q2 2017.
www.cfapubs.org/doi/full/10.2469/faj.v73.n2.8

Short midterm papers due

Fall Recess

8. China case studies: EganaGoldpfeil, Tack Fat, and Sino Forest

- Conflicts of interests in Chinese SOEs and private listed companies
- China's state dominated market society
- Patterns of ethical transgressions and prospects for improvement

Readings:

1. La Porta, Rafael, Lopez-de-Silanes, Florencio, Shleifer, Andrei, and Vishny, Robert. "Investor Protection and Corporate Governance", *Journal of Financial Economics*, Volume 58, Issues 1-2, 2000.
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=183908
2. Rajagopalan, Nandini, and Yan Zhang. "Corporate Governance Reforms in China and India: Challenges and Opportunities", *Business Horizons* #51, 2008, pp.55-64.
Available through Princeton's online ScienceDirect database.
3. de Swaan, J.C., "Corporate Governance An Obstacle to Revival", *South China Morning Post*, December 30, 2009. Available on Blackboard.
4. de Swaan, J.C., "Governing Corporate China – Or Not", *Wall Street Journal Asia*, March 24, 2010. Available on Blackboard.
5. Petition by the Hong Kong SFC against EganaGoldpfeil, August 1st, 2011.
www.sfc.hk/sfc/doc/EN/general/general/press_release/11/11PR88_petition.pdf
6. "Egana and Upbest", Webb-Site.com, July 26th, 2007.
<http://webb-site.com/articles/eganaupbest.asp>
7. "Tack Fat: As Clear as Mudd", Webb-Site.com, August 6th, 2007.
<http://webb-site.com/articles/tackfat.asp>
8. Sino Forest Corporation Initiation report, Muddy Waters Research, June 2, 2011.
www.muddywatersresearch.com/research/tre/initiating-coverage-treto/
9. Anonymous, "Confessions of an S-Chip CEO". Available on Blackboard.
10. Gronow, Nick. "Fraud 101", FTI Consulting paper (Hong Kong), Issue 11
www.fticonsulting-asia.com/en/publications/articles/Issue-11.pdf

Japan case studies: Bull-Dog, TOC, Olympus

- Patterns of corporate governance failures at Japanese companies
- Forces driving systemic status-quo
- Prospects for improvement

Readings:

1. "Corporate Governance in Japan", *The Economist*, May 29th, 2008, www.economist.com, ID#11465285.
2. "Japan High Court Keeps Bull-Dog Sauce from Steel Partners' Jaws", *Forbes*, August 8, 2007.
www.forbes.com/2007/08/08/bulldog-steel-partners-markets-equity-cx_jc_0808markets03.html

3. “Meet Shinzo Abe, Shareholder Activist”, *The Economist*, June 6th, 2015, www.economist.com, ID#21653610.
4. de Swaan, J.C., “Abe Must Double Down on Japan’s Corporate Sector Reforms”, *Financial Times*, September 28, 2016. Available on Blackboard.

9. Character and Ethical Leadership Part II

Previous year guest speakers (trip to New York): Vincent Mai, Founder of Cranemere (innovative/ethical private equity firm); Esha Mufti of Acumen (pioneer impact investment fund)

- Character versus context
- Role models

Readings:

1. Note on Human Behavior: Character and Situation, Harvard Business School Note #9-404-091, February 2011.
<http://cb.hbsp.harvard.edu/cbmp/access/68424785>
2. JC de Swaan, “Vincent Mai as an Ethical Role Model”, *Virtue in Finance* (Cambridge: Cambridge University Press, forthcoming). Available on Blackboard.
3. Roger Berkowitz, “An Interview with Vincent Mai”, *The Intellectual Origins of the Global Financial Crisis* (New York: Fordham University Press, 2012).
4. Acumen Fund web site
<https://acumen.org/>
5. “What You Need to Know About Impact Investments”, Global Impact Investment Network.
<https://thegiin.org/impact-investing/need-to-know/>
5. Brest, Paul, Ronald Gilson, and Mark Wolfson – and respondents. “How Investors Can (and Can’t) Create Social Value?” *Stanford Social Innovation Review*, December 2016.
https://ssir.org/articles/entry/how_investors_can_and_cant_create_social_value

Thanksgiving

10. The ethics of investing

Previous year guest speaker: Andy Golden, President, Princeton University Investment Company

- Character and ethical leadership in investments
- Economic and social value of investing
- Evolution of investment objectives, from socially responsible investments to impact investments
- Contrast with traditional modern portfolio theory

Readings:

6. Shiller, Robert. *Finance and the Good Society*, Princeton University Press, March 2012, pp. 168-177.
7. Bogle, John, C. “The Clash of the Cultures”, *The Journal of Portfolio Management*, Spring 2011.

<http://johncbogle.com/wordpress/wp-content/uploads/2010/04/Clash-of-the-Cultures.pdf>

6. Lewis, Michael. “The Irresponsible Investor”, *The New York Times*, June 6, 2004.
www.nytimes.com/2004/06/06/magazine/the-irresponsible-investor.html
8. Urist, Jacoba. “The Push for Ethical Investment at America’s Colleges”, *The Atlantic Magazine*, April 28, 2017.
www.theatlantic.com/education/archive/2015/04/the-push-for-ethical-investment-at-americas-colleges/391697/

11. Insider Trading and Enforcement Case Studies: Martha Stewart, Galleon, and Sherry Hunt

Previous year guest speaker: Valerie Szczepanik, Head of Enforcement, Asset Management Division, SEC

- Insider trading
- Enforcement challenges
- Whistleblowing

Readings:

1. Note on Insider Trading Liability, Harvard Business School Note #9-305-029, February 2006.
<http://cb.hbsp.harvard.edu/cbmp/access/68424785>
2. Martha Stewart (parts A, B, and C), Harvard Business School Case #9-305-034/035/036, November 2004/January 2006.
<http://cb.hbsp.harvard.edu/cbmp/access/68424785>
3. SEC Complaint Against Galleon Management, Raj Rajaratnam, Rajiv Goel, Anil Kumar, Danielle Chiesi, Mark Kurkland, Robert Moffat, and New Castle Funds, October 16, 2009.
www.sec.gov/litigation/complaints/2009/comp21255.pdf
4. Keefe, Patrick Radden. “The Empire of Edge”, *The New Yorker*, October 13, 2014.
www.newyorker.com/magazine/2014/10/13/empire-edge
5. “Woman Who Couldn’t Be Intimidated by Citigroup Wins \$31 Million”, *Bloomberg Markets Magazine*, May 31, 2012
www.bloomberg.com/news/2012-05-31/woman-who-couldn-t-be-intimidated-by-citigroup-wins-31-million.html
6. SEC: Casino-Gaming Company Retaliated Against Whistleblower, Sept. 29, 2016.
www.sec.gov/news/pressrelease/2016-204.html
7. SEC: SEC Charges Anheuser-Busch InBev With Violating FCPA and Whistleblower Protection Laws, Sept. 28, 2016.
www.sec.gov/news/pressrelease/2016-196.html

12. Improving ethics in financial markets

- Discussion of recent US legislation
- Prospects for improving ethics
- Impact on markets and on social value of finance of improved ethics

Readings:

1. Dodd-Frank Wall Street Reform and Consumer Protection Act, Wikipedia.
https://en.wikipedia.org/wiki/Dodd%E2%80%93Frank_Wall_Street_Reform_and_Consumer_Protection_Act
2. “A Rare Bipartisan Moment Allows a Timid Rollback of Banking Regulation”,
The Economist, May 24, 2018.
www.economist.com/finance-and-economics/2018/05/24/a-rare-bipartisan-moment-allows-a-timid-rollback-of-banking-regulation
3. Shiller, Robert. *Finance and the Good Society*, Princeton University Press, March 2012, pp. 231-239.
4. Bazerman, Max H., and Ann E. Tenbrunsel. *Blind Spots*. Princeton University Press, 2011, Chapter 8, pp. 152-172.
5. Cassidy, John. “What Good Is Wall Street?”, *The New Yorker*, November 29, 2010.
www.newyorker.com/reporting/2010/11/29/101129fa_fact_cassidy