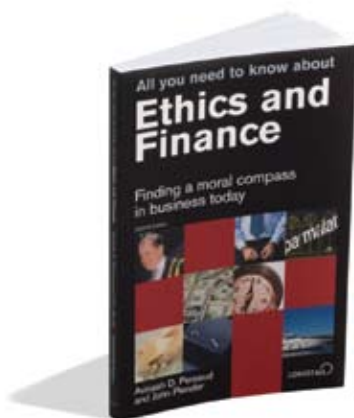


In search of the moral high ground



Avinash D. Persaud and John Plender

Ethics and Finance

Finding a Moral Compass in Business Today

Longtail Publishing Limited, London, 2007, 215 pp., £19.95 (paper).

FINANCIAL markets are often taken to be places in which unbridled self-interest dominates and the participants recognize just one value—money. Each investor wants the best rate of return, each bank wants the highest return on equity, and analysts and traders want the biggest bonus—and everybody will do whatever it takes to get there. Yet financial markets, like society itself, rely on shared ethical standards. Written rules and their enforcement are necessary although, by and large, people and institutions voluntarily constrain themselves. Even when there is little chance of being caught, people do not do certain things they feel are unethical.

Persaud and Plender have written a practical guide to encourage investors and other market participants to abide by ethical standards and to recognize where ethical conflicts may arise. They pointedly avoid philosophical abstractions, arguing simply that ethical behavior is both important in itself and essential for the functioning of markets. They also suggest that ethical behavior is in the interest of the financial institutions and individuals involved. Although

the trade-off between being ethical and making money can seem acute in the short term, it will look much less acute if a longer-term perspective is taken—one in which containing reputational risk and maintaining a level of trust among market participants are important.

In various chapters, Persaud and Plender address the specific ethical conflicts that may arise in areas such as investor protection, speculation, and accounting, and discuss the roles of independent directors, auditors, and regulators. The authors concentrate on ethics in financial markets and do not address issues relating, for example, to the treatment of employees. They illustrate their points by

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citing well-known recent examples of unethical behavior in financial markets and include both executive summaries and structured questions that financial market participants should periodically ask themselves—a first for this kind of book. Indeed, reading between the lines, the authors seem to say that many instances of unethical behavior could have been avoided if the perpetrators had ever stopped to think for a moment.

The authors’ main concern and clearest message centers on conflict of interest, in which an agent takes advantage of the people he or she is meant to be serving. They suggest other criteria for ethical behavior, such as whether others are put at a contrived disadvantage or suffer unmitigated harm, concepts that are not very well explained in this otherwise clearly written book, which is

free of both pomposity and oversimplification. The way I understood it is that financial market participants should not cause significant harm to those who have no connection with a transaction or to those who cannot reasonably be expected to protect themselves from it.

The book has several messages for policymakers, in particular for financial sector regulators and supervisors. First, regulators themselves need to maintain ethical standards, for example, by avoiding explicit or implicit “capture.” That is to say, they must not become beholden to those they are meant to regulate, acting in the interests of the regulated industry rather than of the public at large.

Second, regulators need to pay more attention to ensuring that incentives within financial institutions are aligned with ethical commitments. Many ethical lapses occurred when employees of financial institutions were given (or created for themselves) incentives that generated conflicts of interest. Whereas egregious cases involving company boards and senior management are best known, there are instances of even junior employees being given incentives to fleece their clients.

Third, and perhaps most problematical, regulators and market participants need to be aware of the risk of regulations replacing ethics. Additional regulation typically follows a scandal involving unethical behavior. Not only does the regulatory burden increase, but market participants come to rely more on regulations and on corporate ethics officers than on their own sense of what is right and wrong. Financial market players like to complain about “regulatory overload,” but this book will have achieved something if it makes even a few of them realize that if they take responsibility for their own ethical behavior, all that extra regulation may not be needed.

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