

Third Edition



ethics in finance

John R. Boatright

WILEY Blackwell

Ethics in Finance

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Preface

Writing a book on ethics in finance poses a special challenge. The difficulty does not arise from a lack of subject matter, despite the cynical view that there is no ethics in finance. To the contrary, finance is infused with ethics and could not exist without it. Financial activity is governed by detailed rules, and a high level of integrity is expected of people who bear great responsibility. As a field of study, however, finance ethics is barely formed, and so the first task for a writer in this area is to define the subject, frame the main issues, and identify the relevant ethical principles. Whereas most textbooks present standard material, this one is forced by necessity to be original. Hopefully, *Ethics in Finance*, Third Edition, will continue to advance the important task of creating the field of finance ethics.

Not only is the field of finance ethics still being formed, but it is also highly diverse. People trained in finance enter many different lines of work, in which they encounter a variety of ethical situations and issues. The situation of a stockbroker is different from that of a mutual fund manager, a market regulator, or a corporate financial officer. In addition, finance ethics encompasses broader ethical issues in financial markets, financial services, and financial management, which are addressed by both industry leaders and government regulators. A book on finance ethics must also identify the relevant ethical principles for resolving many different kinds of questions. Some of these involve dilemmas of individual conduct, but the most perplexing and significant issues are related to the operation of financial services providers and financial markets and institutions.

Many ethical issues in finance have already been addressed by legal regulation, as well by firm and industry self-regulation. The role of ethics in such a highly regulated environment is problematic. Why is it not sufficient merely to obey the applicable rules? One answer to this question is that ethical principles lie at the heart of much regulation, and issues not yet settled by law or self-regulation are debated, in part, as matters of ethics. Much of this book is

devoted, therefore, to an examination of existing regulation and proposals for regulatory reform. In addition, regulation, whether it is by government or industry, is a rather ineffective, uncertain guide, and so a commitment to high ethical standards, and not merely to legal compliance, is essential.

Since the publication of the first two editions of this book, much has changed and much has remained the same. In particular, the financial crisis that began in 2007 has renewed interest in finance ethics and led to calls for greater attention to the subject. However, this crisis, for all of the misconduct involved and damage done, raises few novel issues in finance ethics and presents mostly familiar issues in new guises. Still, the third edition of this book devotes considerable space to the ethical aspects of the greatest financial crisis since the Great Depression.

Readers of the first two editions will find the third one extensively revised and expanded. Although the number of chapters remains the same, the material has been substantially reorganized for greater clarity and orderliness. Chapter 2 now offers a more explicit framework for approaching ethics, which presents, first, ethics in markets and, second, the ethics of roles and relationships, including those of agents and fiduciaries. The remaining material is organized around the areas of financial services, financial markets, and financial management. Subjects that are new to this third edition include ethical issues in credit cards, subprime mortgages, microfinance, derivatives, high-frequency trading, and risk management.

As with the first two editions, I am indebted to W. Michael Hoffman and Robert E. Frederick of Bentley University, the editors of the series *Foundations of Business Ethics*, and my editor at Blackwell, Jeffrey Dean. The Quinlan School of Business at Loyola University Chicago has provided critical support for the preparation of the third edition. I am especially grateful for the resources of the Raymond C. Baumhart, S.J., Chair in Business Ethics, which was created to honor a former president of Loyola University Chicago and a pioneer in the field of business ethics. To Ray Baumhart I owe a special debt of gratitude. I also wish to express my appreciation to Kathleen A. Getz, dean of the Quinlan School of Business for her enthusiastic support. As always, I am indebted to my wife Claudia, whose affection, patience, and encouragement have been essential for my work.

John R. Boatright

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Abbreviations

ABS	asset-backed security
ARM	adjustable-rate mortgage
ATR	annualized turnover ratio
CalPERS	California Public Employees' Retirement System
CAPM	capital asset pricing model
CARD	Credit Card Accountability, Responsibility, and Disclosure Act
CDO	collateralized debt obligation
CDS	credit default swap
CEO	chief executive officer
CFO	chief financial officer
CRO	chief risk officer
CSR	corporate social responsibility
ENE	early neutral evaluation
ERISA	Employee Retirement Income Security Act
ERM	enterprise risk management
ESG	environmental, social, governance
ETI	economically targeted investment
Eurosif	European Sustainable Investment Forum
EVA	economic value added
FINRA	Financial Industry Regulatory Authority
FTC	Federal Trade Commission
GAAP	generally accepted accounting principles
GDP	gross domestic product
GSE	government-sponsored enterprise
HFT	high-frequency trading
ICA	Investment Company Act
ICI	Investment Company Institute
IPO	initial public offering
ISS	Institutional Shareholder Services

LDC	less-developed country
LIBOR	London Interbank Offered Rate
M&E	mortality and expense risk
MBS	mortgage-backed security
NASD	National Association of Securities Dealers (now FINRA)
NASDAQ	National Association of Securities Dealers Automated Quotations
NPV	net present value
OPM	other people's money
OTC	over the counter
PDAA	predispute arbitration agreements
REIT	real estate investment trust
RI	relationship investing
SEC	Securities and Exchange Commission
SME	small and medium enterprise
SRI	socially responsible investing
SRO	self-regulating organization
SWM	shareholder wealth maximization
VaR	value at risk
VWAP	volume weighted average price

